Tax
Issue P307/2019 – 9 December 2019

Tax Analysis

Focus on China Tax Legislation - Draft Consumption Tax Law Released

Authors:

Hong Kong
Sarah Chin
Partner
Tel: +852 2852 6440
Email: sachin@deloitte.com.hk

Shanghai
Li Qun Gao
Partner
Tel: +86 21 6141 1053
Email: ligao@deloitte.com.cn

Beijing
Charles Gong
Partner
Tel: +86 10 8520 7527
Email: charlesgong@deloitte.com.cn

Shelley Zheng
Manger
Tel: +86 10 8512 5664
Email: szheng@deloitte.com.cn

On 3 December 2019, China's Ministry of Finance (MoF) and the State Taxation Administration (STA) released a public consultation document for a draft Consumption Tax Law ("draft law"), a turnover tax that applies to certain specific goods ("taxable consumables") at specific stages (e.g. manufacturing). This follows the 27 November 2019 release of a draft VAT law for publication consultation.[1] Both draft laws would provide a statutory basis for all consumption and VAT rules - currently, both taxes are regulated by provisional regulations.

Similar to the draft VAT law, the draft consumption tax law effectively would import most of the current rules set out in the 1993 "Provisional Regulations on Consumption Tax" ("Provisional Regulations") and other relevant regulations, with a few modifications. The consumption tax consultation period is open until 2 January 2020, after which the draft law will be further reviewed. It is unclear when the new law will become effective.

This alert provides an overview of the current consumption tax rules and a high-level review of the main features of the draft law.

Background

Consumption tax is one of China's two main indirect taxes (the other being VAT). Whereas VAT is levied on a broad range of goods and services, the consumption tax is levied on specific categories of non-essential luxury goods, certain consumer goods that are considered harmful to health, and goods that require high energy consumption or cause pollution. The consumption tax is levied once on persons that

[1] Deloitte Tax Analysis on "Value-added Tax Law of the PRC (Consultation Paper)": https://www2.deloitte.com/content/dam/Deloitte/cn/Documents/tax/ta-2019/deloitte-cn-tax-tap3052019-en-191220.pdf

manufacture and/or import, process under consignment or sell taxable goods (unlike VAT, which is paid by sellers throughout the supply chain). For most of the taxable consumables, the consumption tax rates range from 1% to 56%, depending on the product, while for certain specific goods, the tax is computed based on the selling quantity.

Reforms of the consumption tax system have been ongoing for the past several years, with changes and adjustments made to the scope, rates, collection and administration, etc. of the tax. On 9 October 2019, the State Council issued a notice announcing that the collection of the consumption tax for certain products will shift from the production/import stage to the wholesale and retail stages.

As is the case with the recently issued draft VAT law, the proposed changes to the consumption tax are positive steps for the Chinese economy and taxpayers and the tax authorities, as they should provide more clarity and certainty, reduce the tax and administrative burdens, and enhance collection. The draft consumption tax law - which would provide a framework for the tax - takes the reform efforts one step further by aligning measures with the draft VAT law and consolidating many current policies into a single legislative document.

Overview

1. Taxpayer

The draft law would modify the definition of a consumption tax payer. Under the Provisional Regulations, the definition is linked to the stages in which the tax is collected (e.g. manufacturing, importing, wholesale, retail). The draft law would simplify the definition of taxpayer to read "entities and individuals selling, processing under consignment and importing taxable consumables in China." This revision, however, is not expected to result in a substantial change to the definition of consumption tax payers.

The draft law also would clarify that "self-used taxable consumables that are not sold" are subject to consumption tax, while under prevailing policies the "self-use of taxable consumables" are deemed to be taxable. It is unclear whether any substantial change to the scope of the term, "self-use" would result.

The draft law introduces the concept of "withholding agent" but does not provide a definition.[2] Clarification from the authorities is expected.

