

# LEHMANBROWN

雷博國際會計

insights@lehmanbrown

22<sup>th</sup> May 2006

May 2006 - Issues 1

## Q & A: consumption tax adjustments

Recently, with regard to the latest adjustments to consumption tax, which will take effect from April 1st, an official from Finance Ministry talked to the press. Economic Daily's Sun Yong recorded the queries and answers as follows:

**Question ("Q "): Would you introduce the background of this round of adjustment to policies concerning the consumption tax, please?**

**Answer ("A"):** The consumption tax is a kind of tax that was set up when China launched its reform of the taxation system, which was to be levied on some selected products (mainly some consumer goods) for a certain financial or adjustment purpose after levying the value-added tax on goods. At that time, 11 categories of products like cigarettes, alcohol, and cars were selected out to be as the taxable products. As a kind of selective tax, the consumption tax has undertaken such functions as adjusting the production, leading the consumption, and adjusting the allocation of incomes indirectly while shouldering the task to raise financial incomes. For more than a decade, incomes in the form of consumer tax have been increasing rapidly from RMB51.6 billion in 1994 to RMB163.4 billion in 2005, getting more than tripled; in the meantime, such a tax has played an important role in effectively organizing financial incomes, encouraging the rational configuration of resources and correctly leading production and consumption, etc.

With the rapid development of China's economy, some problems existing in the existing system of consumption tax begins to show up: firstly, the tax is levied only on 11 categories of products, thus, making the taxation scope

too narrow; secondly, some products originally included into the category of high-graded consumer goods have been provided with the features of popular consumption; thirdly, the tax rate structure of certain products to be taxed can not adapt to the changes of the domestic industrial structure, consumption level and consumption structure; fourthly, the roles of consumption tax in the promotion of resource saving and environmental protection are to be reinforced.

**Q: What kinds of fundamental principles are mainly followed in this round of adjustment to policies on consumption tax?**

稅

[services@lehmanbrown](mailto:services@lehmanbrown)

Professional Services

Taxation

Financial Accounting

Management Solutions

Business Management

Corporate Restructuring

A: The fundamental principles followed in this round of adjustment to policies on consumption tax are as follows:

Firstly, the principle of bringing consumption tax's adjusting functions into full play. The adjusting function of policies concerning consumption tax must accord with adjustments to the state policies on macro control, be propitious to putting into effect the view of scientific development and the construction of an abstemious society, promoting environmental protection and resource saving and the establishment of a long-effective mechanism of macro control. The tax rate and taxation scope of consumption tax must be adjusted with increases and decreases according to the changes in consumption level and the consumption structure so as to lead the production and consumption of relevant products onto the correct way. Secondly, the principle of optimizing the tax rate structure and embodying the impartial principle in taxation. Thirdly, the principle of facilitating the levy and management of taxation with giving attention to financial incomes.

**Q: Will you please introduce the newly added tax items in detail?**

A: The details of the newly added tax items are as follows:

1. Refined oil product. The current consumption taxes involve two tax items - gasoline and diesel oil. After this round of changes to the tax items, the imposition scope of consumption tax of oil products has been enlarged with the consumption taxes levied on aviation kerosene, naphtha, solvent oil, lubricants, and fuel oils. In addition, some of the above-said newly added oil products can replace gasoline and diesel oil to some extent and some products with high quality can even be used as gasoline and diesel oil; in the actual levy and management, there exists a problem that certain enterprises seek to evade taxation by such shifts as confusing product names. As a result, the above-said oil products are brought into the scope of oil products to be levied of the consumption tax so as to control energy consumption, adjust and control the consumption structure, and reinforce the adjustment of consumption tax to petroleum products. The specific tax rates are RMB0.20 per liter for naphtha, solvent oil and lubricants, the same as that levied on gasoline and RMB0.10 per liter for aviation kerosene and fuel oils, the same as that levied on diesel oil.

Most of products newly added to the list of products levied of the consumption tax in this round like naphtha and solvent oil fall into the category of industrial raw materials, and aviation kerosene is mainly used in aviation; therefore, the levy of consumption taxes will increase the production costs to some extent. Considering the fact that prices of crude oil and refined oil products in the international markets rise comparatively rapidly, it will go against the stabilization of prices if the levy of consumption taxes on the products newly included in the scope of consumption tax levy is conducted too strongly; as ratified by the State Council, the consumption tax will be levied firstly at 30 percent of the tax to be levied when the policy is launched so as to appropriately amortize the impact on prices while relieving the levy of consumption taxes on aviation kerosene. When the conditions become mature in future, consumption taxes will be levied at the rate prescribed legally.

