China enters the Environmental Protection Tax era – Key areas enterprises need to know

The Environmental Protection Tax Law of the People’s Republic of China (“EPT Law”, and Environmental Protection Tax hereinafter referred to as “EPT”), China’s first special separate tax law to demonstrate “green tax system”, as well as the Implementing Regulations on the Environmental Protection Tax Law of the People’s Republic of China (“Implementing Regulations”), has officially taken effect since 1 January 2018, replacing the previous Regulations on the Administration of the Charging and Use of Pollutant Discharge Fees.

Henceforward, in response to this sweeping change from pollutant discharge fee (PDF) to the EPT fee-to-tax (F2T) reform, enterprises, public institutions, and other producers/operators that discharge taxable pollutants directly to the environment within China’s territory and other sea areas under China’s jurisdiction are advised to be more prudent about collecting, calculating and documenting tax data and information regarding EPT.

Since the EPT Law was passed by the National People’s Congress (NPC) Standing Committee on 25 December 2016, China’s legal regime regarding EPT has witnessed the following progress:
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The Ministry of Finance (MOF), the State Administration of Taxation (SAT) and the Ministry of Environmental Protection (MEP) published the exposure draft of the Implementing Regulations for the Environmental Protection Tax (EPT) Law.

The National People's Congress Standing Committee adopted the EPT Law on 25 Dec 2016, and it officially took effect on 1 Jan 2018. To ensure the smooth implementation of the EPT Law, the MOF, the SAT and the MEP announced the Notice regarding the preparation for the Implementation of the EPT Law on 26 Jun 2017, and the Exposure Draft of the Implementing Regulations of the EPT Law was released on 21 Jul 2017. The Implementing Regulations of the EPT Law was released on 25 Dec 2017, and the EPT Law officially took effect on 1 Jan 2018.

31 provincial administrative units announced their respective applicable unit tax amounts in succession. Six circulars on the administrative measures for the tax assessment and collection of EPT (including two exposure draft) were published up to Feb 2018.

The Environmental Protection Tax (EPT) Law was released on 25 Dec 2016, and the Implementing Regulations of the EPT Law officially took effect on 1 Jan 2018.

For the purpose of promoting the smooth implementation of EPT, each province, autonomous region and municipality has announced its respective local applicable unit EPT amounts on taxable air and water pollutants successively in the past six months, as requested by the MOF, the SAT and the MEP. As observed at the macro level, many local governments have set their local unit tax amounts on air and water pollutants above the lower limit set forth in the EPT Law. In particular, the applicable unit tax amounts promulgated by the “Beijing-Tianjin-Hebei” regions are the highest in the nation. For example, Beijing local government sets its local applicable unit tax amounts at the upper limit of those set forth in the EPT Law (i.e., 10 times of the lower limit), demonstrating the local government’s political intention of promoting its regional industrial structure in terms of transformation and upgrading.

The unit tax amounts applicable to provincial administrative units are broadly classified as below:

- **Lowest bracket**: the lower limit of applicable unit tax amounts set forth in the EPT Law, which are adopted by 12 provincial administrative units, namely Liaoning, Jilin, Heilongjiang, Anhui, Jiangxi, Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang, Tibet, and Fujian.
- **Moderate bracket**: applicable unit tax amounts slightly higher than the lower limit of those set forth in the EPT Law, which are adopted by 10 provincial administrative units, namely Zhejiang, Hubei, Hunan, Shanxi, Guangdong, Guangxi, Guizhou, Yunnan, Inner Mongolia, and Hainan.
- **Moderately high bracket**: applicable unit tax amounts slightly higher than those classified into the bracket above, which are adopted by three provincial administrative units, namely Sichuan, Henan, and Chongqing.
- **High bracket**: applicable unit tax amounts significantly higher than those applicable to other regions, which are adopted by six provincial administrative units, namely Beijing, Tianjin, Hebei, Jiangsu, Shanghai, and Shandong.

