The "Business Tax to VAT Reform" in China
High-level assessment carried out by the OECD's Centre for Tax Policy and Administration

The Centre for Tax Policy and Administration (CTPA) in the Organisation for Economic Co-operation and Development (OECD) recently completed a high-level assessment of China’s "Business Tax to VAT" Reform (the B2V Reform) that was implemented on 1 May 2016. The report on the key findings and conclusions of this assessment, including a set of recommendations to support the further successful implementation of this large-scale reform, has been delivered recently to the Chinese government. This assessment was notably based on extensive discussions and exchanges with a wide range of experts within the State Administration of Taxation (SAT) during recent months, including during a mission to Beijing and Nanjing.

The overall conclusion of this assessment is that China has achieved considerable improvements in the design and the operation of its VAT system in an exceptionally short time. China has made sound strategic and policy decisions and has managed the highly complex transition from a cascading set of complex indirect taxes to a modern VAT particularly well.

The B2V Reform has considerably enhanced the overall neutrality of China’s indirect tax system, in accordance with the key VAT neutrality principles set out in the OECD International VAT/GST Guidelines. This important positive effect of the B2V Reform results from the inclusion of the real estate sector and the entire services sector in the VAT system. This notably involved important efforts to extend the application of VAT to financial services. A number of measures could be considered to further advance the domestic neutrality of China’s VAT system. These include the fine-tuning of input-VAT deduction and refund regimes, the gradual reduction of the number of reduced rates and of the small-scale business threshold, and the fine-tuning of the VAT regime for financial services.

The B2V Reform has also significantly enhanced the international neutrality of China’s VAT-system, particularly through the further extension of the zero rating of exports of services, as well as goods exports, in line with international standards. This reform achieves a closer alignment of China’s VAT system with the destination principle as promulgated by the OECD International VAT/GST Guidelines. This principle is accepted as the international norm and is notably sanctioned by World Trade Organisation (WTO) rules. The international neutrality of China’s VAT system could be further enhanced through the continued gradual replacement of export exemption regimes by a generalized zero-rating regime for exports whereby no VAT is levied on exports of goods and outbound services with full right to deduct associated input VAT; and by further gradual fine-tuning of the zero-rating regime and the
export refund process, particularly as regards outbound services.

The advances achieved by China in the administration of the VAT and in the quality of taxpayer services are impressive. These include the streamlining of VAT administration at national and provincial level, intensive communication and training efforts, and large-scale investment in taxpayers’ services to support the efficient and consistent implementation of the reform. The Golden Tax System designed by SAT for the automated and integrated management of key processes in VAT compliance and administration will facilitate better compliance and will enhance the tax administration’s capacity to manage key processes such as input VAT deduction and refunds more efficiently. The Golden Tax System is particularly effective in preventing fraudulent input VAT deduction and refund fraud through false invoices, and will become an increasingly important source of reliable nation-wide data for the tax administration to implement modern risk based tax compliance management strategies to complement the existing mechanical invoice matching process. China is encouraged to continue its efforts to streamline its VAT administration and to ensure a consistent nation-wide implementation of its VAT reform notably through the adoption of an integrated VAT Law, which would enact the rules and principles of the B2V Reform in a coordinated manner. The adoption of such a VAT Law will greatly enhance the certainty and consistency of China's VAT system. China is also encouraged to continue its efforts towards the implementation of a more risk-based approach to complement the Global Tax System, as this is likely to further improve the efficiency and the effectiveness of VAT administration in China. Notably the exemption of taxpayers with a positive compliance history from the invoice verification process under the Golden Tax System is to be welcomed.

The overall conclusion is that the implementation of B2V Reform provides a sound base that will serve China well in the effective transformation towards a modern world class VAT system.