2. One-off wood chopsticks. In an objective sense, the production and use of one-off wood chopsticks have used up a great deal of timber resources and brought about pollution to the environment. To be propitious to reinforcing people's awareness of environmental protection, leading consumption and saving timber resources, one-off

增值税

"Zeng Zhi Shui"

(Value Added Tax)

营业税

"Ying Ye Shui"

(Business Tax)

wood chopsticks have been brought into the scope of consumption tax levy in this round of adjustment with a tax rate of 5 percent.

3. Solid wood floor. Solid wood floor refers to such floor decorating materials with the natural texture, color and pattern of a log that are formed after natural timbers have been dried and processed. In order to encourage economic use of timber resources and protect the ecological environment, solid wood floor has been brought into the scope of consumption tax levy as a tax item in this round of adjustment with a tax rate of 5 percent.

4. Yachts. Yachts belong to a kind of top grade consumables newly emerging in China in recent years, which can be consumed only by a minority group. With an aim to rationally lead the consumption and adjust the allocation of incomes indirectly, yachts have been brought into the scope of consumption tax levy in this round of adjustment with a tax rate of 10 percent.

5. Golf balls and equipment. At the present stage, Golf is still a kind of sport that only a small group with a high level of consumption can afford. To embody the government's adjustment of such a kind of high consumption behavior, golf balls and equipment have been taken as a tax item for the levy of consumption tax in this round of adjustment with a tax rate of 10 percent.

6. Top grade watches. For the moment, prices of some watches are as high as RMB10,000 or even over RMB1 million; some of such watches are made of noble metals and decorated with precious stones or diamonds, which have meant more than their original timing function. In order to embody the adjustment to top grade consumables with taxation, top grade watches have been taken as a tax item for the levy of consumption tax in this round of adjustment with a tax rate of 20 percent.

**Q: Then, why has the tax item of skin and hair care products been cancelled this time?**

A: It was decided that skin and hair care products would be levied of consumption taxes during the taxation system reform in 1994 mainly because such a category of products, which were usually sold at high prices at that time, did not fall into the category of mass consumables. These years, great changes have taken place in people's consumption level and consumption structure with the sustained development of the Chinese economy; and the consumption of skin and hair care products has become increasingly prevalent, thus being provided with features of mass consumption gradually. As a result, the voice requiring a halt to the levy of consumption taxes on skin and hair care products is also loud in the society. Considering that skin and hair care products like bath lotions, shampoos, toilet water, etc. have become necessities for common people, the tax item of skin and hair care products has been cancelled in this round of adjustment so as to make policies concerning the consumption tax better adapt to the requirement of changes in the consumption structure.

**Q: These years, many people propose that consumption taxes should be levied on top grade furniture, top grade garnitures, and even top grade housing; and there are also many people proposing that such behaviors with a high level of consumption in singing halls and ballrooms should be levied of the consumption tax. But this round of enlarging the scope of tax imposition only involves several categories of products**

**but excludes such contents. Could you tell the thinking behind such a decision, please?**

A: With the Chinese economy developing rapidly and the living standard of the Chinese improving in a sustained manner, the income allocation gap between various member citizens in Chinese society has been made larger gradually and there have appeared many new top grade consumables and behaviors of top grade consumption. It should be said that the requirement raised by various circles in the society to conduct adjustments with taxation measures and reinforce the reallocation function of taxation is correct.

But there are several issues to be explained. Firstly, some of the products and behaviors referred to above that are not included in the scope of consumption tax levy can be adjusted only by other taxes. For instance, the transfer of house and land access involves sales tax and deed tax, etc.; tax levied on housing involves housing property tax and so on. More examples include that the existing scope for the levy of consumption tax do not include consumption behaviors and that consumption behaviors in such entertainment places as singing halls are mainly adjusted by sales taxes levied on such places.

Secondly, the maneuverability should be also considered as to whether the adjustment could be conducted by means of consumption taxes besides the necessity of levying taxes. At present, it is difficult to levy consumption taxes on certain products due to tax levy conditions and certain technical reasons. For example, to levy consumption taxes on top grade furniture is rational in terms of policies; but it will be comparatively difficult to maneuver because as furniture can be made of various materials and have various forms, it is hard to determine a maneuverable specific norm as to what belongs to top grade. And there are also many technical problems difficult to solve if taxes are levied based on the price-based grade classification. As far as the current status quo of tax levy and management is concerned, it is still impossible to bring all top grade consumables that be considered as those that should be adjusted into the scope for the levy of consumption taxes.

