

CHINA

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Executive Summary



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Expansion of the VAT pilot reform

As of 1st August 2012 the State Council has decided to expand the pilot scope of the *Measures for the Implementation of Pilots of Reform from Levying BT in Transportation Sector and Part of Modern Service Sector to VAT*. The pilot project for the reform was initially rolled out in Shanghai and due to its success will now be extended to another 10 provinces/cities. In this issue, we provide you with an overview of the basic provisions of the pilot reform, and its effect on the shipping sector.

Foreign Investors' Use of Collectively-Owned Land for Construction Purposes

With any type of land investment comes a variety of different complex legal issues. In this issue, our experts summarize the key points for foreign investors who are considering investing in collectively-owned land for construction purposes.



Expansion of the VAT Reform Pilot

The Pilot Scope of the *Reform from Levying Business Tax ("BT") to Value-added Tax ("VAT")* was expanded

The Premier of the State Council, Mr. Wen Jiabao, presided over an executive meeting of the State Council on 25th July 2012, at which the State Council decided to expand the pilot scope of the reform from levying BT to VAT. During the meeting, the State Council decided to expand the reform pilot to another 10 provinces/cities, including Beijing, Tianjin, Jiangsu, Zhejiang, Anhui, Fujian, Hubei, Guangdong, Xiamen and Shenzhen, as of 1st August 2012. The pilot project for the reform was firstly conducted in Shanghai in the transportation sector and part of the modern service sector. The State Council also decided to keep on expanding pilot areas next year and choose parts of industries to make pilots nationwide.

In accordance with the decisions of the meeting, on 31st July 2012, the Ministry of Finance and State Administration of Taxation jointly issued the *Notice About Pilots of Reform from Levying BT in Transportation Sector and Part of Modern Service Sector to VAT* in 8 Provinces and Cities Including Beijing, by which Beijing and Tianjin have been formally covered by the pilot areas of tax reform,

and the sectors in which pilots are made include fields such as transportation sector and shipping service sector etc. With the expansion of the pilot scope, it is clear that the reform from levying BT to VAT represents the general trend which conforms to long-term needs.

Basic Provisions

At the beginning of the pilot project, the Ministry of Finance and State Administration of Taxation promulgated on 16th November 2011 *Measures for the Implementation of Pilots of Reform from Levying BT in Transportation Sector and Part of Modern Service Sector to VAT* (hereinafter referred to as "the Measures"), and set up a pilot in Shanghai. In accordance with the Measures, the companies and individuals providing services in the transportation sector and part of the modern service sector (hereinafter referred to as "taxable services") in the territory of the People's Republic of China (hereinafter referred to as "China") are taxpayers of VAT. Taxpayers shall pay VAT for providing taxable services but not BT any more according to the Measures. Taxable services include those provided by the companies or individuals outside of China.

Article 12 of the Measures stipulates that the rates of VAT are as below:

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1. Where a lease service of tangible personal property is provided, the rate is 17%. (Bareboat charter of ocean shipping vessels falls within this category.)
2. Where service of transportation sector is provided, the rate is 11%. (Both voyage charters and time charters fall within this category.)
3. Where services of the modern service sector are provided (except for lease service of tangible personal property), the rate is 6%. (Including services at ports and wharf, services at cargo and passenger transport stations, salvage services, customs broker services, shipping agency services, storage services and loading and unloading services etc.)
4. Where taxable services stipulated by the Ministry of Finance and State Administration of Taxation are provided, the rate is zero.

Effects of the Reform

The reform has strengthened the supervision over tax revenue of the shipping sector to some extent. In practice, in order to avoid business tax, some companies often adopt means such as opening personal accounts and offshore accounts to receive and pay money so as to decrease the turnover in accounting books and ultimately avoid business tax. After VAT is levied, since most shippers or transport service receivers are taxpayers of VAT prior to the reform, they will certainly require the shipping service providers to issue VAT invoices in the course of receiving shipping services after the reform. Under such circumstances, the shipping companies will scarcely avoid taxes again.

On the other hand, shipping companies will have the opportunity to apply for the input tax deduction in case they pay the VAT in lieu of BT. This provides an opportunity of lessening or reducing burden on shipping companies.

Further Clarifications Required

However, we note that the rates of VAT stipulated in the Measures are not unified, which causes some uncertain factors

influencing whether it will really relieve the burden of taxation on companies or not.