In Hebei and Jiangsu, EPT is levied with different unit tax amounts according to the grading of the regions. In Shandong and Shanghai, EPT is based on the types of pollutants. In Liaoning, Yunnan, Shanghai, and Chongqing, transitional period is allowed for applicable unit tax amounts.
Technical analysis for the purpose of EPT implementation

**Determination of the measuring methods of discharged pollutants**

Strong connection with engineering related aspects is one of the main features of EPT as distinctive from other taxes, which is based on the data collected from the discharge amount of taxable pollutants. The EPT Law has clearly stipulated that the discharge amount of taxable pollutants and decibels of noise shall be measured using the following methods in sequence:

**Measuring methods of the discharge amount of taxable pollutants and the decibels of noise**

► The first applicable method is to apply automatic pollutant monitoring equipment that meets the requirements of the national installation regulations and monitoring specifications.

► The second applicable method is to adopt pollutant monitoring data that meet the requirements of the national regulations and monitoring specifications collected by the monitoring organizations, where self-monitoring data collected by the enterprises in conformity with the national regulations and monitoring specifications are also adoptable.

► The third applicable method is to apply pollutant discharge coefficients and material balance methods specified by the competent environmental protection authorities of the State Council.

► Lastly, where none of the conditions above is fulfilled, the discharge amount and the decibels of noise shall be calculated based on the sampling-based measuring method provided by the competent environmental protection authorities of the local governments at the level of province, autonomous region or municipality.

Given that the EPT Law and the Implementing Regulations have not elaborated further details about measuring the amount of particular taxable pollutants discharged, enterprises (especially those with no automatic pollutant monitoring equipment) may raise many questions in practice, for example:

- As for the method of applying an automatic pollutant monitoring equipment to measure the discharge amount, the taxpayer must install and use the equipment that meet the requirements of the national regulations and monitoring specifications, and also connect such equipment with the monitoring network of its competent environmental protection authorities as required in the Implementation Regulations. Otherwise, EPT will be levied by converting the tax base, which will be determined with reference to generated amount of taxable pollutants rather than the discharge amount, into the pollutant equivalent if the taxpayer fails to connect its equipment with the monitoring network of its competent environmental protection authorities. However, the prevailing laws and regulations have yet to clarify how such equipment should be installed and connected with the required network. Meanwhile, there has not yet been any fund or policy support provided along with the F2T to incentivise enterprises to invest in automatic pollutant monitoring equipment. Enterprises may suffer from setbacks in active high investment in qualified monitoring equipment arising from high financial pressures.

But it is possible that local governments would gradually keep the pace and release supporting implementation plans for preferential policies, in response to the motive of EPT Law. In a long run, the marginal cost would decrease gradually if enterprises invest in the equipment for once.

- If an enterprise fails to purchase or install automatic pollutant monitoring equipment for any reason in the short run, either the monitoring data collected by the monitoring organizations or those collected by the enterprise on its own should be used to measure the discharge amount of its taxable pollutants. In this regard, there may be issues in practice. For example, it is uncertain whether the data monitoring tool/method used by the enterprise or the selected monitoring organization is in line with the established tax laws, and also whether it is allowed by the competent tax authorities/environmental protection authorities. In addition, EPT is filed regularly, to be specific, it is in general calculated on monthly basis and paid on quarterly basis, but the requirements and frequency of monitoring corresponding to EPT filing are yet to clarify. According to relevant provisions of the Implementing Regulations, the competent environmental protection authorities shall be legally responsible for monitoring and regulating taxable pollutants, as well as formulating and improving pollutant monitoring specifications. It can therefore be concluded that the competent environmental protection authorities may release relevant detailed monitoring specifications to further clarify such issues in practice. Furthermore, enterprises are advised to take into consideration the relevant costs of monitoring under the measuring methods.

