China takes a closer step towards the completion of the Resource Tax Reform

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In brief

Since 2010, the Chinese government has been gradually pushing forward the Resource Tax (RT) Reform, with an aim to replace the existing volume-based taxation method by an ad valorem based taxation method as well as to clean up various charges and fees levied on resources. Following this objective, China has undergone several rounds of RT Reform in recent years, from crude oil and natural gas to coal, from the western regions to nationwide. Recently, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) jointly issued Caishui [2016] No.53 (Circular 53)\(^1\) to comprehensively move forward the RT Reform by expanding it to almost all of the remaining taxable resources and piloting RT on water resources in the Hebei Province. This is a significant step towards the completion of the RT Reform. Meanwhile, the issuance of Caishui [2016] No.54 (Circular 54)\(^2\) and Caishui [2016] No.55 (Circular 55)\(^3\) on the same date provides further clarifications on detailed matters relating to RT Reform policies. These three new circulars will take effect from 1 July 2016.

In this issue of News Flash, we will walk you through the progress of the RT Reform over the past few years, introduce the highlights of this round of RT Reform and share our observations with you. Relevant enterprises should assess the potential impact on their business and get prepared.

In detail

Recap of the key developments of the RT Reform

Since 1994, China had levied RT on mineral resources and salt based on the volume-based taxation method. Under such method, the relatively fixed taxation base standard cannot be adjusted with the price fluctuation of the resources in a timely manner. Hence, the RT system cannot play an effective and efficient role in regulating the market supply and demand for resources. In addition, other issues like the overlapping of RT and charges as well as the limited taxable scope have always existed. In order to improve the tax system, the Chinese government has gradually pushed forward the RT Reform since 2010 after years of deliberation. We summarise the key developments of the RT Reform as follows:

- 31 May, 2010: The State Council officially approved the promulgation of the RT Reform policies\(^4\).
- 1 June, 2010: The Xinjiang Autonomous Region was selected as the pilot area to implement the RT Reform and the ad valorem taxation method was introduced for crude oil and natural gas\(^5\).
- 1 December, 2010: The ad valorem taxation method was extended to 11 other western provinces in China\(^6\).
- 1 November, 2011: The State Council amended the Provisional Regulations on China’s Resource Tax to implement the ad valorem taxation method for crude oil and natural gas nationwide\(^7\).
- 1 December, 2014: The scope for applying the ad valorem taxation was expanded to coal nationwide. Meanwhile, the provincial level authorities were granted the discretionary power to determine the applicable tax rate within a prescribed range\(^8\). In addition, charges and fees levied on crude oil, natural gas and coal were being cleaned up\(^9\).
- 1 May, 2015: The taxation method for rare earths, tungsten and molybdenum was changed from volume-based to ad valorem based\(^10\), and the relevant charges and fees were also being cleaned up\(^11\).
Expanding taxable scope of resources

Currently, the taxable scope of resources only covers crude oil, natural gas, coal, metal and other mineral resources as well as salt, while other natural resources which are closely related to our daily life are not included. To better leverage RT policies for environment protection purposes, the Chinese government has for the first time put forward a plan to gradually expand the taxable scope to natural resources such as water, forest, meadow, mudflat, etc.

According to Circular 53, Hebei Province is selected to be the first pilot area to experiment the RT Reform on water resources, and the RT on water resources will replace the existing water charges. Pursuant to Circular 55, RT will be levied on an ad valorem basis on both individuals and enterprises that take surface water and underground water. Different taxation standards would apply, depending on the categories of water, the industries that the taxpayers belong to and the differentiated usage of water, to encourage recycling and restrain over-consumption.

The pilot policy of levying RT on water is expected to be rolled out to the rest of China in the years to come. Meanwhile, in relation to other resources like forest, meadow, mudflat, etc., each province is advised to draw up their own RT Reform plan based on their actual circumstances for the State Council’s approval.

Rolling out the ad valorem taxation method comprehensively

As of 2015, the taxation method for six taxable resource items, i.e. crude oil, natural gas, coal, rare earths, tungsten and molybdenum, has already been changed to an ad valorem basis with the corresponding charges and fees being cleaned up. This round of RT Reform further expands the reform scope to almost all of the remaining taxable items. Apart from a small number of resources like clay and gravel which will continue to be taxed based on volume for the ease of administration, almost all mineral resources and salt would be taxed on ad valorem basis. Consistent with the previous rounds of RT Reform, the provincial level governments are allowed to determine the specific tax rate within a prescribed range by observing the principle of not increasing the tax burden of enterprises.

