

China to speed up the progress towards law-based taxation

*The draft Land Appreciation Tax Law
was released for public comments*

With the implementation of China's 13th Five-Year Plans which propose to fully promote the principle of "Legalization of Taxation" (税收法定原则) by 2020, the Chinese government has made considerable progress on tax legislation in recent years. Recently the MOF and STA jointly released the "LAT Law of the PRC (Discussion Draft)" for public consultation which will be closed on 15 August 2019.

Overview

With the implementation of China's 13th Five-Year Plans which propose to fully promote the principle of "Legalization of Taxation" (税收法定原则) by 2020¹, the Chinese government has made considerable progress on tax legislation in recent years. Currently, China levies a wide range of taxes including 18 types of taxes, eight of which are levied based on tax laws (see Figure 1 for details).

After the Two Sessions in 2019, the Ministry of Finance (MOF) issued the 2019 Legislative Work Plan², which mentioned that the MOF will strive to complete the drafting of laws for certain taxes (including Value-added Tax, Consumption Tax, Stamp Duties, City Construction and Maintenance Tax, Land Appreciation Tax (LAT), Custom Duties, etc.) within 2019, and will be submitted to the State Council for first deliberation in a timely manner. In response, the MOF and State Taxation Administration (STA) recently jointly released the "LAT Law of the PRC (Discussion Draft)" (the "Discussion Draft") for public consultation which will be closed on 15 August 2019.

This news alert is to provide you with insights by comparing the Discussion Draft with the prevailing LAT Regulations³ as well as relevant provisions, discussing the major changes and sharing our observations with you.

Note:

1. 13th Five-Year Plan of the People's Republic of China for National Economic and Social Development
http://www.npc.gov.cn/wxzl/gongbao/2016-07/08/content_1993756.htm
2. http://tfs.mof.gov.cn/zhengwuxinxi/caizhengfazhidongtai/201903/t20190320_3199939.html
3. Provisional Regulations of the PRC on LAT (Revised in 2011)
http://www.gov.cn/gongbao/content/2011/content_1860848.htm



Figure 1. Legislative process of China's taxes



Major changes in the Discussion Draft

The Discussion Draft contains 22 articles, which stipulate LAT taxpayers, taxable scope, deduction items, tax rates and base, tax incentives, the time when LAT obligation arises as well as the LAT filing deadlines, etc.

Compared with the Regulations, the framework of the LAT and tax burden in the Discussion Draft remains basically unchanged. However, certain changes are made to regulate the property market under the current Chinese economic context. Major changes in the Discussion Draft include:

- ▶ Expanded taxable scope - the LAT will also apply to collectively-owned properties (including land-use rights, aboveground structures and their attached facilities, the same below), in addition to the state-owned properties
- ▶ Slight changes are made to LAT incentives
- ▶ Add provisions regarding the time when the LAT obligation arises
- ▶ LAT filing deadlines and collection and administration are adjusted

We discuss below the details of the above-mentioned changes and the impacts they may create.



Expanded taxable scope - LAT shall also apply to collectively-owned properties

The Discussion Draft stipulates the taxable scope and non-taxable scope for LAT purposes as follows:

Taxable scope

The Discussion Draft expands the taxable scope of LAT by stipulating that, in addition to state-owned properties, LAT shall also apply to collectively-owned properties. In other words, transfer of collectively-owned properties or investment with such properties shall be subject to LAT.

The official interpretation of the Discussion Draft (the "Official Interpretation")⁴ clarifies that, upon the imposition of LAT on collectively-owned properties, the current Land Appreciation Adjustment Fee (LAAF)⁵ may be eliminated. According to the prevailing regulations, LAAF is levied on gains derived from transfers of rural collectively-operating construction land at rates ranging from 20% to 50%.

Non-taxable scope

The Discussion Draft clarifies that transfers of right to contractual land management (土地承包经营权) do not fall into the taxable scope of LAT.