- As for pollutant discharge coefficients and material balance method, the MEP released the *Notice on Publishing Pollutant Discharge Coefficient and Material Balance Method Used for Calculating the discharge amount of Pollutants (the Notice)* on 28 Dec 2017 to specify the discharge amount of pollutants for pollutant discharging enterprises supporting 17 industries that have been included in pollutant discharge permit management (e.g., thermal power), and those supporting certain industries that have not been included in pollutant discharge permit management (e.g., tin mining). According to the Notice, different calculation methods shall be applied for different pollutants discharged by the industries concerned in sequence under different circumstances, so such measurement and calculation is complicated and often extremely challenging and difficult. Enterprises shall apply the corresponding calculation methods cautiously according to the actual conditions in order to avoid tax calculation errors. Except the first two scenarios under regulation by the Notice, local provincial environmental protection authorities shall determine the measuring methods with reference to relevant regulations and in accordance with the scientific and reasonable principles for pollutant discharge enterprises belonging to the remaining industries not covered by the Notice, and report to MFE for record.
Hereby, pollutant discharging enterprises belonging to the remaining industries shall pay attention to the follow-up regulations on calculation methods issued by the local provincial environmental protection authorities.

Where the first three measuring methods of discharge amount of taxable pollutants mentioned above are not applicable due to various objective causes, enterprises should calculate and pay the EPT using the measuring method determined by local government departments. At present, some regions have released respective circulars on administrative measures for the tax assessment and collection of EPT (including Discussion Draft), for example, the Hainan Province Administrative Measures for Tax Assessment and Collection of EPT (Trial Implementation) released by Hainan Province and Guangdong Local Tax Bureau Administrative Measures for the Tax Collection upon Assessment Method of EPT (Exposure Draft) released by Guangdong Province. However, the above-mentioned documents merely cover small-scale polluters, such as livestock farming, small enterprises, and tertiary industry (e.g., hospitals, catering and entertainment services). In another word, general manufacturing enterprises (also viewed as the most affected industry by EPT) may face challenges of internal tax management as the applicable tax assessment and collection methods remain uncertain. On the other hand, taking the above-mentioned exposure draft released by Guangdong Province as an example, it specifically stipulates that small-scale polluters which could not measure discharge amount of water pollutants shall strictly pay tax as per their actual water consumption, to be specific, assuming the discharge amount of water pollutants equivalent to water consumption). This regulation may aggravate tax burden of the affected enterprises. From a factual influence perspective, it is a punitive measure imposed on such scenario where the regulated enterprises could not provide their pollutant discharge data by actual monitoring or material balance method.

In view of the above, in principle, the EPT Law encourages taxpayers to increase investment in environment-friendly construction and use automatic pollutant monitoring equipment. We recommend that the taxpayers which may encounter such issues as applying the tax collection upon assessment of EPT should fully consider their business situations, reasonably analyse and validate the measuring methods applicable to the enterprises according to the appropriate sequence as mentioned above and upon reasonable basis of the EPT Law and the Implementing Regulations. Upon that, enterprises are also suggested to proactively provide and explain their legal basis, analysis and validation basis to competent tax authorities.

As stipulated in Article 21 of the EPT Law, as for tax collection upon assessment of pollutant discharge amount, competent tax authorities will work with competent environmental protection authorities to determine the types and amounts of pollutants discharged and the amounts of tax payable. In practice, we cannot rule out the possibility that local tax authorities and environmental protection authorities may determine the applicable tax basis under this method for enterprises based on mutual negotiations and comprehensive inspections on the discharge level of the enterprises. In order to respond to this situation appropriately, we suggest that enterprises subject to EPT should firstly complete internal examination and evaluation under the tax collection upon assessment method to determine a preliminary reasonable approach and conclusion before the inspections of competent authorities. Adequate preparations prior to the formal assessment will help enterprises gain capability of more effective responses and communications with competent tax authorities and environmental protection authorities in the course of formal inspections.

