

# Interpretation of Fiscal Policies from the Third Plenary Session – the Shift of the Consumption Tax Collection Stage: Direction and Challenges of Reform

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## In brief

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The recent 3rd Plenary Session of the 20th Central Committee of the Communist Party of China passed the "Decision of the CPC Central Committee on Further Deepening Reform and Advancing Chinese-Style Modernization," which proposed the overall guideline of "advancing the reform of Consumption Tax collection by moving the tax collection point downstream and steadily devolving it to local authorities" in the part concerning the deepening of fiscal and taxation system reforms. The downstream shift in the Consumption Tax collection point is an important direction for the reform of China's Consumption Tax system. This means, under the premise of controllable tax collection and management, gradually moving the tax collection point for certain current Consumption Taxable items from the production or import stage to the wholesale or retail stage. This reform measure will help to expand local revenue sources and guide local governments to pay more attention to and improve the consumption environment.

In light of the continuously released signals of reform, PwC has reviewed the process of moving the Consumption Tax collection point downstream and analyzed the key issues that need attention in this reform, as well as the potential impact on related enterprises. It is hoped that this will contribute to the introduction of specific subsequent policies and help enterprises to make the necessary preparations.

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## In detail

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### Review of the Process of Shifting the Consumption Tax Collection Stage

The direction of shifting the Consumption Tax collection stage has been determined for a long time. After the "Business Tax transition to Value-Added Tax (VAT)" reform, in order to increase local revenue sources, government at state level has conducted multiple research and discussions on shifting the Consumption Tax collection stage. In September 2019, the State Council issued the "Notice on Distributing the Implementation of a Larger Scale of Tax Cuts and Fee Reductions and Adjusting the Reform Plan for the Division of Central and Local Revenues," which clarified the reform measures of "moving the tax collection point downstream and

steadily devolving it to local authorities." In December 2019, the Ministry of Finance and the State Taxation Administration issued the "Notice on Publicly Soliciting Opinions on the 'People's Republic of China Consumption Tax Law (Draft for Comment)'," which specified that the State Council could, based on factors such as economic development, industrial policies, industry development, and changes in residents' consumption levels, implement pilot reforms of the Consumption Tax, and adjust the tax items, tax rates, and collection stages. In March 2021, the Fourth Session of the Thirteenth National People's Congress passed the "Resolution on the National Economic and Social Development Fourteenth Five-Year Plan and the Outline of the Long-Range Objectives Through the Year 2035," which mentioned under the topic of perfecting the modern tax system, "adjust and optimize the scope and tax rates of Consumption Tax, move the tax collection point downstream and steadily devolve it to local authorities."

The Third Plenary Session of the Twentieth Central Committee once again emphasized the advancement of moving the tax collection point downstream and steadily devolving it to local authorities, pointing the direction for future Consumption Tax reform and demonstrating the national level's determination to cultivate new local tax sources.

## Issues and Challenges to Consider with the Shift in the Consumption Tax Collection Phase

### 1. Impact on the Tax Burden of Goods Subject to Consumption Tax:

When the collection point of Consumption Tax is shifted to the wholesale or retail stage, the price of goods at these stages is generally higher than at the production or import stage, leading to an increased tax base for Consumption Tax. If the current Consumption Tax rates remain unchanged, this will inevitably result in a higher tax burden, which could drive up the final price of goods. To avoid this, it is recommended to conduct tax burden calculations for different collection phases before implementing policy changes, and to appropriately reduce the Consumption Tax rate to maintain the overall tax burden, or make suitable adjustments for each Consumption Tax item.

### 2. Accurate Division and Definition of the Tax Collection Phase:

Since Consumption Tax is collected at a single phase, defining the phase at which goods are taxable is crucial. With the vibrant development of China's market economy, the distribution channels for various goods are diverse and complex. Taking alcoholic beverages as an example, there are multiple stages including production, multi-level distribution, retail, and consumption, as well as various sales models such as direct sales from manufacturers, specialty tobacco and liquor stores, supermarkets, hotels and restaurants, e-commerce platforms, and group purchasing, etc.. This diversity complicates the accurate definition of the wholesale or retail phase. Inaccurate definitions can lead to underpayment or double payment of Consumption Tax, increasing compliance costs for businesses and the difficulty of tax collection for tax authorities.

