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KPMG TaxWatch Webcast: Taxation in China— VAT Reform Pilot to Expand Nationwide Beginning August 1

July 11, 2013





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Today's Speakers

- Linda Zhang, Tax Partner, Head of U.S. China Practice, KPMG LLP
- Sandy Nicolson, Managing Director, Indirect Tax, KPMG LLP
- John Wang, Tax Partner, KPMG in China
- Wayne Tan, Senior Manager, International Corporate Services, U.S. China Practice, KPMG LLP

John Wang

**Name and Organization**

John Wang, KPMG Advisory (China) Ltd.

Position

Partner, Tax

Qualifications

Certified PRC Tax Agent, MBA

Experience

John was previously a tax official in the Chongqing Municipality State Tax Bureau, with more than seven years of tax audit and administration experience. John joined KPMG in China after completing his MBA courses in the United Kingdom in 2004.

In his career as a tax consultant at KPMG, John has deployed the knowledge and skills acquired from both his work at the tax authority and his MBA studies in providing advisory services to multinational clients and domestic clients in a wide variety of industries. John maintains good working relationship with many tax authorities and has helped many KPMG clients in their discussions and negotiations in respect of various tax matters with the tax authorities. John has been actively involved in helping companies to get prepared for the ongoing PRC VAT reform.

Contact Information

Tel: +86 (21) 2212 3438
john.wang@kpmg.com

Administrative

- CPE regulations require online participants take part in online questions
 - You must respond to a minimum of four questions per 50 minutes in order to be eligible for CPE credit
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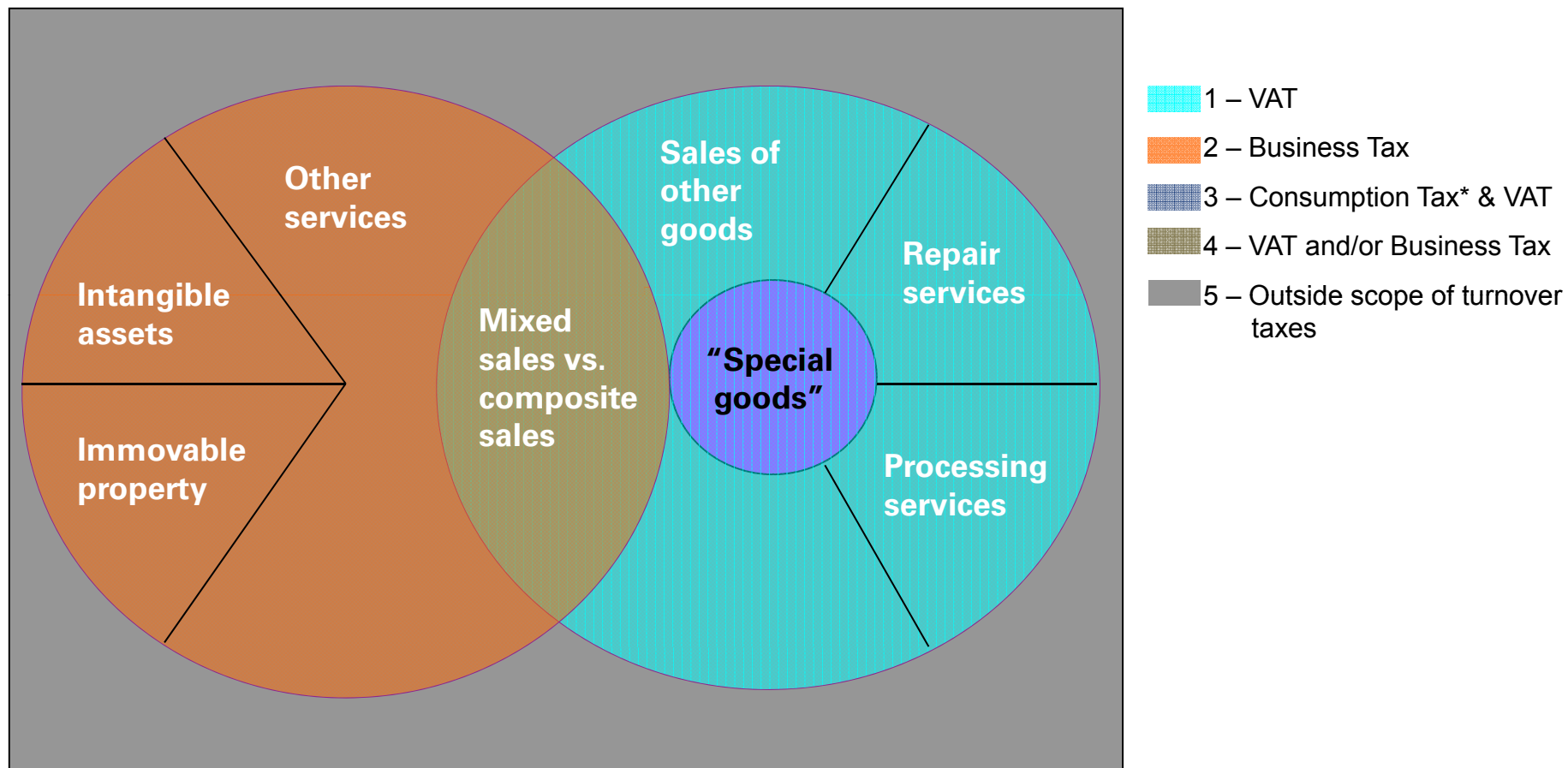
Agenda