**Implications under the new EPT collection and administration approach**

**Collaborative management conducted by tax authorities and environmental protection authorities**

According to relevant contents in the Circular of the Joint Deployment by MOF, SAT and MEP on the Requirement of Comprehensive Preparation for the Implementation of the EPT Law, the previous collection and administration approach of PDF under which the environmental protection authorities are in charge of fee collection and administration on their own will be entirely replaced by a brand-new approach of “Tax filed by enterprises and collected by tax authorities, in collaboration with environmental protection authorities and with information shared amongst involved parties”. Under this new approach, tax authorities are mainly responsible for tax collection and administration, which helps reinforce the compelling force of tax collection, while environmental protection authorities could save more energy on monitoring and regulating the pollutant discharge, which helps strengthen regulations on tax collection, so as to ensure an effective enforcement of the EPT Law. On this basis, competent tax authorities and environmental protection authorities will set up a core tax collection and administration system and a tax-related information sharing platform to exchange information of tax payments and pollutant discharge of enterprises, so as to achieve a collaborative administration of taxation and environmental protection in an efficient way. Under the new approach to tax collection and administration, the parties involved may perform the respective main responsibilities and obligations as shown here:
Environmental protection authorities should provide relevant or per discharge. At the same time, competent authorities shall be discharged, in the course of EPT filing on a quarterly basis. The types, amounts and concentration of taxable pollutants declare EPT related information to tax authorities, such as taxpayers.

As stipulated by the EPT Law, taxpayers are obliged to make tax adjustments subsequently. In the future, tax authorities will gradually establish a set of comprehensive tax regulatory systems, and may measure the discharge amount of taxable pollutants by checking the enterprises’ production formula, materials, wastes and other information, and review the data against the tax information declared by taxpayers, so as to strengthen regulation on enterprises in terms of compliance with relevant tax laws and regulations.

Under the EPT Law, with the coordination of environmental protection authorities, tax authorities will be able to collect more comprehensive tax-related discharge information of enterprises, so as to facilitate more in-depth tax inspections, which indicates stricter requirements on enterprises to prepare for tax inspections and manage relevant risks. Under the comprehensive collection and administration system, enterprises are required to incorporate EPT filing into their overall tax compliance and internal control management, so as to fully comply with their compliance obligations on tax filing and declaration of tax information. At the same time, since the EPT involves cooperation between departments within the enterprises other than the tax departments, such as the environmental protection and production departments, it is recommended that the enterprises take measures to ensure the consistency and accuracy of the source of its pollutant data and the processing of tax data. In any event of non-compliance with tax filing or incorrect tax information, the enterprise may subject to penalties stipulated in the Law of the People's Republic of China on the Administration of Tax Levying (“Administration of Tax Levying”), and be criminally liable according to the EPT Law and the relevant laws and regulations.

By establishing an information sharing platform, the new EPT collection and administration system authorizes tax authorities and environmental protection authorities to establish and maintain a real-time information exchanging mechanism, which helps government authorities to collect tax-related data and tax declaration information of enterprises. In the future, relevant government authorities may further increase transparency and publicity of environmental protection information and data across the whole society.

The collection and administration role of tax authorities and the countermeasures of enterprises to prevent risks

As stipulated by the EPT Law, taxpayers are obliged to declare EPT related information to tax authorities, such as the types, amounts and concentration of taxable pollutants discharged, in the course of EPT filing on a quarterly basis or per discharge. At the same time, competent environmental protection authorities should provide relevant discharge data and other relevant information of pollutant discharging entities under their monitoring and administration to tax authorities on regular basis. Therefore, tax authorities will have the authority to compare tax data and information collected from both sources. In case any inconsistency among the data collected, data presented by competent environmental protection authorities shall be used to determine the tax base.

At the same time, tax authorities have the authority to request competent environmental protection authorities to review relevant data if any unusual condition is suspected by tax authorities, and then
Under the rigid enforcement of EPT, we would like to draw enterprises’ attention again to the calculation method, collection and administration of EPT, which are different from those applicable to PDF in the past. It is recommended that enterprises should conduct analysis and assessment on the impact of tax payment, and not to use the old PDF calculation method for future filing of EPT, so as to reduce the tax risks.

**Focus on the local policies and communications with local governments**

The EPT Law stipulates that the tax collection departments of EPT should be the local tax authorities where the taxable pollutant discharge. In addition, according to Guofa [2017] No. 56, all the revenue collected from EPT belongs to local governments, instead of being shared with the central government. At the same time, the people’s governments of provinces, autonomous regions and municipalities are authorized to determine the applicable unit tax amounts for taxable pollutants and number of taxable pollutant items for the same discharge outlet within the legitimate tax range based on actual situation, after reporting to the Standing Committee of the People's Congress at the same level for decision-making and reporting to NPC Standing Committee and the State Council for record. In addition, the "local discharge standards" mentioned in the preferential EPT rules and the local governments’ incentive measures mentioned in the EPT Law are highly depended on the participation of local governments.