2. Scope and Tax Rate

The draft law does not make any changes to the 15 categories of taxable consumables (i.e. tobacco, wine, high-grade cosmetics, precious jewellery and jade, firecrackers and fireworks, oils, motorcycles, cars, golf balls and clubs, luxury watches, yachts, disposable wooden chopsticks, solid wood floor, batteries, and coatings), or the tax rates and stages in which consumption tax is collected for each category.

For more information, please contact:

Indirect Tax Service
Asia Pacific Leader
Hong Kong
Sarah Chin
Partner
Tel: +852 2852 6440
Email: sachin@deloitte.com.hk

Northern China
Beijing
Yi Zhou
Partner
Tel: +86 10 8520 7512
Email: jchow@deloitte.com.cn

Eastern China
Shanghai
Li Qun Gao
Partner
Tel: +86 21 6141 1053
Email: ligao@deloitte.com.cn

Southern China
Guangzhou
Janet Zhang
Partner
Tel: +86 20 2831 1212
Email: jazhang@deloitte.com.cn

Western China
Chongqing
Frank Tang
Partner
Tel: +86 23 8823 1208
Email: ftang@deloitte.com.cn

[2] According to the draft law, "For processing under consignment, the consignee shall collect and pay the consumption tax at the time of delivery." However, the consignee should not be the "withholding agent" named in the draft law.

Based on a consumption tax reform pilot program announced on 9 October 2019, consumption tax will shift from the production/import stage to the wholesale and retail stages for certain consumer goods.[3] In light of this change in the collection of the consumption tax, it was expected that the tax rates of affected goods would be adjusted since the sales prices of goods at the wholesale/retail stage typically are higher than at the manufacturing/import stage. The draft law does not include any rate changes, but it would authorize the State Council to adjust the consumption tax rate as deemed necessary and to conduct pilot programs (see Section 10, "Consumption Tax Reform Pilot Program").

3. Gross Sales

The draft consumption tax law defines "gross sales" to include all consideration, including cash and non-cash economic benefits, which is consistent with the definition in the draft VAT Law (see Deloitte Tax Analysis on the draft VAT Law for more comments).

4. Determination of Tax Base

The draft law provides:

> *"Where the sales price and quantity of taxable consumables reported by a taxpayer is obviously low and lacking a bona fide commercial purpose, the tax authorities and customs are authorized to determine the sales price and quantity for tax purposes."*

The following changes would be made to the Provisional Regulations:

- *"… without a justified reason"* is changed to *"… lacking a bona fide commercial purpose,"* which places more emphasis on the motivation for taxpayer behavior. The revised language is in line with that in the draft VAT law, the Enterprise Income Tax Law and the Individual Income Tax Law.[4]

- The word, *"quantity"* is added to the tax base that may be determined by the authorities, since consumption tax is computed based on quantity for certain categories of taxable consumables. The *customs* authorities would have power to determine the tax base since consumption tax is collected by customs on behalf of the tax authorities in the case of imported taxable consumables.

In practice, some enterprises may obtain consumption tax savings through related party transactions. If the draft law is enacted, such arrangements may be challenged under the "bona fide commercial purpose" criterion, similar to the situation under the Enterprise Income Tax Law.

5. Credit for Purchased Taxable Consumables

Although consumption tax generally is collected one time, credit for the tax paid is allowed in limited circumstances where specific taxable consumables are purchased for continuous production of specific taxable consumables. The draft law integrates the situations specified under prevailing policies with some adjustments; for example, "purchasing taxed jewellery and jade for the production of jewellery and jade" would be eliminated to be consistent with the recent pilot program that shifts the collection of consumption tax from the production stage to the wholesale/retail stage for jewellery and jade.

To qualify for the consumption tax credit, the taxable consumables must be purchased from a party that is subject to consumption tax for selling consumables under the same tax category. The draft implies that purchasing from a wholesaler/retailer (instead of a manufacturer) may result in a disqualification for the credit.