- China's turnover tax system
- VAT reform pilot program update
- Cross-border services
- Case studies
- Preparing for VAT reform
- Key Takeaways
- Q&A

China's Turnover Taxes



Overview of Turnover Taxes in China



*Consumption tax essentially applies to luxuries including cosmetics, watches, and tobacco

How China's VAT Differs from Other VAT Systems Internationally

Key Features	China	Internationally
Refunds of VAT where input VAT > output VAT	Not generally, except for certain exports of goods	Most countries give refunds of excess VAT credits
Registration for VAT	At the branch level	At the legal entity level
Registration of foreign entities for VAT	Foreign entities not eligible to register for VAT	Most countries allow foreign entities to register for VAT
Transactions between branches	Can give rise to VAT liabilities	Not usually recognized for VAT purposes
Transactions between entities in wholly owned groups	Generally no ability to consolidate VAT filings within corporate groups	Many countries allow taxpayers to consolidate their VAT filings within a corporate group so that transactions between wholly owned entities do not attract VAT
VAT credits	Focus in China is on precise documentation to claim a VAT credit – any defect in VAT invoices can invalidate a claim	For internationally is generally on the substance of the transaction. Mere defects in VAT invoices do not usually invalidate claims
Exports	Exports of goods may be zero rated, but in China there may still be some VAT leakage	Exports of goods are zero rated – no VAT leakage
Purchase price adjustments	China's rules for adjusting VAT as a result of purchase price changes are rigid. May be instances where no adjustment is allowed, even though commercially the price has effectively changed	Most countries have broad rules which allow for VAT to be adjusted where there is a post-purchase change to the price

China's Golden Tax System – An Unique System

- The golden tax system (“GTS”) is a nation-wide e-tax system focused on producing a more efficient tax and data collection system, while reducing fraud.
- Businesses in China must obtain “special VAT invoices” (“fapiao”) to claim an input VAT credit.
- Special VAT invoices are controlled by the tax authorities and are issued through the GTS via state-regulated computerised cash registers.
- No real discretion where no, or incorrect, special VAT invoice.
- In order to claim an input VAT credit the special VAT invoices must be verified via the GTS.
- The GTS and ERP are not linked with each other unless interface solution is implemented by the Company.

Polling Question #1

- China VAT reform aims to convert which tax into VAT?
 - Business Tax
 - Consumption Tax
 - Corporate Income Tax

Update of the VAT Reform Pilot Program



Timeline for Expansion of the VAT Reforms in China



Service Industries Subject to the VAT Pilot Program


Industry	VAT Rate
Leasing of tangible movable property	17%
Transportation services	11%
Research and development (R&D) and technical services	6%
Information technology (IT) services	6%
Cultural and creative services	6%
Logistics and ancillary services	6%
Certification and consulting services	6%
Small scale VAT taxpayers	3%


Polling Question #2

- Generally, which of the following industry's turnover tax burden may be increased under the current VAT reform pilot program?
 - Transportation
 - Advertisement
 - IT services
 - Consulting

What Future VAT Reforms Are Yet to Come?

New Tax Circular – CaiShui (2013) No. 37

 Provinces not yet subject to the VAT pilot program

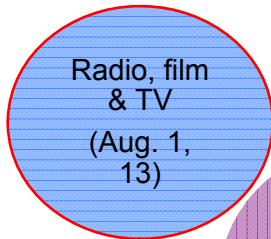
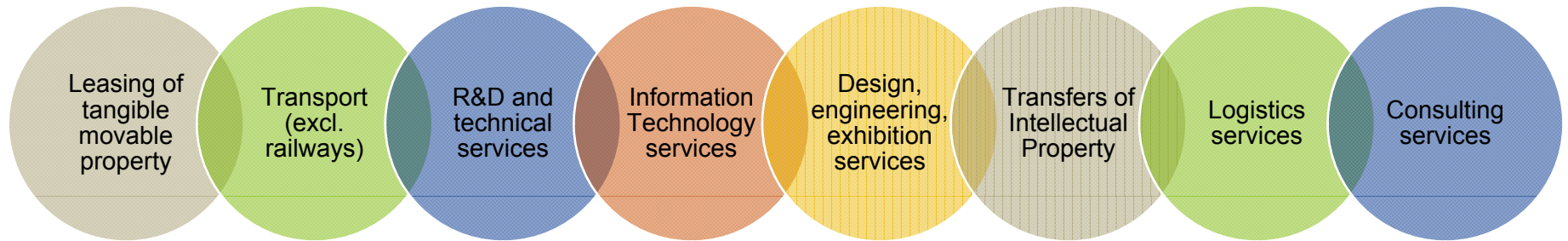
 Provinces that have already adopted the VAT pilot program

