

China

December 12, 2011

Shanghai To Implement Value-Added Tax Pilot Program on January 1, 2012

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Currently most enterprises providing services in Shanghai do not pay value-added tax (VAT). Instead they pay a business tax based on their revenues, which in Shanghai currently ranges from 3% to 5% but can be significantly higher for specific sectors. That will change soon. Officials have announced a pilot program imposing VAT in Shanghai beginning January 1, 2012, on services including transportation, technology, creative, logistics, authentication and consulting, and movable property leasing. Tax rates under the pilot VAT program will range from 3% to 17%.

On November 16, 2011, the Ministry of Finance and the State Administration of Taxation jointly released the *Notice on Promulgation of the "Pilot Scheme for Replacing Business Tax with Value-Added Tax"* (Circular 110). Circular 110 paves the way for eliminating the business tax eventually and replacing it with value-added tax. The VAT reform will be launched by a pilot program to be implemented in Shanghai.

Shanghai Pilot Program

Circular 111, the *Notice on the Pilot Scheme for Replacing Business Tax on the Transport Sector and Selected Modern Service Sectors with Value-Added Tax in Shanghai*, contains detailed implementation rules applicable to the pilot program in Shanghai, which is to commence on January 1, 2012.

Under Circular 111, not only domestic entities and individuals in Shanghai that provide VAT-taxable services, but also overseas entities and individuals rendering VAT-taxable services to persons in Shanghai, are required to pay VAT. Where an overseas supplier does not have a business establishment in Shanghai, its withholding agent or service recipient will pay VAT if the withholding agent or service recipient is established or resides in Shanghai. If services are provided by foreign entities to entities in China and the service is consumed entirely outside China, VAT will not apply.

The VAT-taxable services in Shanghai and the corresponding VAT rates are:

VAT-Taxable Services		VAT Rates
Transportation	Land transportation	11%
	Water transportation	
	Air transportation	
	Pipeline transportation	
R&D and technology	R&D services	6%
	Technology transfer services	
	Technology consulting services	
	Contractual energy management services	
	Project survey and exploration services	
Information technology	Software services	6%
	Circuit design and testing services	
	Information system services	
	Operation process management services	
Culture and creation	Design services	6%
	Trademark and copyright transfer services	
	Intellectual property services	
	Advertising services	
	Conference and exhibition services	
Logistics and auxiliary services	Aviation services	6%
	Port services	
	Transport terminal services	
	Salvage assistance services	
	Cargo transport agent services	
	Customs brokerage services	
	Storage services	
	Load-unloading services	
Movable property leasing	Finance lease	17%
	Operating lease	
Authentication and consulting	Verification services	6%
	Authentication services	
	Consulting services	

Entities and individuals providing taxable services with annual turnover of less than RMB 5 million may be treated as "Small Scale VAT Taxpayers." The VAT rate for these taxpayers is 3%, regardless of the services provided by them. However, Small Scale VAT Taxpayers are not entitled to any input VAT credit. Businesses with sales income below the RMB 5 million threshold may still register as general VAT taxpayers, provided they have sound and complete accounting records in place. In such cases they will have to pay VAT rates listed above but they will be entitled to input VAT credit.

Taxable service providers with annual turnover of RMB 5 million or greater will have to register as general VAT taxpayers and establish systems to generate VAT invoices.

Circular 111 also contains a number of exemptions.

Some Observations

All taxable services providers and recipients in Shanghai will be affected by the pilot program. In general, the pilot program will reduce the indirect tax liabilities of the pilot VAT taxpayers, as input VAT incurred will be creditable against output VAT. However, the actual impact on specific VAT taxpayers is still unclear. The varying rates and the fact that VAT is only imposed on VAT-taxable service providers in Shanghai will likely affect taxpayers in different sectors differently and create some technical or practical issues.

The program is to be implemented by the tax bureau of each district in Shanghai. Each district has its own rules and procedures, so the scope of application and timetable will vary from district to district. We understand that one district will introduce the program gradually, commencing with certain selected businesses first, to enable the district to fine-tune the rules before extending the program to all businesses in the district. Businesses that provide VAT-taxable services in Shanghai should contact their local tax bureaus to find out if the pilot program is immediately applicable to them on January 1, 2012. Even if the program will not immediately apply to them, they should consult their tax advisors early to prepare themselves for speedy transition to the pilot program when the program becomes applicable to them.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors of this alert.

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