China:  
Collection of Local Education Surcharge to be unified throughout country

The Shanghai and Jiangsu government authorities have announced that they will be collecting the 2% Local Education Surcharge retroactively as from 1 January 2011 and 1 February 2011, respectively. The local tax burden on enterprises in the two regions will be significantly increased by this change, particularly when considering the abolition of the long-standing exemption from the City Maintenance and Construction Tax and National Education Surcharge for foreign-invested entities (as from December 2010).

The Local Education Surcharge is imposed on both entities and individuals on the total of VAT, Business Tax and Consumption Tax payable, with the revenue collected used to finance local education. Until recently, the surcharge was only levied in certain regions of China. However, in November 2010, the Ministry of Finance issued guidance (Circular 98), urging all local governments to impose the Local Education Surcharge at a flat rate of 2%, with a view to unifying the application of the surcharge throughout the country.

The circulars issued by the Shanghai and Jiangsu government authorities are in response to Circular 98 and, as illustrated in the following table, the new policies will increase the total local surcharge to 13% in Shanghai and to 12% in Nanjing, the capital of Jiangsu province.

<table>
<thead>
<tr>
<th>Local surcharges</th>
<th>Beijing</th>
<th>Shanghai</th>
<th>Nanjing</th>
</tr>
</thead>
<tbody>
<tr>
<td>City Maintenance and Construction Tax</td>
<td>7%</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>National Education Surcharge</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Local Education Surcharge</td>
<td>Collection schedule to be confirmed</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>River Maintenance Fee</td>
<td>-</td>
<td>1%</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>10%</td>
<td>13%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Comments

For taxpayers located in regions that do not yet impose the Local Education Surcharge, or in areas where the applicable rate was less than 2%, Circular 98 creates an additional tax burden. Although the collection schedule still needs to be confirmed in some areas (such as Beijing), it is expected that the 2% surcharge will soon become applicable in all provinces throughout China.

Since the City Maintenance and Construction Tax, National Education Surcharge and Local Education Surcharge are all calculated on the VAT payable, Business Tax and Consumption Tax, there are financial implications, in particular, for taxpayers with significant indirect tax payables.

For the short term, affected taxpayers, especially in those areas where the Local Education Surcharge has not yet been imposed, should consider issuing invoices before the surcharge is levied. For the long term, a comprehensive tax planning strategy with a view to simplifying transaction procedures should be considered to eliminate or reduce unnecessary layers of transactions.

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