Clean-up of resource-related charges

The concept of ‘cleaning up charges and replacing them with taxes’ was first introduced in the 2014 Government Work Report. It could be seen from the aforementioned key development of the RT Reform that such concept has already been included in the previous rounds of RT Reform since 2014. There is no exception in this round of RT Reform.

Replicating preferential tax policies to mineral resources

The RT Reform on coal in 2014 provided two concessional tax treatments (i.e. 50% and 30% tax reduction respectively) for certain coal mining activities to encourage coal mining enterprises to enhance the resource utilisation rate. We are glad to see that similar concessional tax treatments are also applicable to mining activities in this round of RT Reform. Circular 54 further clarifies the criteria for enjoying such incentives.

In addition, to encourage extracting mineral products from low-grade ores or wastes, the provincial level governments are delegated with the power to decide whether or not tax reduction or tax exemption policy should be granted to these types of activities. Meanwhile, RT on qualified intergrowth ores are still temporarily exempted with the aim to enhance the extraction rate.

The takeaway

Similar to other tax reforms that China has been undertaking in recent years, the RT Reform is also carrying out in stages. Apart from the stages approach, the RT Reform has also considered the interest of all parties.

- From the taxpayers’ perspective, even though the change of the taxation method may increase the tax burden when the prices of resources go up, the clean-up of charges and fees should help ensure that the tax burden will remain stable for enterprises.
- From the perspective of revenue allocation, apart from RT on marine oil and natural gas, RT on other resources is revenue of the local governments. In other words, all of the tax revenue relating to this round of RT Reform belongs to the local governments. The delegation of powers to determine the specific tax rates and detailed tax incentives in their localities will motivate local governments to be more active in the RT Reform. In the meantime, the principle of maintaining the same level of tax burden on replacing charges with RT will help maintain the stability of local revenue.
- From the society’s perspective, the RT Reform is expected to change the current situation of relying on the consumption of natural resources for economic development, and encourage enterprises and individuals to focus on resource conservation and environment protection to drive ‘green development’ forward.

This round of RT Reform is not going to be the last. It is anticipated that the pilot RT Reform on water resources will be expanded nationwide in due course and more natural resources will possibly be included in the RT Reform in the near future. Relevant enterprises and individuals are suggested to keep a close eye on the trend of the reform, study the potential impact on their business and get prepared in advance.

Endnote

1. Notice Jointly Issued by the MOF and SAT on Comprehensively Promoting the Resource Tax Reform
2. Notice Jointly Issued by the MOF and SAT Regarding the Policies of Resource Tax Reform
3. Notice Jointly Issued by the MOF, SAT and Ministry of Water Resources Releasing the <Provisional Measures for the Pilot Reform of Resource Tax on Water>
4. Notice Issued by National Development and Reform Commission (NDRC) and Forward by the State Council on Opinions on Key Work for Deepening the Economic System Reform in 2010 (Guofa [2010] No.15)
5. Notice Jointly Issued by the MOF and SAT Regarding Issuance of <Regulatory Rules for Reform of Resource Tax for Oil and Gas Industry in Xinjiang> (Caishui [2010]No.54)
6. Notice Jointly Issued by the MOF and SAT Regarding Certain Matters on Resource Tax Reform on Crude Oil and Natural Gas in Western Region (Caishui [2010] No.112)

8. Notice Jointly Issued by the MOF and SAT Launching the Reform on Resource Tax Collection on Coal (Caishui [2014] No.72)

9. Notice Jointly Issued by the MOF and NDRC Regarding Certain Matters on Overall Review of Mineral Compensation Charges and Governmental Fees Related to Coal, Crude Oil and Gas (Caishui [2014] No.74)

10. Notice Jointly Issued by the MOF and SAT Regarding the Implementation of the Reform Concerning the Ad Valorem Calculation and Collection of Resource Tax on Rare Earths, Tungsten and Molybdenum (Caishui [2015] No.52)

11. Notice Jointly Issued by the MOF and NDRC Regarding Cleaning Up the charges and fees levied on Rare Earths, Tungsten and Molybdenum (Caishui [2015] No.53)


13. Notice Jointly Issued by the MOF and SAT Launching the Reform on Resource Tax Collection on Coal (Caishui [2014] No.72) and Public Notice Jointly Issued by the SAT and National Energy Administration (NEA) Implementing the Relevant Matters Regarding the Preferential Treatment for Resource Tax on Coal (SAT, NEA Public Notice [2015] No.21)
Let’s talk

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