- Extend to nation-wide
- New sector included
- Consolidate previous VAT reform rules
- Other VAT policies changes

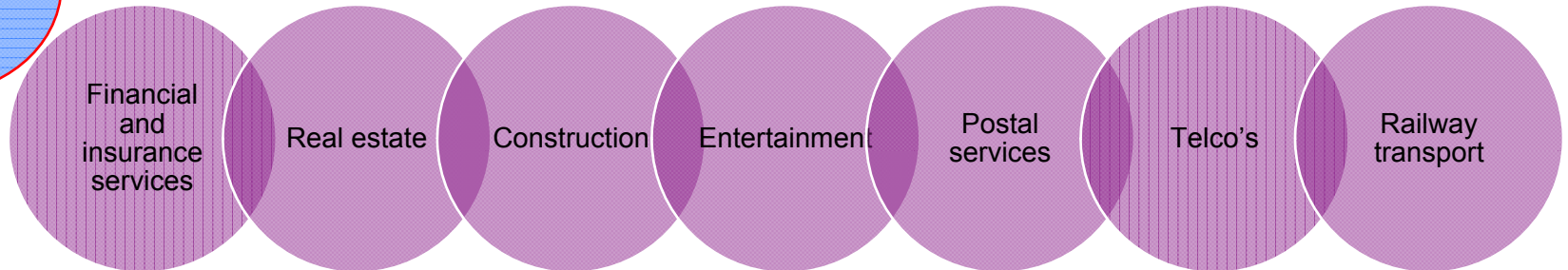


What Future VAT Reforms Are Yet to Come?