Currently, qualifying enterprise restructuring and reorganization shall not be subject to LAT, as stipulated in a MOF/STA circular which is effective until 31 December 2020⁶. However, the aforementioned tax free treatment is not mentioned in the Discussion Draft. Whether it will be renewed after expiration may be clarified by the guidelines subsequent to the official launch of the LAT Law.

Business communities have long been concerned about whether a share transfer shall be subject to LAT if the assets involved are mainly properties⁷. So far, the Chinese government has not yet issued generally applicable provisions with respect to that question. Several replies⁸ previously issued by the STA to local authorities on specific cases, however, may imply that the answer is "YES". It is on the other hand interesting that the Supreme People's Court did not seem to agree with that position. In a number of cases with regard to the transfer of shares involving property, the Supreme People's Court held that LAT should not be imposed.

The aforesaid STA's replies was issued under circular coding of Guoshuihan (i.e. more so like an internal circular) which are less legally binding. Besides, such replies were addressed to specific cases upon requests, which shall not be considered as a guiding principle when dealing with all other similar cases. The issue is not covered in the Discussion Draft. It still remains to be uncertain on whether the relevant provisions will be introduced after this round of consultation.

Tax rates & base--remain unchanged

In the same manner as seen in current provisions, the Discussion Draft stipulates that LAT is levied on gains realized from property transactions at four-level progressive tax rates (ranging from 30% to 60%), based on the "appreciation amount" which is the consideration received from the transfer of property less the total deductible amount.

Level	Tax base	Tax rate
1	The part of appreciation amount not exceeding 50% of the deductions	30%
2	The part of appreciation amount exceeding 50% but not exceeding 100% of the deductions	40%
3	The part of appreciation amount exceeding 100% but not exceeding 200% of the deductions	50%
4	The part of appreciation amount exceeding 200% of the deductions	60%

Note:

4. <http://tfs.mof.gov.cn/zhengwuxinxi/zhengcefabu/201907/P020190716548351268898.doc>

5. Caishui [2016] No. 41, etc

6. Caishui [2018] No. 57

7. i.e., land use rights, aboveground structures and their attached facilities

8. Guoshuihan [2000] No. 687, Guoshuihan [2009] No. 387, Guoshuihan [2011] No. 415



Deductible items--Other deductible items to be stipulated by the State Council instead of the MOF

The provisions on “deductible items” in the Discussion Draft is mainly consistent with that under the prevailing Regulations, except that the authority to stipulate “other deductible items” has been transferred from the MOF to the State Council.

In addition, according to the Official Interpretation, as costs of collectively-owned and state-owned properties could be quite different, it may be difficult for the Chinese government to launch unified provisions on deductible items for LAT purposes at the current stage. Thus, it is not unreasonable to expect that different rules on deductible items for these two types of properties may be released separately after the official launch of LAT Law.

Provisions on LAT incentives--slight changes

Slight changes are made to certain provisions on LAT incentives in the Discussion Draft:

Items	Discussion Draft	Remarks
Continue the prevailing policies	<ul style="list-style-type: none"> Secured housing with an appreciation rate of less than 20% are exempt from LAT 	<ul style="list-style-type: none"> According to the prevailing provisions⁹, entities that transfer old houses as designated housing (e.g., low-rent housing, affordable housing, resettlement housing, public rental housing, etc.) are exempt from LAT provided that the appreciation amount does not exceed 20% of the deductible amount
New incentives	<ul style="list-style-type: none"> The State Council is authorized to stipulate other circumstances under which LAT reduction/exemption can apply 	<ul style="list-style-type: none"> Relevant provisions shall be submitted to the <u>Standing Committee of the National People's Congress</u> for record
	<ul style="list-style-type: none"> Provincial-level governments are authorized to reduce/exempt LAT on collectively-owned properties in areas with less developed property market 	<ul style="list-style-type: none"> Relevant provisions shall be submitted to the Standing Committee of the People's Congress at the same level for record
Adjusted Authorization	<ul style="list-style-type: none"> The provision “ordinary residential buildings with a land appreciation rate of less than 20% are eligible for LAT exemption” is replaced by “provincial-level governments are authorized to grant LAT reduction/exemption based on local conditions for the aforementioned ordinary residential buildings” 	