1. Whether the rates are suitable

The Measures stipulate that the VAT rate in transportation sector is 11%, and that of the shipping sector is 6%. However, in accordance with the Provisional Regulations on Business Tax, the rate of BT in the transportation sector is 3%, and that of service sector is 5%. In the course of the pilot in Shanghai, many shipping and logistics companies complain that their burden of taxation has not been lightened, but even increased under some circumstances.

The Ministry of Transport of China has drawn up *Opinions on Further Perfection of the Reform from Levying Business Tax to Value-added Tax of Shipping Companies* (hereinafter referred to as the "Opinions"). The Opinions suggest that the rate of the VAT for the transportation sector shall be fixed at about 6-7%. Compared with the present 11% VAT rate applicable in the Measures, this is nearly 50% lower.

2. Coordination with the original national and local tax preferential policies

With regard to the construction of the international shipping center, both the central and local governments of China issued a lot of policies that support the shipping sector and shipping service sector, among which are many business tax relief policies in respect of those sectors. For instance, the preferential policies for Dongjiang Free Trade Port Zone of Tianjin and the modern service sector issued by Tianjin government, etc. Therefore, issues with respect to how these policies are coordinated with the policies of levying BT to VAT and how to regulate the original tax preferential policies deserve attention and consideration.

3. Arrangement about the taxable services of foreign companies and individuals in China

With regard to the taxable services of foreign companies and individuals in China, the Ministry of Finance of the People's Republic of China and State

Administration of Taxation issued the *Supplementary Notice About Tax Policies for the Pilot Scope of the Reform from Levying Business Tax to Value-added Tax of Transportation Sector and Part of Modern Service Sector* in July. The notice stipulates that where any company or individual in any country or region, which has not reached any bilateral transportation tax exemption arrangement with the Chinese government, renders international transportation services to any company or individual in China, to which Article 6 of the Measures (CS [2011] No.111) is applicable, the withholding agent shall withhold the VAT according to the Measures during the period of the pilots.

In order to prevent those taxes, such as business tax or income tax, etc. from being levied by two countries repeatedly, China has reached the bilateral transportation tax exemption arrangement or agreement with many countries or regions. The aforesaid supplementary notice clearly stipulates that any company or individual in any country or region which has not reached the tax exemption arrangement with China shall pay the VAT for the taxable services rendered in China. However, it is still not clear about how to levy taxes on those companies or individuals in countries or regions which have reached the tax exemption arrangement with China.

Moreover, with regard to any country or region which has not reached a tax exemption arrangement with China, in respect of taxable international transportation services rendered in the aforesaid pilot scope, the tax rate of 11% for the transportation sector is applicable. This rate is higher than the business tax of 3% in other non-pilot areas.

In summary, there is no doubt that the purpose and the final results of the reform from levying BT to VAT will relieve the tax burden on companies. However, we should also pay close attention to some problems arising during the implementation of the reform and adjust in time once the true effects of the reform can be seen.

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Foreign Investors' Use of Collectively-Owned Land



Introduction

In Guangdong Province, it is common for foreign investors to use collectively-owned land to construct factories, warehouses, and offices for business operations. From our experience, we think it is important to summarize the points below for foreign investors considering investing in collectively-owned land for construction purposes.

The Ownership Rights and the Land Use Rights

Some foreign investors believe that signing the Land Transfer Contract or similar contracts with a villagers' committee (or the collective economic organization in rural areas of China), and paying the land price, gives them permanent ownership rights or ownership rights for a very long period of time, as stipulated in the Land Transfer Contract. Additionally, the foreign investor also believes that they will have the right to dispose of the land at their own discretion.

However, according to the PRC's Land Law and PRC regulations, all land in China is either owned by the state or by the villagers' committee, making the land either state-owned or collectively-owned land. Individuals and enterprises cannot own land.

The PRC Land Law and regulations for collectively-owned land, and premises constructed upon such land, is not as developed as those laws and regulations in relation to state-owned land, so practices often vary among the different provinces. Due to the lack of national legislation, generally, the provincial regulations or municipal regulations are adhered to.

In June 2003, the government of Guangdong Province issued the *Notice Regarding Trial Implementation of the Transfer of the Rights to Use of*

Collectively-Owned Land for Construction Purposes (YUEFU No.[2003]51). In addition, the *Administrative Measures of Guangdong Province for the Circulation of the Rights to Use Collectively-Owned Land for Construction Purposes (Guangdong Government Order No.100)* entered into force in October 2005.



