China Tax Alert

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Ongoing Resource Tax reforms significantly expanded

Regulations discussed in this issue:

- Notice on Comprehensive Implementation of the Resource Tax Reform (Cai Shui [2016] No. 53, "Circular 53") issued jointly by the MOF and the SAT and effective from 9 May 2016.
- Notice on Clarifying Specific Policies in Resource Tax Reform (Cai Shui [2016] No. 54, "Circular 54") issued jointly by the MOF and SAT and effective from 9 May 2016.
- The Pilot Provisional Regulation on Water Resource Tax Reform (Cai Shui [2016] No. 55. "Circular 55") issued jointly by the MOF, SAT and MWR on 9 May 2016 and effective from 1 July 2016.
- Announcement on Issuing of Revised Resource Tax Returns (SAT Announcement [2016] No.38, "Announcement 38") issued by SAT on 22 June 2016 and effective from 1 July 2016.

Introduction

On 9 May 2016 the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) jointly issued Circulars 53 and 54. These push further forward the ongoing reform of Resource Tax. Separately, also on 9 May, MOF, SAT and Ministry of Water Resources (MWR) jointly issued Circular 55. This expanded Resource Tax to cover water supplies on a pilot basis in Hebei province. All of these new rules come into effect from 1 July 2016.

- The Resource Tax reforms, which commenced their current phase in 2010, are remaking the face of resource taxation in China. Certain key objectives are being followed by policy makers:
- Taxation levels are being made more sensitive to the state of the market for resources. To this end Resource Tax has transitioned from a volume basis to an ad valorem basis;
- Encouragement is being given to more efficient use of resources and national environmental policy objectives are being pursued. To this end Resource Tax rules have been fine-tuned to allow for lesser tax impositions on enterprises which use resources more effectively and which recover waste resources;
- The Chinese national tax system is being reformed to take excessive discretion away from local governments in setting government revenue raising policies. To this end the imposition of a diverse range of local resource-related fees and levies on enterprises have been prohibited. At the same time, local governments are being awarded the Resource Tax revenues and are being given some flexibility as to the rates and exemptions they use when applying Resource Tax. This allows for sustainable local government financing as well as local economy sensitivity;

This China Tax Alert provides an overview of the steps taken in recent years to reform Chinese resource taxation, explains the significance of the latest circulars, and indicates how resource taxation is likely to develop in future. Clearly, whether the changes result in increased or lowered tax burdens for enterprises will depend on the nature of the resources they deal in and the location of their operations in China. Opportunities beckon in particular for suppliers of advanced machinery and technology for more efficient, environmentally sensitive use of resources, given the potential for significant Resource Tax savings these may deliver to Resource Tax-paying enterprises.

Resource Tax reform

Similar to other major economies in the world, the mining tax regime in China is complicated. On top of the ordinary Corporate Income Tax, VAT and other taxes, Resource Tax has been imposed on the extraction and sale/use of mineral resources since 1984. In 1994, the calculation method of Resource Tax was changed to a volume basis and rate had been remained at a fixed level for quite a long period. This was accompanied by a proliferation of local government levies and government fund contributions related to resource extraction, use and sale. From 2010 onwards Resource Tax reform has been moved forward, step-by-step, aiming to solve four key issues: expansion of the taxable scope, change of the tax base, adjustment of the tax rate and rationalisation of resources-related levies.

Our analysis below looks at Resource Tax reform under the following headings:

i. Bringing more resources within the scope of Resource Tax;
ii. Resource tax shift from a volume basis to an ad valorem basis;
iii. Abolition of the local charges and funds for mineral resources;
iv. Preferential policies for mineral resources and flexibility for local governments;
v. Administration of Resource Tax.

This is followed by a number of KPMG observations on the likely impact of the reforms, and potential future developments.

i) Bringing more resources within the scope of Resource Tax

A pilot program for introducing Resource Tax on water has been initiated in Hebei Province, effective from 1 July 2016. This involves transforming water resource fees to taxes levied on a volume basis, and the tax will cover both surface water and underground water. The Hebei pilot program is expected to be expanded nationwide in due course. In addition, the governments at provincial level are empowered to develop plans, subject to the approval of the State Council, for levying Resource Tax on forests, pastures and shoals.