Service industries already subject to the current VAT pilot program

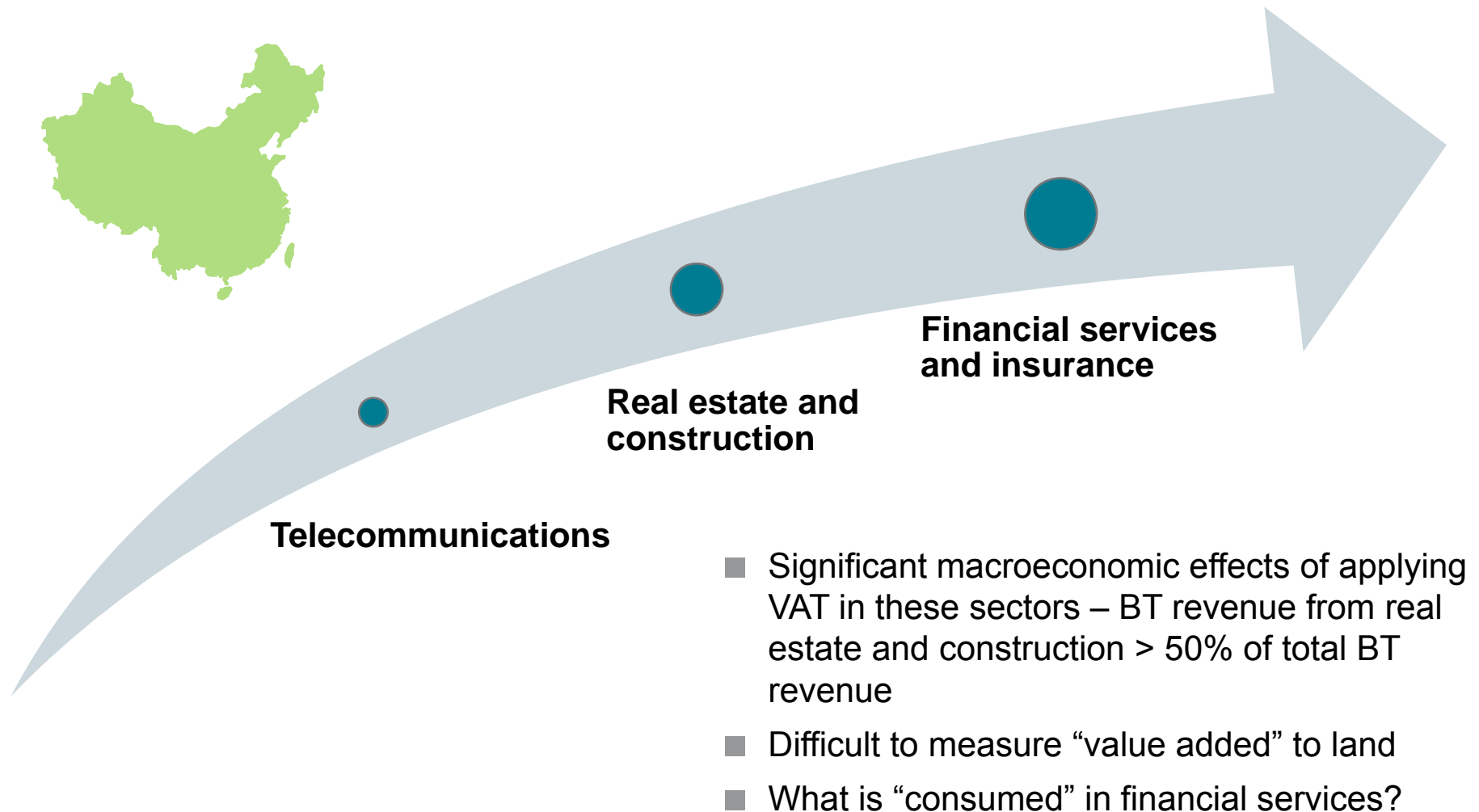


Service industries not yet subject to the VAT pilot program



The Road Ahead

The three hardest sectors for VAT are still to transition:



Polling Question #3

- Which industry will be newly included into the VAT reform pilot program from August 2013?
 - Radio, TV, film
 - Logistics
 - Transportation
 - Real estate construction

Cross-border Services



Key VAT Implications for Cross-border Transactions

Location of supplier	Location of recipient / place of consumption	VAT treatment
In China*	Outside China**	<u>Zero-rated or exempt</u>
Outside China	In China*	If no agent, recipient may claim input VAT credit subject to documentary requirements
Outside China	Services consumed wholly outside China	<u>Not subject to VAT</u>
Outside China	Leased goods used entirely outside China	Not subject to VAT



* In a city/province subject to the VAT pilot program currently before August 1, 2013

**Provided the services do not relate to goods or real estate located in China

Key VAT Implications for Cross-border Services

Exports:

	Output VAT	Creditable input VAT
Zero– rated	No	Yes
Exempt	No	No

Imports:

	Output VAT	Creditable input VAT
Agent or purchaser	Withholding of VAT	Yes, if general VAT taxpayer

Services consumed wholly outside of China:

- foreign entities providing services to Chinese entities which are fully provided and consumed outside China
- foreign entities leasing tangible goods to Chinese entities where the goods are entirely used outside China

Exemptions and Concessions – Exported Services

Industry	VAT treatment	
	VAT zero-rated	VAT exemption
Leasing of tangible movable property		<ul style="list-style-type: none"> Leasing of tangible movable property if the object of the lease is used outside China
Transportation services	<ul style="list-style-type: none"> Qualified international transportation 	<ul style="list-style-type: none"> Unlicensed international transportation
R&D and technical services	<ul style="list-style-type: none"> R&D and design services provided to overseas entities 	<ul style="list-style-type: none"> Engineering as well as exploration services where the related project or mineral resources are located outside China Technology transfer, technology consulting, energy management services (except where the object of the energy management contract is located in China) provided to overseas entities
IT services		<ul style="list-style-type: none"> Software services, circuit design and testing services, business process management services provided to overseas entities