Thirdly, the impacts on consumption demands should be also considered while levying consumption taxes. Insufficient consumption is still an unfavorable factor that is restricting China's economic development for the time being. The impacts on relevant industries and the consumption demands must be taken into account with the overall requirements of macro control policies accorded with while selecting consumables to be levied of consumption taxes. The newly added tax items in this round of adjustment have been selected out and determined with various factors having been considered. In future, we will make adjustments in time according to the actual situation of economic operations with conditions in various aspects getting mature gradually.

**Q: Please give an introduction to policy adjustments to the existing tax items and tax rates.**

A: As to the existing rate of consumption tax, only that of two tax items (cigarettes and firecrackers & skyrockets) has not been adjusted; that for all other tax items has been changed in different degrees. The several tax items that have involved changes to the corresponding tax rate include cars, motorcycles, liquors and alcohol, automotive tires.

1. Cars

Main contents of this round of adjustments to the consumption taxes on cars include: a) the category division of cars for the purpose of consumption taxes is consolidated with China's new standard for the category division, and the tax item of cars is divided into two sub-items of passenger cars and medium- and light-duty commercial passenger cars; b) the tax rate structure of cars will be adjusted with the tax rate of cars with a larger displacement volume improved. Various passenger cars (with cross-country vehicles included) will be levied of consumption taxes at 6 rates according to the respective displacement volumes. As to all medium- and small-sized commercial buses, a tax rate of 5 percent will apply. Thus, the gaps in terms of tax rate between cars with various displacement volumes will be broadened with the tax burdens of cars and cross-country cars with a large displacement volume and a high energy consumption added while having the tax burdens of vehicles with a smaller displacement volume alleviated, thus incarnating the policies to encourage the production and use of vehicles with a small displacement volume. (3) As to energy-saving and environment-friendly motor vehicles like hybrid vehicles, certain preferential measures concerning taxation will apply. Specific preferential measures will be jointly constituted by the Ministry of Finance and the State Bureau of Taxation and be implemented after being ratified by the State Council.

## 2. Motorcycles

The tax rate structure of consumption taxes levied on motorcycles has been adjusted, and the existing tax rate of 10 percent will be replaced with two different tax rates based on various displacements. Motorcycles with a displacement volume no more than 250ml will be levied of consumption taxes at the rate of 3 percent; meanwhile, the tax rate of 10 percent will not be changed for motorcycles with a displacement volume more than 250ml. On the one hand, such an arrangement has incarnated the principle of imposing taxes based on the displacement volume; on the other hand, the tax rates for motorcycles with a low displacement volume will be properly reduced.

## 3. Automobile tires

In order to relieve the tax burdens of manufacturers of bias tires appropriately, the tax rate for automobile tires will be lowered from 10 percent to 3 percent in this round of policy adjustment with such factors as the production of enterprises and financial incomes taken into account comprehensively. An exemption policy will be continually applied to radial tires.

## 4. Distilled spirit

In this round of adjustment to consumption taxation policies, the key is that the differential tax rate for distilled liquor made from grains and various kinds of potatoes has been replaced by a uniform tax rate of 20 percent. Moreover, international experiences will also be used as references for the research on methods of tax levy and management relevant to OEM distilled spirits and the consummation of policies, laws and regulations concerning taxation on relevant dealings so as to regulate the taxation basis for consumption taxation and stop leaks. For a next step, it is necessary to cooperate with other departments to consummate laws and regulations on the production and circulation of liquor products, shape up a strict mechanism for market access, and enhance the enforcement of administrative measures and laws to firmly beat counterfeits and fake products as well as such illegal behaviors as tax dodging and tax evasion.

## *"Providing an alternative in China"*

**[insights@lehmanbrown](mailto:insights@lehmanbrown) provides updates of the latest business news, taxation and accounting regulations in the People's Republic of China. It is designed to provide you with interesting and informative information to assist in your dealings with China or any China-related issues that you may encounter. If you do not wish to receive this newsletter, we have provided an un-subscribe facility below.**

LehmanBrown also provides a monthly newsletter *Peeling the Onion* which investigates certain topical issues affecting businesses in China, particularly for those companies and individuals with operations in the PRC, or looking to establish a presence in-country.



### Recent editions include:

Due Diligence in China    Transfer Pricing Strategies in China    Business Fraud in China    Corporate Valuations in China

Crisis Management in China    China's Changing Tax Environment    Internal Controls in China    Establishing an SME in China

Managing Your China Business Under SARS    Treasury Management in China    Banking in China    Mergers and Acquisitions in China

Bridging the Accounting Standards Gap in China    The Changing Role of CFOs and Accountants in China

Transfer Pricing Investigations...When not if!

You can subscribe to these newsletters through our website: [www.lehmanbrown.com](http://www.lehmanbrown.com)