Note:

9. Caisui [2008] No. 24, Caishui [2013] No. 101, MOF/STA PN [2019] No. 61, etc.



The time when the tax obligation arises and LAT filing deadline

The Discussion Draft stipulates the time when the LAT obligation arises, i.e., the date when the property transfer contract is signed. To facilitate taxpayers' filing of LAT, the different deadlines set for LAT declaration and payment respectively under the current Regulations have been integrated and simplified in the Discussion Draft. The relevant provisions are as follow:

Item	Discussion Draft		LAT Regulations
The time when the tax obligation arises	<ul style="list-style-type: none"> ▶ The date when the property transfer contract is signed 		<ul style="list-style-type: none"> ▶ Not mentioned
LAT deadlines	<ul style="list-style-type: none"> ▶ Property developers 	<ul style="list-style-type: none"> ▶ Provisional LAT filing deadline: within 15 days from the end of the month when the tax obligation arises ▶ LAT clearance deadline: within 90 days from the date of satisfying certain criteria 	<ul style="list-style-type: none"> ▶ LAT declaration deadline: within 7 days from the date when the property transfer contract is signed ▶ LAT payment deadline: within the time limit designated by the relevant tax authority
	<ul style="list-style-type: none"> ▶ Other LAT taxpayers 	<ul style="list-style-type: none"> ▶ LAT declaration and payment deadline: within 30 days from the date when the tax obligation arises 	

Simplified procedures for LAT clearance

Tightened criteria for mandatory LAT clearance

Under current provisions, a property developer is liable to pay provisional LAT in advance and have to perform LAT clearance upon certain conditions are met. After the clearance, any overpayment shall be refunded, or any underpayment shall be supplemented. The Chinese government sets two types of criteria under which property developer should perform clearance on either a mandatory or a discretionary basis:

- ▶ **Mandatory clearance:** a taxpayer **must** compute the LAT for the entire project once certain criteria are met (e.g., the construction and sale of a property project has been completed)
- ▶ **Discretionary clearance:** a taxpayer **may** be requested by the tax authority to settle LAT under certain circumstances, e.g., more than 85% of the total sellable floor area of a completed property project has been sold (hereinafter referred to as the "85% threshold")

The Discussion Draft does not separate clearance requirements into mandatory and discretionary, instead, it only stipulates mandatory clearance and the relevant criteria. Moreover, certain criteria currently set for discretionary clearance have been re-categorized as mandatory in the Discussion Draft.



The comparison of criteria for LAT clearance between the Discussion Draft and current provisions are as follow:

Items	Discussion Draft	Current rules ¹⁰
Criteria for mandatory clearance	<ul style="list-style-type: none"> ▶ 85% threshold is met ▶ The 85% threshold is not met, but the unsold portion has been rented out or retained for own use by the property developer ▶ Fails to complete sales three years after a sale/pre-sale permit is granted ▶ The ownership rights of a work-in-progress property development project are transferred to another party ▶ The land-use right is directly transferred ▶ The taxpayer files an application for tax deregistration without having its LAT cleared; or ▶ Other criteria specified by the State Council 	<ul style="list-style-type: none"> ▶ The construction and sale of a property project has been completed ▶ The ownership rights of a work-in-progress property development project are transferred to another party; or ▶ The land-use right is directly transferred
Criteria for discretionary clearance	<ul style="list-style-type: none"> ▶ Not mentioned 	<ul style="list-style-type: none"> ▶ 85% threshold is met; ▶ The 85% threshold is not met, but the unsold portion has been rented out or retained for own use by the property developer ▶ Fails to complete sales three years after a sale/pre-sale permit is granted ▶ The taxpayer files an application for tax deregistration without having its LAT cleared; ▶ Other criteria specified by the provincial-level tax authorities

In the context of rapid soaring housing price in Chinese property market in recent years, LAT clearance may create pressure on a property developer's cash flow, especially on those who indeed need to pay a large amount of taxes after accurate computation. In practice, many taxpayers would defer LAT clearance even if the relevant criteria for discretionary case are met, on the basis that they have not received any notice with regard to LAT clearance from the tax authorities.