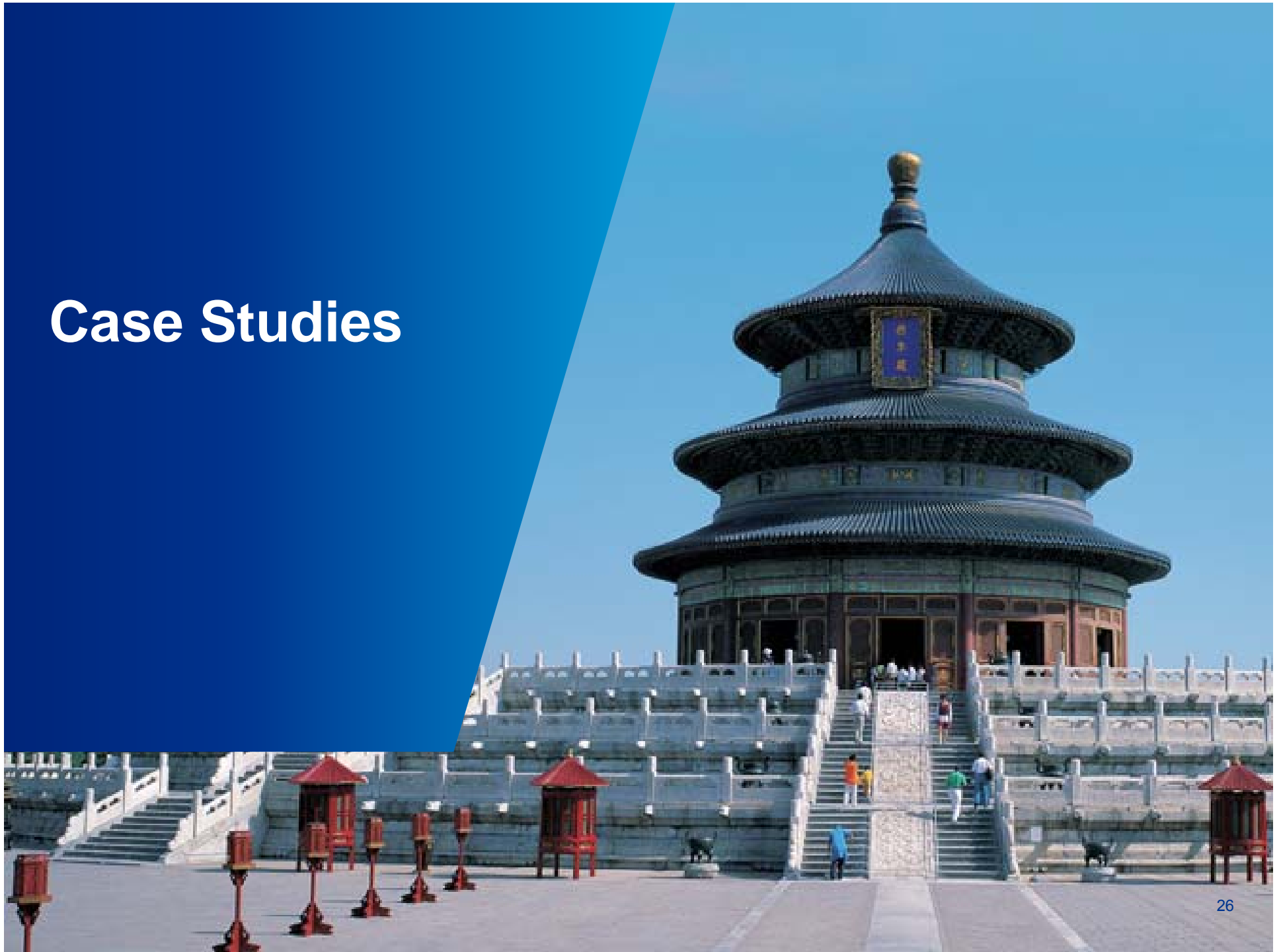
Exemptions and Concessions – Exported Services

Industry	VAT treatment	
	VAT zero-rated	VAT exemption
Cultural and creative services	<ul style="list-style-type: none"> Design services provided to overseas entities (except for design services in relation to immovable property located in China) 	<ul style="list-style-type: none"> Convention and exhibition services for events located outside China Trademark and copyright transfer services, intellectual property services provided to overseas entities Advertising services where the related advertisement is released outside China
Logistics and ancillary service		<ul style="list-style-type: none"> Warehousing services where the location of the warehouse is outside China Logistics and ancillary services provided to overseas entities (except warehousing services)
Certification and consulting services		<ul style="list-style-type: none"> Certification, verification and consulting services provided to overseas entities (except for services in relation to goods or immovable property located in China)

