

## New changes to indirect tax surcharges

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#### In brief

- » The Urban Maintenance and Construction Tax Law of the People's Republic of China came into effect on 1 September 2021.
- » The newly promulgated law has further clarified provisions on the of calculation basis, the identification of the taxpayer's location, and tax payment and withholding obligations.

Feedback

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**2021 (No. 16 issue)**

October 2021

**In detail**

On 11 August 2020, the Standing Committee of the 13th National People's Congress passed the Urban Maintenance and Construction Tax Law of the People's Republic of China (hereinafter as the "UMCT law"), which came into effect on 1 September 2021.

UMCT is not a new tax but has been levied for over 30 years under a set of temporary regulations. UMCT is a surcharge levied on indirect taxes liability (i.e. VAT and consumption tax). In other words, to a taxpayer, the higher its indirect tax liability, the more its UMCT liability will be.

According to the previous temporary regulations, and also now the new law, UMCT is collected and kept by the local governments and must be spent only on urban construction and maintenance projects, such as public housing, roads and bridges, water supply, drainage, heat supply, ferry, gardening, hygiene, fire safety, traffic signage, and lighting, etc.

While maintaining the same principles, rates, and measures of the temporary regulations, the new UMCT law, applicable also to other local levies such as education surcharges, has introduced some changes and clarifications that could have a significant bearing on a taxpayer's indirect tax burden.

**1. Clarification on tax base**

To avoid increasing the burden of the tax-refundable enterprises, article 2 of the UMCT Law clarifies that the tax base of UMCT shall exclude the VAT refunds.

In addition, it had been unclear whether the VAT exemption and credit should be subject to UMCT which is inconsistently practiced in various places. The "Announcement on Determination of Tax Base for UMCT" (hereinafter as the Announcement No. 28), which came into force at the same time as the UMCT Law, stipulates that the VAT exemption and credit shall be levied on urban construction tax.

Thus, the tax base is VAT+ consumption tax (excluding the two taxes paid due to import of goods or sale of labor services, services, and intangible assets within the territory by overseas entities and individuals), + VAT exempt credits – directly exempted or reduced VAT on consumption tax - refunds of VAT credits.

**2. UMCT exempted on imported and services**

According to Caishuizi [1985] No. 69, imported products have been exempted from UMCT. However, for imported services and intangible assets, in the prevailing practice, UMCT used to be withheld by Chinese importers when paying abroad.

The law has introduced a significant change in this regard. Article 3 stipulates that imported services are no longer subject to UMCT. This shift has aligned the UMCT practice for imported services with that for imported goods, both exempted from the reversed charges system.

Meanwhile, according to article 2 of Announcement No. 28, the tax base for education surcharge and local education surcharge shall be the same as that for UMCT, indicating that while UMCT is not levied on imported services, no education surcharge and local education surcharge will be levied.

**3. Taxpayer's location determined by the local authority**

The new law continues to adopt the same tax rates of the previous regulation, depending on the level of locality: 7% for taxpayers in a city, 5% for taxpayers in a county or a town, and 1% for taxpayers not located in a city, a county or a town. On this basis, the new law states that a taxpayer's official location

## 2021 (No. 16 issue)

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shall be determined by the local authority based on relevant rules. Therefore, in practice, the final tax rate will be determined according to actual conditions and local requirements.

#### 4. Clarification on withholding timing and withholding agent

The new law adopts the same provision that the UMCT liability timing as that of the previous regulations, being the same timing for VAT and consumption tax.

In addition, a new regulation on withholding agents has been added. The withholding agents of UMCT are the entities and individuals obligated to withhold VAT and consumption tax. They are required to withhold UMCT when withholding VAT and consumption tax.

Tax declaration procedures are also simplified. The State Administration of Taxation is actively promoting a combined declaration of UMCT, VAT, and consumption tax, and aims to achieve soon a synchronized and simultaneous levy in all situations.

#### WTS China observation

According to the new UMCT Law, the State Council can formulate preferential policies for UMCT reductions and exemptions for key groups. The previous tax incentives for the new start-up of retired soldiers, small-scale VAT taxpayers, and major national water conservancy projects will continue. It is expected that there will be no major changes to them in the short term.

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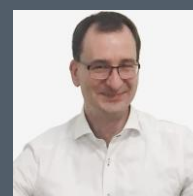
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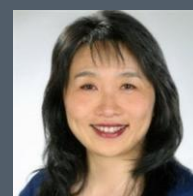
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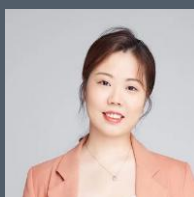
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