These two regulations were a breakthrough in land use legislation in China. From these two regulations it is clear that:

1. The ownership of collectively-owned land for construction purposes and the land use rights of the same piece of land can be separate and belong to different parties;
2. Consistent with previous regulation, the villagers' committee (or rural collective economic organization) holds the ownership rights of collectively-owned land unless the land is taken by the state government. Then, the land is changed from collectively-owned land to state-owned land;
3. There are provisions and proceedings that dictate how the land use rights (i.e. sales, leases, transfers, mortgages) of collectively-owned land can be transferred. Generally, the user of the land needs to pay the transfer price or rent to the landowner, the villagers' committee, to obtain the land use rights. Additionally, the relevant regulations dictate that land users can only obtain the land use rights for a certain time period, not permanently.

Thus, it is important to note that signing a land transfer contract and paying money will not guarantee permanent land ownership in Guangdong Province. Unlike many foreign countries, in China, as mentioned above, land use rights can only be obtained for a certain time period. Foreign investors should make strong business decisions before embarking on different investment opportunities.

Registration Procedures for the Land Use Rights of Collectively-Owned Land for Construction Purpose

The previously mentioned two legislations, the *YUEFU No.[2003]51* and the *Guangdong Government Order No.100*, require that the parties involved file applications with the local authorities (i.e. the local bureau of land resources). The local authorities handle the registration procedures and issue the relevant certificates. Through the local authorities, the Chinese government strictly controls and supervises land transfers.

However, we find that many foreign investors fail to adhere to the necessary application and registration procedures, so they never receive an official certificate that records their title to the land use rights.

This failure brings many potential legal risks to the land user. For example, the land transfer contract will only be binding between the villagers' committee and the land user. It will not be legally binding against a good-faith third party. If the villagers' committee signs another land transfer contract with a good-faith third party for the same piece of land and both parties complete the relevant registration procedures, then according to the government the good-faith third-party is lawful user of the land. The original foreign investor will immediately lose all of their land use rights. Although PRC Contract Law allows the original foreign



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investor to sue the villagers' committee for monetary compensation for breaching the contract, the foreign investor will still lose the land.

Therefore, although it might be time-consuming and expensive, to protect one's rights and interests, we advise all foreign investors to complete the aforesaid application and registration procedures. It is also very important to receive the certificate that records title to the rights to use the collectively-owned land for construction purposes

Transferring a Premises Located on Collectively-owned Land for Construction Purposes to a Third Party

In practice, foreign investors often wish to sell the premises (a factory or warehouse) located on the collectively-owned land for construction purposes to a third party at their discretion.

Article 6 of the *Guangdong Government Order No.100* provides that if the right to use the collectively-owned land for construction purposes is transferred, leased, or mortgaged, then the building or any other adhesive substance on the land is also transferred, leased or mortgaged. Similarly, if the building or any other adhesive substance on the collectively-owned land for construction purposes is transferred, leased, or mortgaged, the right to use the collectively-owned land occupied by the building or adhesive substance will also be transferred, leased, or mortgaged.

According to Article 6, foreign investors transfer their land use rights to a third party when they sell the premises. If a foreign investor fails to complete the application and registration procedures as mentioned in Part II, then the third party cannot register as a lawful user of the land even

if the third party has signed a sales/transfer agreement or has consent from the landowner and the villagers' committee.

Additionally, if the premise was constructed without completing the relevant application procedures, then as an illegal building, it can be demolished by the local authorities at any time.

Thus, we recommend that foreign investors do not ignore the local application and registration procedures, especially if the foreign investor plans to transfer the land use rights and/or the ownership of the premise to a third party. Additionally, delaying the completion of the aforesaid procedures will only add to the necessary time and cost.

Conclusion

Some lawyers and experts have advised that the State revises its land law so that the transfer of collectively-owned land for construction purposes can be formally recognized as lawful by national legislation. Such national legislation will also eliminate inconsistencies and uncertainties inherent in local legislation, thereby enhancing the effective land use in rural areas.

Presently, before foreign investors make investments in collectively-owned land for construction purposes, we suggest that they obtain legal advice in order to avoid fraudulent losses and unnecessary delays and costs.

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