Polling Question #4

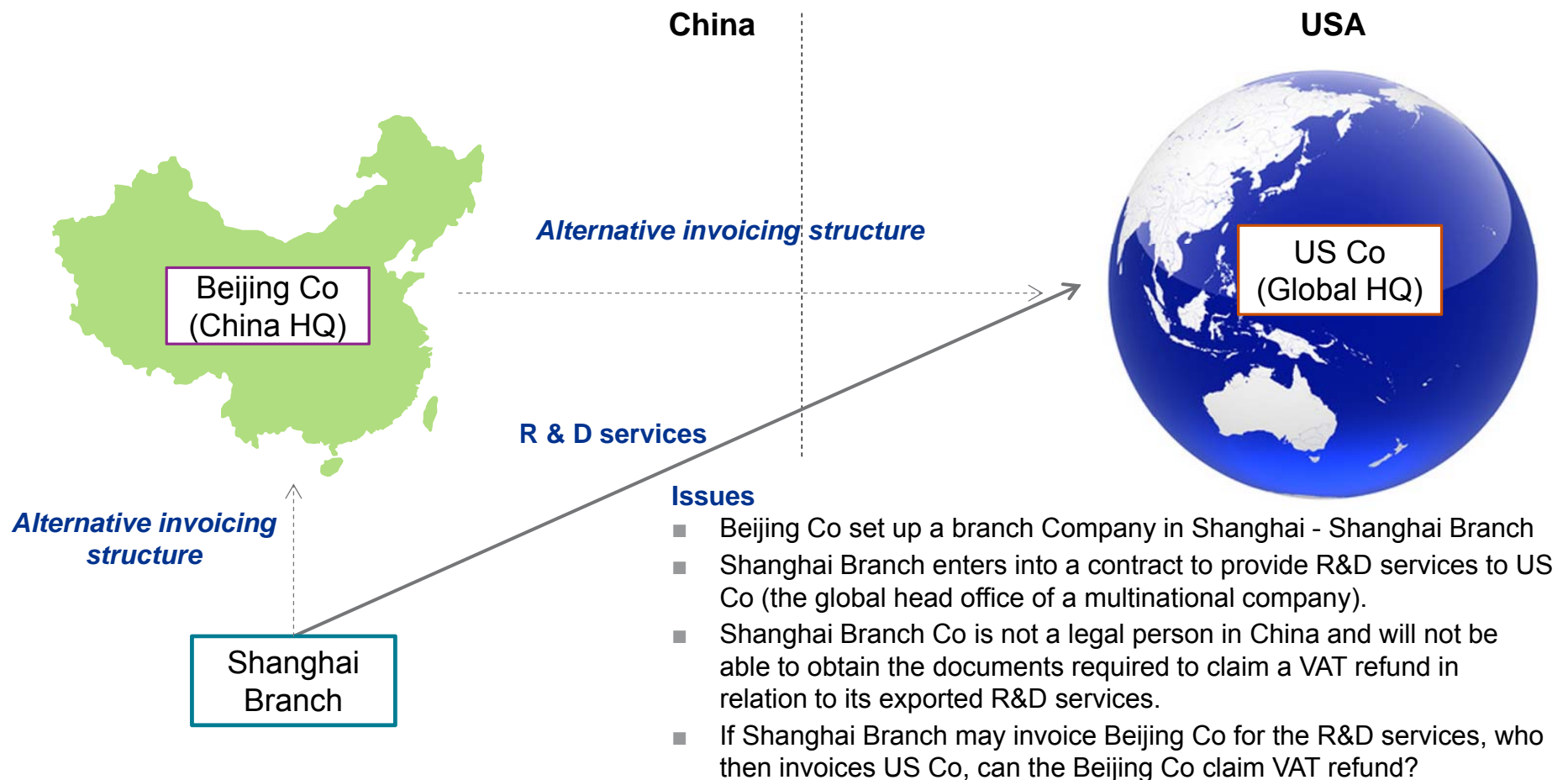
- Technology transfer, technology consulting, energy management services (except where the object of the energy management contract is located in China) provided by a China company to overseas entities could enjoy VAT:
 - Exemption
 - Zero-rated

Case Studies



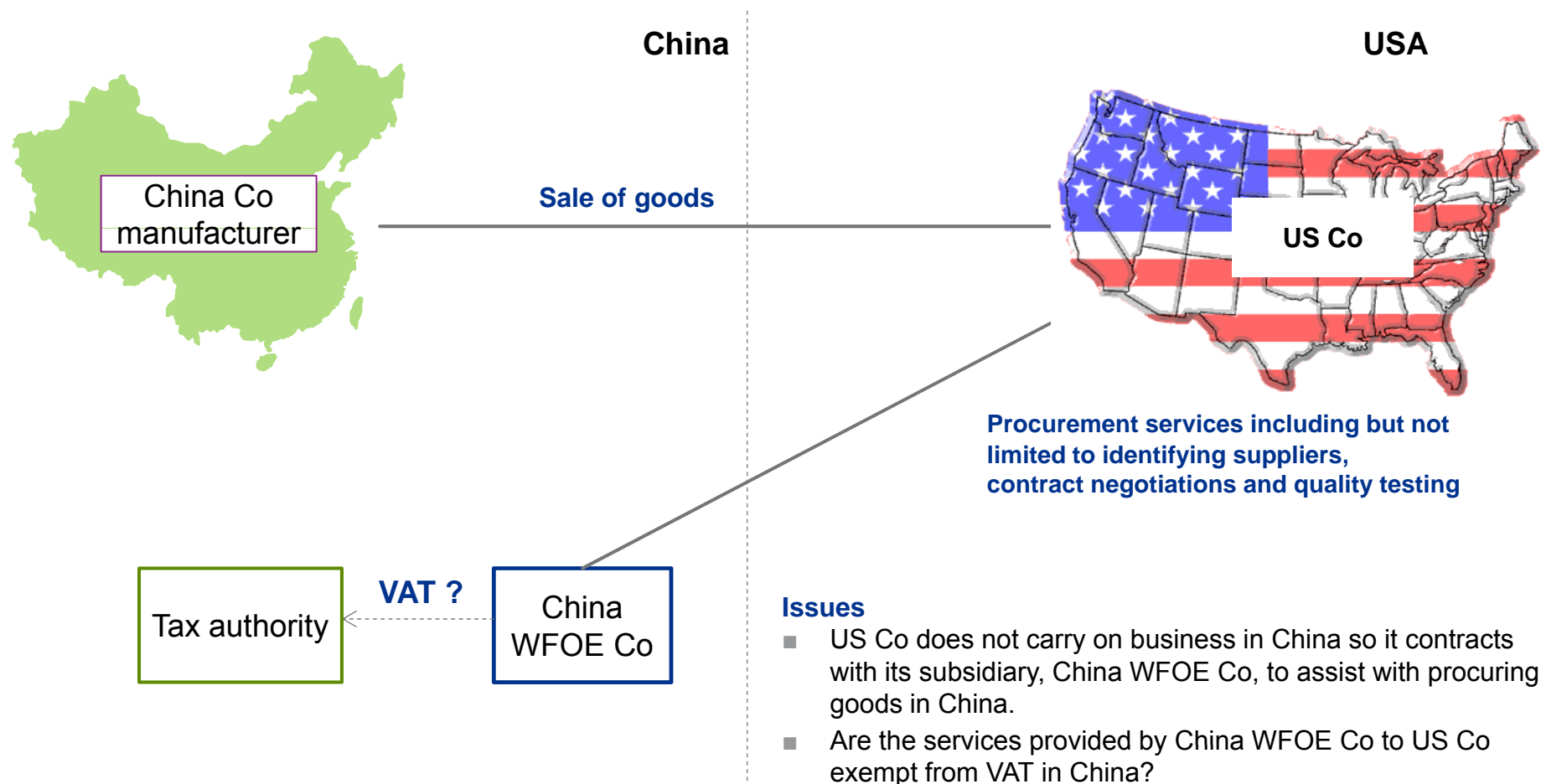
Case Study #1 – Research and Development Centers

