



Advance Ruling system being explored by Chinese tax authorities

Background

In recent years, the focus of taxpayer services from the Chinese tax authorities has gradually shifted.

Traditionally, the Chinese tax authorities tend to stress tax administration at a relatively basic level, such as improving the attitude of the tax officials as service providers, enhancing tax compliance and reducing tax collection costs.

Now the Chinese tax authorities are setting their sights higher and are aiming to provide more enhanced taxpayer services e.g. guiding taxpayers to comply with tax regulations on their own, helping taxpayers to manage tax risks, and providing taxpayers with more customised assistance.

Among the types of enhanced taxpayer services, an Advance Tax ruling (or Private Tax ruling) system has been accepted by many countries as a key element. In China, that need is more acute given the considerable scope for uncertainties under China's tax laws.

KPMG has been actively providing technical input to the State Administration of Taxation (SAT) on Advance Tax rulings systems being operated in other jurisdictions. If China introduces a system of advance rulings, that would benefit both taxpayers and the SAT. Taxpayers benefit in obtaining certainty before entering into transactions, and the SAT benefits from enhanced levels of voluntary compliance by taxpayers.

What is an Advance Tax ruling?

An Advance Tax ruling is a tax authority's interpretation of how the tax laws should be applied to a given set of facts submitted by a taxpayer. In common terms, an Advance Tax ruling is a systematised way of interpreting tax laws. It is similar to a policy ruling that has been frequently issued by the SAT to lower level tax authorities in China. However, an Advance Tax ruling differs from a policy ruling in that the former is addressed to a taxpayer rather than a tax authority. An Advance Tax ruling is intended to have the same legal force as regulatory circulars, and is generally issued by the highest tax authority in a jurisdiction.

In addition, the Advance Tax ruling mechanism plays an important role for taxpayers in maintaining open and transparent relationships with tax authorities, allowing proper budgeting of tax costs, reducing uncertainty in financial statements for investors, removing risks of tax penalties, and improving tax compliance. For these reasons, the Advance Tax ruling system has been embraced by many countries.

Global adaption of Advance Tax ruling systems

According to 2009 statistics released by the Organisation for Economic Cooperation and Development (OECD), 28 out of 30 OECD countries, including Australia, Canada, France, Germany and the United States, have implemented Advance Tax ruling systems. Among 13 major non-OECD countries, 12 countries, such as Singapore, South Africa and Argentina, have also adopted similar Advanced Tax ruling regimes. It is important to note that not all these countries use the term 'advance rulings' in defining the system. Some countries adopt the name 'private rulings' and others choose 'product rulings' as the designation. Despite the differences in terminology, these mechanisms are broadly similar in both essence and objective. Normally, these advance ruling systems cover all types of taxes in the respective countries.

One of the reasons why advance ruling mechanisms have been embraced by tax authorities in many countries is that, like other types of law, tax laws normally contain ambiguities. Such ambiguities may include what particular words in the tax laws mean, how the tax laws may apply to specific factual situations, and what evidence may be needed to support factual claims. Through an advance ruling mechanism, taxpayers have the opportunity to understand the expectations of the tax authorities before the transaction takes place, and if necessary, take steps to manage those risks. In addition, if a number of taxpayers request advance rulings on similar issues, this helps the tax authorities to identify and understand the contentious issues in the tax laws that urgently require clarification and refinement.

In developing its system of Advance Tax rulings, the SAT have closely studied the advanced ruling systems of other countries, most notably in Australia, New Zealand and Canada, seeking to leverage off best practices. The Chinese version of the system is expected to be rolled out imminently.

Benefits of an Advance Tax ruling system in China

KPMG China believes that an advance ruling system is an important step in modernising and developing the Chinese tax system, both for the benefit of taxpayers and tax authorities.

The biggest benefit that the Advance Tax ruling mechanism offers to taxpayers is in providing certainty in the application of tax laws to specific transactions being contemplated by the taxpayer.

When a central tax authority issues an advance ruling over a tax-related matter submitted by a taxpayer, all the tax authorities in the country must abide by it. The tax treatment specified in such a ruling is unique and definite. Equally though, the taxpayer is obligated to provide the central tax authority with accurate information about the proposed transaction or factual circumstance, with material errors in disclosure generally invalidating any ruling.

For the Chinese tax authorities, an advance ruling system is also of great significance. In 2008, the SAT formed the Large Enterprise Division, and started to handle requests from certain large enterprises at a more senior level. In 2009, the SAT unveiled a system of carrying out direct tax administration of selected enterprises, and began to provide customised taxpayer services to some large enterprises on a trial basis.

If the SAT successfully implements an Advance Tax ruling system and thus achieves a breakthrough in Chinese tax administration, this would accord the Large Business Enterprise Division with a distinguished characteristic and differentiate the Division from traditional tax collection organisations within China. Furthermore, such an advance ruling system would significantly enhance the degree of tax compliance and the quality of tax administration for large enterprises, elevate taxpayer services to a higher level, materially decrease tax compliance costs for both taxpayers and tax authorities, and represent an important step towards modernising tax administration in China.

As for the scope of taxpayer candidates eligible to obtain Advance Tax rulings, the pilot scheme is initially expected to be limited to large enterprises which have executed Tax Compliance Agreements with the tax authorities. This is because applications for Advance Tax rulings normally require close attention to the presentation of factual material, and a high degree of technical detail, which may be beyond the capacity of small and medium-sized enterprises in China currently. If all taxpayers were allowed to submit ruling requests from the beginning of the program, it may be difficult to control the quality of the requests and the rulings.

Assuming the pilot program proves to be successful, it can then be expanded to cover all taxpayers in China. Based on experiences from Australia, Canada and the United States, applicants are encouraged to express their views on the issues when presenting their ruling requests. This assists the tax authorities to understand the taxpayer's position and arguments, and take them into consideration when making their decision.

It is expected that both prospective and past transactions fall within the scope of matters to be covered by the Advance Tax ruling system in China. If a taxpayer seeks to apply a ruling to past transactions, it should disclose to the tax authorities the details of the transactions and the associated tax treatment. This will facilitate the Chinese tax authorities transitioning from the traditional approach of tax audit, tax adjustment, and tax penalty on a post-transaction basis to a new approach of working with taxpayers transparently in solving problems. In turn, this transition in approach by the tax authorities will further encourage taxpayers to disclose material transactions voluntarily.

Successful establishment of the advance ruling system needs to be supported by a professional implementation team from the SAT. In that regard, we understand that the SAT is committing to the allocation of sufficient human resources to staff this new functional unit, and to ensure the quality of those resources is continually improved.

The Advance Tax ruling system is expected to be administered transparently, with rulings to be published on the SAT's website, without disclosing the taxpayer's identity. This step should ensure that the views of the SAT in particularly contentious areas of the tax laws also become more readily accessible.

This is an important development in tax administration in China, which KPMG strongly supports.

For further reading on advance tax rulings in China, please refer to the following documents:

- Interview published by China Tax News on 20 February, 2012 (interview with Khoon Ming Ho, Partner in Charge, Tax, KPMG China and Lachlan Wolfers, Leader, KPMG Centre of Excellence, Indirect Taxes, KPMG China) – [English](#) / [Chinese](#)
- [Opinion piece](#) by Khoon Ming Ho published by China Tax News on 20 February, 2012

**This China alert issue is adapted from KPMG's contribution to the China Tax Journal.*

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