The Discussion Draft tightens the LAT clearance criteria, if it finally passes in the same way, property developers who can now benefit from the discretionary treatment shall perform clearance on a mandatory basis. For instance, a property developer who meets the 85% threshold must settle its LAT within 90 days from the date of meeting such criteria; while it may not conduct LAT clearance until required by in-charge tax authority under current regulations. Any non-compliance may trigger penalties prescribed in the Tax Collection and Administration Law if the Discussion Draft is officially launched. Such tightened treatment reflects the Chinese government's current attitude towards curbing speculative development and boosting healthy development of the property market.

Note:

10. Guoshuifa [2006] No. 187, Guoshuifa [2009] No. 91



Confirmation on LAT clearance - cancelled in the Discussion Draft

The Discussion Draft stipulates that the filing of LAT for property development projects shall include two stages, the provisional LAT filing and final LAT clearance. It also simplifies the procedures of LAT clearance by eliminating the approval requirement.

Currently, a taxpayer conducting LAT clearance shall first submit relevant documentation to the in-charge tax authority for approval, and then settle LAT after receiving a written notification stating the final LAT owed to or from the tax authority. The Discussion Draft takes away the approval requirement and stipulates that, property developers shall settle the LAT by themselves if the prescribed criteria are met. This is indeed consistent with the current trend in simplified tax administration by having the taxpayer settle their tax first based on their own assessment and leave for the tax authority to administer later.

According to the current provisions, a taxpayer shall submit documentation within 90 days from the date when the relevant criteria are met (for mandatory cases) or when the notification is received (for discretionary cases). However, the review period, which is determined by the provincial-level tax authority, usually lasts for a very long time.

Take Guangdong Province as an example, according to prevailing rules¹¹:

- ▶ The in-charge tax authority shall make a conclusion within 180 days from the date of accepting the documentation
- ▶ If facing difficulty, it can be extended by 90 days upon approval by the county/district-level tax authorities
- ▶ In special circumstances, another 90-day extension can be granted upon approval by provincial tax authorities; in such case, a written notification shall be delivered to the taxpayer

In other words, it may take up to 360 days to make a conclusion on a LAT clearance case.

As mentioned above, the approval requirement is removed in the Discussion Draft. Taxpayers reaching the relevant criteria shall have their LAT cleared within prescribe time limit. There is no doubt that once the provision is finalized, the LAT clearance process will be greatly accelerated. However, every coin has two sides, the lack of tax authorities' written notification may result in tax uncertainty. Meanwhile, it is not unreasonable to expect tax authorities to adopt more stringent follow-up administrations after the cancellation of approval. Taxpayers are strongly recommended to retain sufficient documentations to support the positions taken (e.g. proper official invoice for each deducted cost is usually the more vulnerable part when facing investigation).

Conclusion

In addition to the above-mentioned content, the Discussion Draft also proposes establishing mechanisms for information sharing and coordination among relevant authorities to enhance the collection of LAT. In addition, according to the Discussion Draft, it can be expected that, with the final promulgation and enactment of the LAT Law, a series of implementation measures will be introduced by both central and local governments.

The LAT, which is closely connected to other types of taxes (e.g., Corporate Income Tax, Value-added Tax) of property developers, was designed by the Chinese government for the purpose of reasonably regulating the property market. If this Discussion Draft is to be adopted as proposed, the provisions on mandatory clearance would inevitably bring pressure on the cash flow of property developers in China. With that, we also wonder if the Chinese government will consider introducing transitional arrangements to ease the impact. We will keep you posted with any updates.

The public is encouraged to provide comments on the proposed LAT Law through the website of the MOF or STA, or by means of letters submitted before or on 15 August 2019.

Note:

11. Administrative Regulations on LAT Clearance (Guangdong Tax Services, STA Public Notice [2019] No. 5)
http://www.gd-n-tax.gov.cn/gdsw/ssfggds/2019-06/28/content_de90e72141a24f1e88f49d8513c7d2e9.shtml



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