Shanghai branch provides R&D services to global headquarters



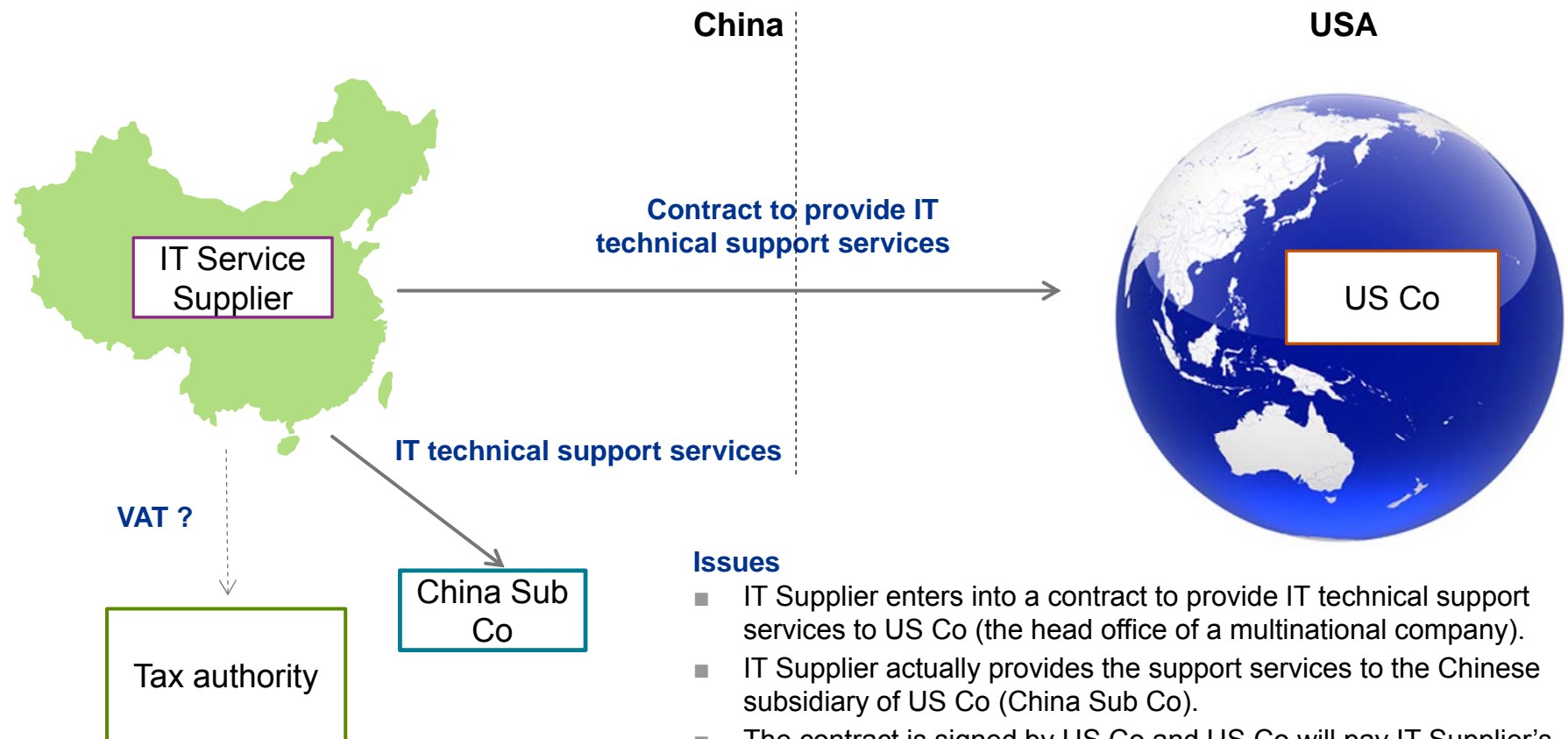
Case Study #2 – Services in Relation to Goods or Real Estate in China

