SUBJECT
CHINESE GOVERNMENT EXPANDS IMPLEMENTATION OF VAT REFORM EFFECTIVE MAY 1, 2016

SUMMARY
On March 7, 2016, China’s Ministry of Finance (“MOF”) and State Administration of Taxation (“SAT”) jointly issued Notice Caishui [2016] No. 32 (“Notice”) as a result of the 4th Session of the 12th National People’s Congress (“NPC”) held on March 5, 2016.

DETAILS
On January 1, 2012, China launched its Value-Added Tax (“VAT”) Reform Pilot Program in the city of Shanghai and gradually expanded the program nationwide. The VAT Reform Pilot Program was initially rolled out in specified industries, including transportation, research & development, information technology (“IT”), creative cultural business, leasing of moveable and tangible goods, attestation and consulting, and logistics and ancillary.

According to the Notice released on March 7, 2016, effective May 1, 2016, the current VAT Reform will be expanded to the following four additional industries nationwide:

1. Construction industry;
2. Real estate industry;
3. Financial services industry; and
4. Lifestyle services industry (i.e., hospitality, food and beverage, healthcare, and entertainment).

The Notice mandated that all existing Business Tax ("BT") payers will be converted into the VAT system and covered by the VAT Reform.
Before the VAT Reform Pilot Program launched in 2012, VAT was levied on the supply of goods; the provision of repair, processing and replacement services; and imports, while BT was levied on the provision of other services and the transfer of intangibles and real properties. Co-existence of the VAT and BT has led to a number of issues such as double taxation because an input tax credit is available for VAT payers, while generally no such mechanism exists under the BT system. The aim of the VAT Reform is to reduce double taxation in the prevailing system and to foster development of specified modern service industries by gradually transitioning these industries from the BT system to the VAT system.

In accordance with Notice Caishui [2016] No. 32, upon implementation, VAT will ultimately apply to sales and importation of all goods and provision of all services in or to China. The BT will effectively cease, which represents $320 billion and 15 percent of Chinese 2015 tax revenue based on the Chinese Ministry of Commerce statistics.1

BDO INSIGHTS
As the expanded VAT Reform becomes effective on May 1, 2016, the timeframe for successful implementation is extremely challenging for both the affected enterprises and tax authorities at all levels, particularly given the complexity of the VAT issues arising in these newly covered sectors. Detailed implementation rules are expected to be released by authorities soon.

The expanded VAT Reform presents various opportunities and challenges for all affected businesses. Uncertainties and questions are likely to follow. While the underlying matter is tax compliance, the VAT reform will require changes in affected enterprises' operations models, management processes and financial reporting.

Affected businesses and companies, which include multi-national enterprises operating in China, are advised to assess their preparedness and proactively design a plan to ensure compliance, smooth transition, and minimization of the transition costs. Actions which we believe companies should consider performing in the near term include the following:

1. Obtain a complete and accurate understanding and interpretation of the new rules and implementation guidance from MOF and SAT. Prepare an implementation plan for the changes upon the May 1, 2016 effective date. New rules include but are not limited to the Chinese VAT Golden Tax System, VAT invoicing system, VAT verification process, monthly VAT filing and the increasing scrutiny under the VAT Reform.

2. Analyze the impact on the overall business model, and assess means by which to optimize the business model and maximize tax savings in China.

3. Perform a thorough tax and financial analysis of the transaction flows and analyze the detailed tax impact on each income stream in China.

4. Revisit pricing policies including, but not limited to, related party transactions in China.

5. Reassess relative business contract clauses with regard to taxes for existing and potential customers.

6. Review and update financial accounting and IT systems in China, and evaluate the overall impact on the business model (e.g. pricing, invoicing, financial reporting, input and output VAT accounting entries, net basis method etc.). Ensure the changes in accounting and IT systems comply with the VAT requirements.

7. Update accounting policies and book-keeping operations for proper accounting for assets and liabilities associated with VAT, and transition from BT to VAT for accurate financial reporting and tax filing.

8. Organize and provide internal and/or external trainings for employees and other stakeholders.

1 Source: Chinese Ministry of Commerce http://gks.mof.gov.cn/zhengfuxinxi/tongjishuju/201601/t20160129_1661457.html
9. Evaluate the overall impact on annual financial statements and the audits of both statutory stand-alone and consolidated financial statements.

10. Discuss the detailed implementation plan with local tax advisors and leverage resources such as industry and tax experts to minimize transition and tax compliance costs.