Now the objective of "fully expanding the taxable scope" has been basically achieved. The summary below tracks the timeline of the changes of taxable scope of Resource Tax:

Period	Changes of Taxable Scope
1984 to 1993	Crude oil, natural gas, coal, metallic mineral products and other non-metallic mineral products
1994 to 2016	Crude oil, natural gas, coal, other non-metallic mineral ore, Ferrous and non-ferrous metallic mineral ore and salt
Since 1 July 2016	In addition to the existing scope, water resource pilot reform in Hebei and resource tax on forests, pastures and shoals to be added in future

Coal bed methane (CBM) extracted from the ground was originally not subject to Resource Tax. However, given the increase of CBM projects CBM will be subject to Resource Tax from 1 July 2016, with a simultaneous abolition of Mineral Resource Compensation Fee levied on CBM. As will be seen from the below, CBM is subject to a lower Resource Tax rate than natural gas and coal, implying continuance the tax policy in encouraging development of CBM production.

ii) Resource tax shift from a volume basis to an ad valorem basis

In 2010 the Resource Tax on crude oil and natural gas shifted from a volume-based to an ad valorem-based calculation method. Coal, rare earths, and other minerals were transitioned in subsequent years so that, by 2016, almost all mineral resources had shifted to an ad valorem basis. Resource tax for clay and sand stone, for ease of administration, remains on a volume basis. See below the transition timeline for Resource Tax on different minerals.

Period	Change of Calculation Method for Resource Tax	Rates
From Oct 1984	Ad valorem basis with progressive rate based on profit level	
From Jan 1994	Resource Tax moves to a volume basis calculation	
From June 2010	Resource Tax for crude oil and natural gas moves to ad valorem basis. Initial pilot program (Xinjiang, western provinces) expanded nation-wide in 2011	5% to 10%.
From Dec 2014	Resource Tax on ad valorem basis levied for coal	2% to 10%
From May 2015	Resource Tax levied for rare earths, tungsten, molybdenum on ad valorem basis	

Period	Change of Calculation Method for Resource Tax	Rates
(Continued)		
From July 2016	21 listed resources and metal ores transition to ad valorem basis, including iron, gold, copper, bauxite, lead and zinc, nickel, tin, graphite, diatomite, kaolin clay, fluorite, limestone, pyrite, phosphorus, potassium chloride, potassium sulphate, mineral salt, lake salt, salt derived from subterranean brine by means of solar evaporation, coal bed methane, and sea salt	1% to 20%
	Certain non-listed non-metal ores may be taxed on either ad valorem or volume basis	Max 20% (value) Max RMB30 per ton/m^2 (volume)
	Clay and sandstone remain on volume basis	RMB 0.1 - 5 ton/m^2

By making Resource Tax levels more sensitive to the pricing of resources on markets, it is hoped that enterprises will be encouraged to improve their usage of resources. Particular encouragement is given to the more efficient use of resources through the special incentives and reductions in resource tax for use of certain grades of resource. The reform is not, of itself, intended to radically increase tax revenues and provincial governments have been instructed to ensure that the burden of resource taxes, post-reform, is equivalent to the combined burden of the resource tax and local levies (now abolished), pre-reform.

Please see Appendix I below for an illustrative example of the impact of resource-related levies, on coal usage, before and after the Resource Tax reform of 2014 in Shaanxi Province.

iii) Abolition of the local charges and funds for mineral resources

Various levies, including Local government charges and fund contributions, have been levied on enterprises, alongside Resource Tax, for many years. These principally included:

- Mineral Resources Compensation Fee;
- Levies made under Price Regulating Funds;
- Various local funds, e.g. Coal Sustainable Development Fund in Shanxi Province.

The central government commenced abolition of these charges, starting with coal, crude oil and natural gas, in 2014. As the abolition spread to other resources, the same steps were followed:

- Mineral Resources Compensation Fee rate reduced to zero;
- Price Regulating Fund levies terminated;
- Other local charges and funds for mineral resources are prohibited.

Period	Abolition of Local Charges and Funds for Mineral Resources
From Jan 1994	Introduction of mineral resources compensation fee
From Dec 2014	Abolish charges and funds for coal, crude oil and natural gas, in particular: ➢ Adjust the applicable Resource Tax rate from 5% to 6% for crude oil and natural gas when reducing the rate of Mineral Resources Compensation Fees from 1% to zero; ➢ Cancel Coal Sustainable Development Fund (Shanxi Province), Ecological Compensation Fee for Primary Ore (Qinghai Province) as well as Local Economic Development Fee for Coal (Xinjiang Province)
From May 2015	Abolish charges and funds for rare earths, tungsten and molybdenum
Since 1 July 2016	Abolish all remaining local charges and funds for mineral resources and transform water resource fees into resource tax in Hebei province as a pilot program

iv) Preferential policies for mineral resources and flexibility for local governments

Before the commencement of the Resource Tax reform in 2010, the majority of the existing volume-based Resource Tax rates were set by central government. It was difficult for the local governments to tailor resource tax policies to local economic circumstances, except via their local levies. While the Resource Tax reform takes away the freedom of local governments to impose their existing local levies, at the same time it is provided that governments at provincial level may determine or propose, to MOF and SAT, the tax items and tax rates for Resource Tax, within the prescribed range of rates.