Procurement services



Case Study #3 – Cross-border Services

Contract entered into with overseas entity to perform services in China



Issues

- IT Supplier enters into a contract to provide IT technical support services to US Co (the head office of a multinational company).
- IT Supplier actually provides the support services to the Chinese subsidiary of US Co (China Sub Co).
- The contract is signed by US Co and US Co will pay IT Supplier's fees.
- Are the services provided by IT Supplier to US Co subject to VAT in China?

Preparing for VAT Reform



Prepare for the VAT Reform



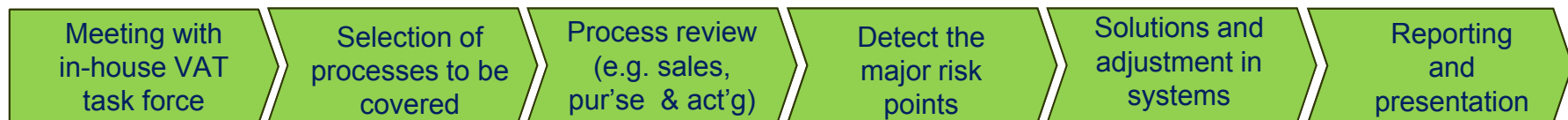
Prepare for the VAT Reform

Steps for responding to the VAT reform:

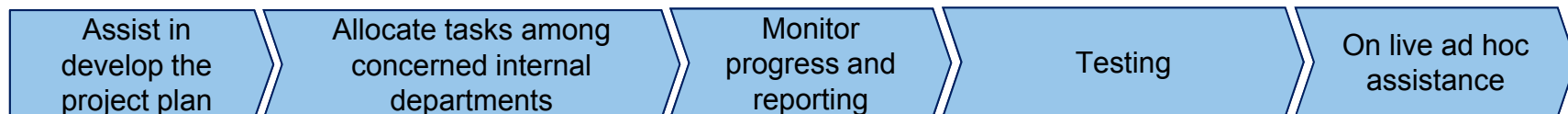
Training: to equip our people with necessary knowledge and skills



Process review: to detect the VAT processes that need to be properly managed for VAT compliance



Project management: to act as the project manager and provide technical support in implementation stage



Summary – Key Takeaways



Summary of Key Takeaways

- China VAT reform pilot program will be extended nationwide, covering transportation, assets leasing, logistics, IT, consulting, TV and film, etc. modern service industries from August 1, 2013
- China company providing services to overseas companies may potentially enjoy VAT exemption or zero-rated
- VAT withheld for foreign company providing services to Chinese entities could be used as input VAT credit by the Chinese entities; therefore, the total China turnover tax would be potentially reduced
- Implementation rules for the relevant VAT exemption /zero-rated treatment are still unclear. Discussion with your China tax adviser for the relevant transactions is necessary
- Effort and time required for transition from BT to VAT are often underestimated, early preparation and proper planning are critical

Summary of Key Takeaways (continued)

- Key to identify who will own China VAT reforms in the U.S. tax department/locally
- Importance of reviewing contractual arrangements (including those from U.S.)
- Importance of reviewing supplier contracts to ensure supplier passes on benefits in the transition from business tax
- Importance of ensuring invoices on purchases and sales compliant
- Potential to revisit supply chains to help ensure indirect efficiencies captured

Polling Question #5

- Would you like a KPMG professional to contact you regarding the topics discussed today?
 - Yes
 - No



Q&A

Q&A (continued)

click 'ask a question' on your media player to ask a question

Today's Presenters

Sandy Nicolson	+1 408-367-2801	anicolson@kpmg.com
Wayne Tan	+1 408-367-1574	wtan@kpmg.com
John Wang	+86 (21) 2212 3438	john.wang@kpmg.com
Linda Zhang	+1 212-954-2423	lindazhang@kpmg.com



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Thank you for joining us. Please send any questions to us-taxwatch@kpmg.com

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