---

[3] Deloitte Tax Newsflash on Consumption Tax Reform:
https://www2.deloitte.com/content/dam/Deloitte/cn/Documents/tax/tax-newsflash/deloitte-cn-tax-newsflash-bilingual-191118.pdf

[4] The term "justifiable reason" is still in the Tax Administration and Collection Law, under which the tax authorities can determine the tax amount in cases where the tax base declared by a taxpayer is obviously low and lacking justification.

6. Preferential Policy

The consumption tax exemption for exports of taxable consumables would remain unchanged, and the draft law would authorize the State Council to stipulate consumption tax exemption and reduction policies.

7. Triggering of Tax Liability

The draft law would modify the rules governing when consumption tax liability is triggered in various circumstances. These proposals generally align with those in the draft VAT Law and are consistent with the current consumption tax collection and administration practices.

8. Information Sharing

Similar to the draft VAT law, the draft consumption tax law would require the customs authorities to share import and export information with the tax authorities, and other relevant government departments or entities (e.g. development and reform departments, public security, market supervision bureaus, etc.) to provide necessary data for consumption tax administration purposes. These measures would give the tax authorities greater access to taxpayer information, which would enhance tax collection and enforcement.

9. Tax assessment period

As in the draft VAT law, the draft consumption tax law provides that the tax assessment period may be 10 days, 15 days, one month, a quarter or a half year. Compared with the Provisional Regulations, the draft law would eliminate the three currently permitted tax assessment periods of one day, three days and five days, and would add a new half-year period. These changes are designed to reduce the number of filings for some taxpayers.

10. Consumption Tax Reform Pilot Program

The State Council would be authorized to conduct consumption tax pilot programs that include adjustments to taxable items, tax rates and the stages for collection. However, it should be noted that the two changes previously announced by the State Council, i.e. the transition to consumption tax liability at the wholesale/retail stage for certain products and the reallocation of more consumption tax revenue to the local government, are not reflected in the draft law.

Deloitte Comments

The release of the draft law marks a significant step forward in consumption tax legislation in China. In general, not many substantial changes are proposed, which should help to ensure a smooth transition, as well as stability and consistency of tax policies. It is noteworthy that the draft modifies multiple provisions to keep pace with the proposed VAT legislation, which should mitigate conceptual differences amongst different taxes and make the tax law easier to understand and follow. In addition, the details of the pilot program are not reflected in the draft law, which suggests that further guidance is still being considered.

Potentially affected businesses should monitor the progress of the consumption tax legislation, assess the impact of the proposed changes and consider necessary actions, including leveraging digital technologies to establish a robust consumption tax compliance system.

Tax Analysis is published for the clients and professionals of the Hong Kong and Chinese Mainland offices of Deloitte China. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter. For more information or advice on the above subject or analysis of other tax issues, please contact:

Beijing
Andrew Zhu
Partner
Tel: +86 10 8520 7508
Fax: +86 10 8518 1326
Email: andzhu@deloitte.com.cn

Chengdu
Frank Tang / Tony Zhang
Partner
Tel: +86 28 6789 8188 / 8008
Fax: +86 28 6500 5161
Email: ftang@deloitte.com.cn
tonzhang@deloitte.com.cn

Chongqing
Frank Tang / Tony Zhang
Partner
Tel: +86 23 8823 1208 / 1216
Fax: +86 23 8859 9188
Email: ftang@deloitte.com.cn
tonzhang@deloitte.com.cn

Dalian
Jihou Xu
Partner
Tel: +86 411 8371 2888
Fax: +86 411 8360 3297
Email: jihxu@deloitte.com.cn

Guangzhou
Victor Li
Partner
Tel: +86 20 8396 9228
Fax: +86 20 3888 0121
Email: vicli@deloitte.com.cn

Hangzhou
Qiang Lu / Fei He
Partner
Tel: +86 571 2811 1901
Fax: +86 571 2811 1904
Email: qilu@deloitte.com.cn
fhe@deloitte.com.cn