Circular 53 provides that, for minerals extracted from low-grade ore, waste rock, tailings, waste residue, waste water and waste gas, Resource Tax can be reduced or exempted, as determined by the provincial governments. In addition, other beneficial tax treatments are also provided in Circular 54 to encourage mining enterprises to optimize resource utilisation, drawing on experience with coal resource tax policies applied from 2014, which grants a 50% reduction on resource tax for backfill mining methods and a 30% reduction for resources derived from exhaustion stage mines and low abundance oilfields respectively.

v) Administration of Resource Tax

SAT released amended Resource Tax return forms on 22 June 2016 for use from 1 July 2016. The “volume-based method” and “the ad valorem based method” focus of the old returns is scrapped, and the new version consists of one master form and three appendices. These should be completed by tax payers who exploit or produce raw ore or concentrate, and cover tax exemption and reduction items. The more detailed Resource Tax returns assist the tax authorities in their enforcement efforts.

KPMG Observations

Following abolition of the local charges on resource extraction and use, Resource Tax becomes the exclusive national tax levied on the use of state-owned mineral resources, in the nature of mining rent or royalty.

The revenue of the Mineral Resources Compensation Fee (now abolished) was shared by the central and the local treasury and subject to special budget management to ensure the direct use of the revenue raised for mineral resources exploration. Resource Tax revenues (except Offshore Petroleum Resource Tax) will, by contrast, constitute 100% local fiscal revenue.

The mechanism for allocating specialized funds to mineral resources exploration from the central government is now altered. More investment, for these purposes, must come from local governments in future. Considering the expected decline of local financial revenues after VAT reform, Resource Tax is likely to remain a local tax in the medium term. In the long term, it remains to be seen whether the allocation of revenues between the central and the local governments will be adjusted.

Overall, the Resource Tax Reform in 2016 is intended by the government to have a positive impact on the mining industry. The ad valorem based calculation method aims to build up an automatically adjustment mechanism and promote the utilization efficiency of resources, together with the effect of relevant tax incentives. Abolition of various local charges and funds is intended to achieve a rationalisation of resources-related levies. Further guidance is anticipated to allow the new system to bed down and we suggest relevant enterprises should keep a close eye on policy developments, assess the business impact and prepare for upcoming changes.

Appendix: Illustrative Example of Impact Resource Tax reform of 2014 in Shaanxi Province

Before 1 December 2014		After 1 December 2014	
Types of Tax / Charges *	Tax / Charge Rate	Types of Tax / Charges	Tax / Charge Rate
Coal Price Regulating Fund **	RMB15/ton	Coal Price Regulating Fund	-
Mineral Resource Compensation Fee	1%	Mineral Resource Compensation	-
Resource Tax	RMB3.2/ton	Resource Tax	6%
Total Payable	RMB18.2/ton +1%	Total Payable	6%
Resource-related levies testing before and after Resource Tax reform:			
1. Assuming the taxable price*** is RMB400/ton			
Resource-related Levies Payable	RMB22.2	Resource-related Levies Payable	RMB24
Difference			+RMB1.8
2. Assuming the taxable price is RMB300/ton			
Resource-related Levies Payable	RMB21.2	Resource-related Levies Payable	RMB18
Difference			-RMB3.2
3. Assuming the taxable price is RMB200/ton			
Resource-related Levies Payable	RMB20.2 RMB	Resource-related Levies Payable	RMB12
Difference			-RMB8.2

* Types of Tax / Charges only include Coal Price Regulating Fund, Mineral Resource Compensation Fee, etc. The tests above are performed for reference only and no other local government charges have been considered.

** Pursuant to Administrative Measures of Collecting Coal Price Regulating Fund of Shaanxi Province (Shan Jia Jian Fa 2005, No. 137), the Coal Price Regulating Fund of raw coal (including washed coal) is RMB15/ton.

***After 1 December 2014, taxable price for coal is determined on the sales price excluded from freight and washing costs.

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