### 3. Setting Reasonable Transition Policies to Avoid Double Taxation:

During the shift in the Consumption Tax collection phase, there may be situations where a distributor's inventory has already been taxed at the production or import phase. If this inventory is taxed again at the wholesale or retail phase, it would result in double taxation. It is advisable to establish reasonable transition policies, manage inventories of traceable goods (such as ordinary cars, luxury watches, etc.) to avoid double taxation, and for hard-to-trace goods (such as luxury cosmetics, disposable wooden chopsticks, etc.), set a lower tax rate for a transitional period to control the overall tax burden.

### 4. Preventing Abnormal Increases in the Consumption of Goods Subject to Consumption Tax:

The purpose of levying Consumption Tax is to curb the consumption of products that harm public health, high-energy-consuming products, high-pollution products, and certain luxury goods. After the shift and decentralization of the Consumption Tax collection phase, it is important to monitor whether local governments encourage the development of industries such as tobacco and alcohol, luxury goods, and high-pollution and high-energy-consuming industries to increase local tax revenue. The government should adhere to the original intent of the Consumption Tax and avoid adverse effects on public health and energy conservation.

## Impact on Related Enterprises

### 1. Expansion of the Scope of Consumption Tax Payers:

After the shift in the Consumption Tax collection phase, the taxpayers will change from producers and importers to a broader range of distributors and retailers. Many enterprises that have never declared Consumption Tax will need to do so, and these enterprises should conduct preparation like researching and analyzing Consumption Tax policies, establishing standard procedures for tax collection and reporting, upgrading business and financial systems, and preparing for tax audits and

management by tax authorities to meet the requirements of taxable goods identification, accounting, invoicing, and compliance reporting under the Consumption Tax policy.

## **2. Repricing and Business Negotiations Along the Supply Chain:**

As Consumption Tax is tax included in price, changes in the tax collection phase will inevitably lead to repricing along the supply chain. From the factory price at the production stage to the selling price at the wholesale stage and the retail price, changes in prices at each stage will lead to a series of changes in enterprise income, costs, value-added tax, income tax, etc. Enterprises need to conduct thorough calculations and negotiate with suppliers and customers to supplement and revise existing contracts to protect their economic interests. In real business scenarios, pricing must consider more complex factors, such as the company's position in the supply chain, and improper pricing can lead to unnecessary losses.

## **3. Strengthening Tax Management and Supervision in Group Enterprises:**

Due to the diversity and complexity of distribution channels, some distributors or retailers may misjudge taxable activities, leading to underpayment of Consumption Taxes. Given the close cooperation between group enterprises and distribution channels and the shared brand, underpayment of taxes could affect the brand image and reputation of the entire group. Therefore, group enterprises need to strengthen tax management and supervision of distributors and retailers.

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## **The takeaway**

In the process of shifting the Consumption Tax collection phase, the direction of Consumption Tax reform is relatively clear. Enterprises involved in goods subject to Consumption Tax should closely monitor the situation, assess the impact of policies on all aspects of their business, and prepare for future tax system changes.

PwC will continue to monitor the dynamics of Consumption Tax reform and the industries involved, sharing observations and insights in a timely manner. Please stay tuned.

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## Let's talk

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**PwC's China Indirect Tax Team** comprises a team of professionals with rich indirect tax experience and integrated knowledge, both internationally and domestically, stationed in our Beijing, Shanghai, Guangzhou, Shenzhen and Hong Kong offices. We advise businesses on Chinese indirect tax matters and work on Chinese indirect tax developments. Our Indirect Tax Team in China is part of PwC's global indirect tax network of 1,800 experienced and specialized professionals.



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