Under the EPT system, the local governments are given comprehensive authority in all aspects, from development of policies to execution of tax collection and administration. If enterprises have any uncertainties, they should proactively communicate with competent local tax authorities and local environmental protection departments, so as to maintain an efficient communication channel with local government departments.

In addition, enterprises are recommended to be prepared proactively, so as to seize the opportunity to enjoy the EPT incentives. Enterprises should pay attention to the following aspects when enjoying tax incentives:

► Firstly, enterprises should understand their applicable pollutant discharge standards at both national and local levels in advance, and complete self-assessment to check if criteria of the tax incentives can be met.

► Secondly, enterprises should consult local tax authorities about the operating procedures to enjoy tax incentives, e.g., registration procedures and submission of documents.

► Finally, enterprises should keep all supporting documents relevant to tax incentives properly, so as to prevent any potential tax audit risks.

**EY provides comprehensive EPT services**

**“Three-step” EPT services**

We will assist pollutant discharging enterprises to comply with EPT filing and management from the aspects of “compliant measurement” and “risk control”, and assist enterprises to manage and control the risks arising from both internal multi-departmental collaboration and external multi-departmental management under EPT system effectively. At the same time, taking the opportunity of implementation of EPT, we will assist pollutant discharging enterprises to fully improve the internal management level of environmental information, in response to inspections by environmental protection departments or other external regulatory departments and more transparent and public information disclosure.

Based on our experience, we divide the EPT services into three steps, namely pre-assessment, design and implementation support.
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Customized Support for EPT Implementation

Credentials of EY Climate Change and Sustainability Services (CCaSS) Group
The CCaSS team consists of more than 100 professional members in China
Close communications with environmental protection authorities
Possession of a list of qualified third-party monitoring agencies, and familiarity with environmental protection measurement procedures
Experience in publishing of the Environmental, Social and Governance (ESG) Report

Scope of work and key services
Instruction of methods for measuring discharge amount and analysis of pollutant monitoring data deviations
Verification and determination of applicable methods for measuring discharge amount, and provision of advice on improvements
Assistance with measuring discharge amount or PEW
Design of platform of exchanging EPT related data
Provision of advice on management of automatic environmental protection monitoring process
Provision of advice on energy conservation and discharge reduction/clean production processes

Requirements for compliance with EPT filing and management
Control of environmental protection risk
Compliance of tax management

1. Effective identification and categorization of taxable pollutants
2. Determination of tax method for taxable pollutants and measurement of discharge amount
3. Submission of discharge information
4. Maintenance of disclosure of environmental protection information and monitoring devices/data availability
5. Clarification of requirements and procedures for tax incentives
6. Calculation of PE, determination of tax base and calculation of tax payable according to tax laws
7. Facilitating the compliance of measuring methods for pollutants (including monitoring agencies, tools/methods and data, etc.) with tax laws
8. Tax filing and submission of tax-related information to tax authorities

Value-added services: advice on tax exemption/reduction and advice on improvement of comprehensive environmental information management

During the whole F2T reform, EY CCaSS Group will work closely with our Indirect Tax Group.

1. Working together to analyze the current situation of discharge management
2. Working together to prepare a list of EPT requirements
3. Working together to identify the EPT record management system
4. Working together to develop a system for communications on changes of discharge situation
5. Working together to provide training services
6. Working together to provide support in terms of tax and environmental protection policies
7. Working together to assist the connection between tax systems and environmental protection monitoring systems
8. Working together to improve data and filing processes

Conclusion
The EPT era has arrived since 2018 New Year’s Day. We would like to remind enterprises to pay attention to that the enforcement of EPT is more rigid than PDF. Therefore, pollutant discharging enterprises should not only pay attention to tax burden costs, but also to other various issues, such as analysis of tax-related information of taxable pollutants, tax filing, internal management of tax compliance and connection between enterprises’ internal tax systems and other systems. If any support is required, please do not hesitate to contact our professional teams.
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About EY

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