Zhengzhou
Charles Gong
Partner
Tel: +86 371 8897 3701
Fax: +86 371 8897 3710
Email: charlesgong@deloitte.com.cn

Harbin
Jihou Xu
Partner
Tel: +86 451 8586 0060
Fax: +86 451 8586 0056
Email: jihxu@deloitte.com.cn

Hong Kong
Sarah Chin
Partner
Tel: +852 2852 6440
Fax: +852 2520 6205
Email: sachin@deloitte.com.hk

Jinan
Beth Jiang
Partner
Tel: +86 531 8518 1058
Fax: +86 531 8518 1068
Email: betjiang@deloitte.com.cn

Macau
Raymond Tang
Partner
Tel: +853 2871 2998
Fax: +853 2871 3033
Email: raytang@deloitte.com.hk

Nanjing
Frank Xu / Rosemary Hu
Partner
Tel: +86 25 5791 5208 / 6129
Fax: +86 25 8691 8776
Email: frakxu@deloitte.com.cn
roshu@deloitte.com.cn

Shanghai
Maria Liang
Partner
Tel: +86 21 6141 1059
Fax: +86 21 6335 0003
Email: mliang@deloitte.com.cn

Shenyang
Jihou Xu
Partner
Tel: +86 24 6785 4068
Fax: +86 24 6785 4067
Email: jihxu@deloitte.com.cn

Shenzhen
Victor Li
Partner
Tel: +86 755 3353 8113
Fax: +86 755 8246 3222
Email: vicli@deloitte.com.cn

Suzhou
Kelly Guan
Partner
Tel: +86 512 6289 1328 / 1297
Fax: +86 512 6762 3338
Email: kguan@deloitte.com.cn

Tianjin
Bill Bai
Partner
Tel: +86 22 2320 6699
Fax: +86 22 8312 6099
Email: bilbai@deloitte.com.cn

Wuhan
Gary Zhong
Partner
Tel: +86 27 8526 6618
Fax: +86 27 6885 0745
Email: gzhong@deloitte.com.cn

Xiamen
Jim Chung
Partner
Tel: +86 592 2107 298
Fax: +86 592 2107 259
Email: jichung@deloitte.com.cn

About the Deloitte China National Tax Technical Centre

The Deloitte China National Tax Technical Centre (“NTC”) was established in 2006 to continuously improve the quality of Deloitte China’s tax services, to better serve the clients, and to help Deloitte China’s tax team excel. The Deloitte China NTC prepares and publishes “Tax Analysis”, “Tax News”, etc. These publications include introduction and commentaries on newly issued tax legislations, regulations and circulars from technical perspectives. The Deloitte China NTC also conducts research studies and analysis and provides professional opinions on ambiguous and complex issues. For more information, please contact:

National Tax Technical Centre
Email: ntc@deloitte.com.cn

National Leader/Northern China
Julie Zhang
Partner
Tel: +86 10 8520 7511
Fax: +86 10 8518 1326
Email: juliezhang@deloitte.com.cn

Western China
Tony Zhang
Partner
Tel: +86 28 6789 8008
Fax: +86 28 6317 3500
Email: tonzhang@deloitte.com.cn

Eastern China
Kevin Zhu
Partner
Tel: +86 21 6141 1262
Fax: +86 21 6335 0003
Email: kzhu@deloitte.com.cn

Southern China (Mainland)
German Cheung
Director
Tel: +86 20 2831 1369
Fax: +86 20 3888 0121
Email: gercheung@deloitte.com.cn

Southern China(Hong Kong)
Doris Chik
Director
Tel: +852 2852 6608
Fax: +852 2851 8005
Email: dchik@deloitte.com.hk

If you prefer to receive future issues by soft copy or update us with your new correspondence details, please notify Wandy Luk by either email at wanluk@deloitte.com.hk or by fax to +852 2541 1911.