



*cutting through complexity*

# VAT Reforms in China

## Consulting, Advertising & Intercompany Services

KPMG in China

- Lachlan Wolfers, Jean N Li
- March 2012



# Agenda

- **Background to VAT reforms**
- **General rules**
- **Industry specific rules**
- **Industry based examples**
- **Profitability impact**
- **How to prepare for VAT reforms**
- **How KPMG is assisting its clients**

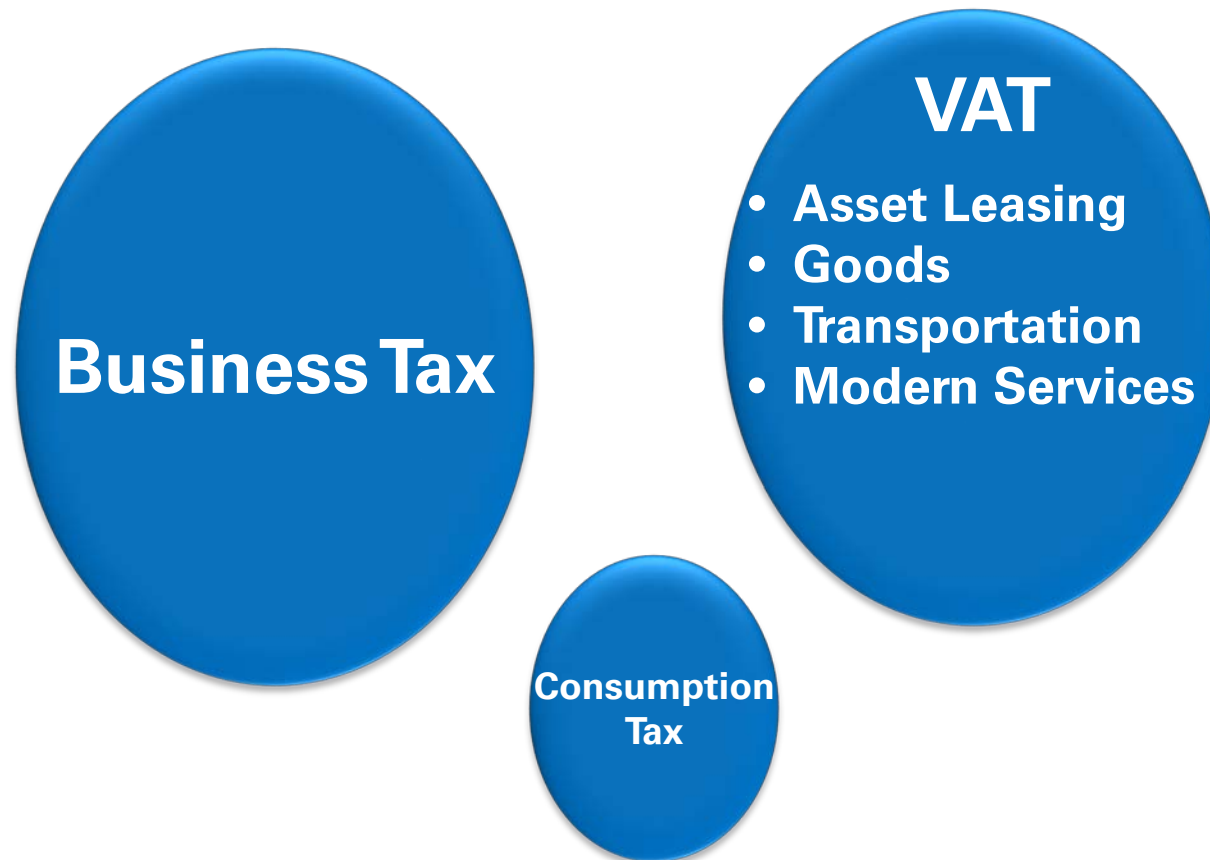
# Pre-reforms

75%

**Business Tax**

**VAT**

**Consumption  
Tax**



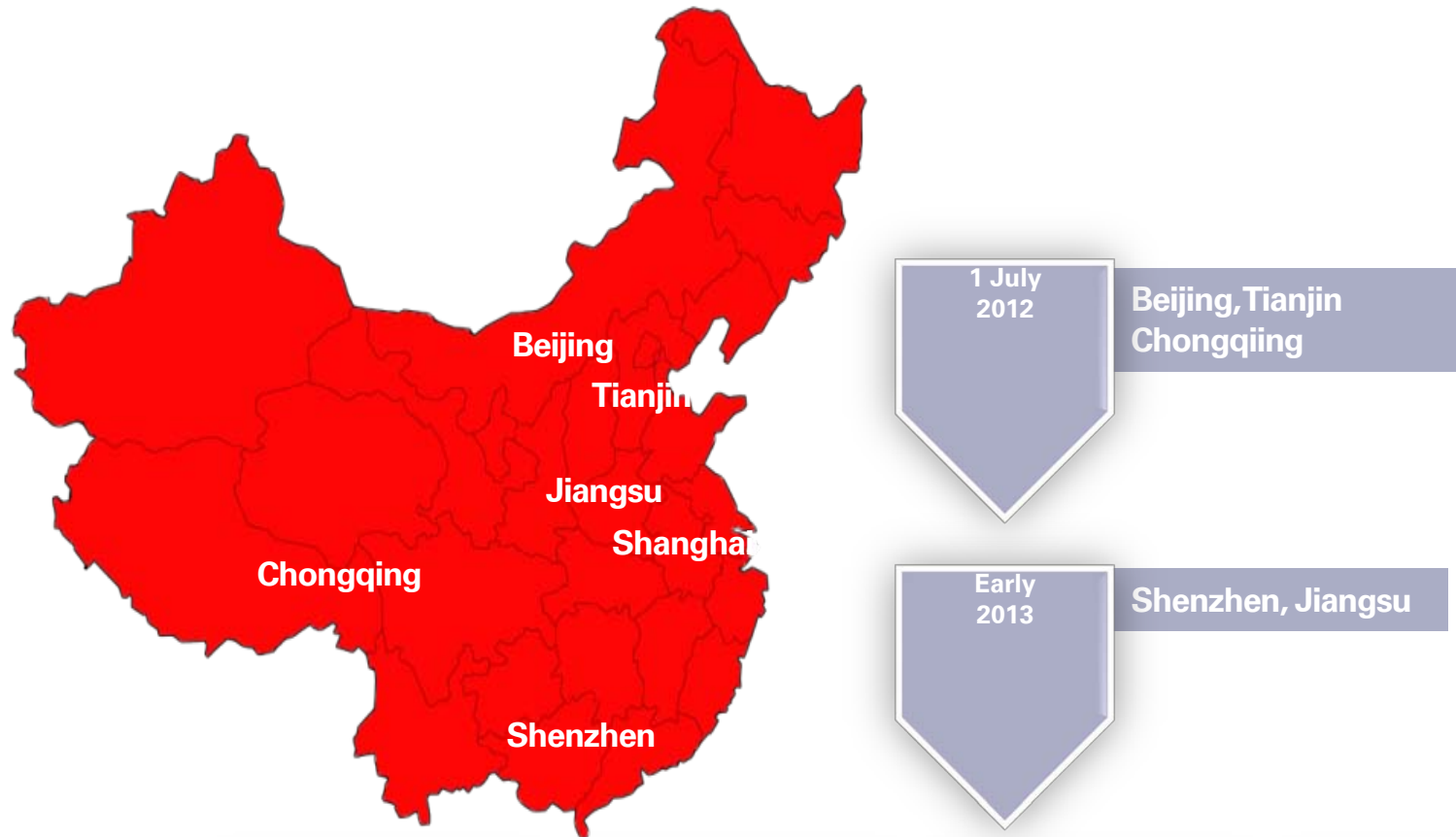
From  
1 January  
2012



Shanghai: VAT

Rest of mainland China: Business Tax

# Likely rollout of VAT reforms across China



Expansion by Scope:

Financial Services

Real Estate &  
Construction

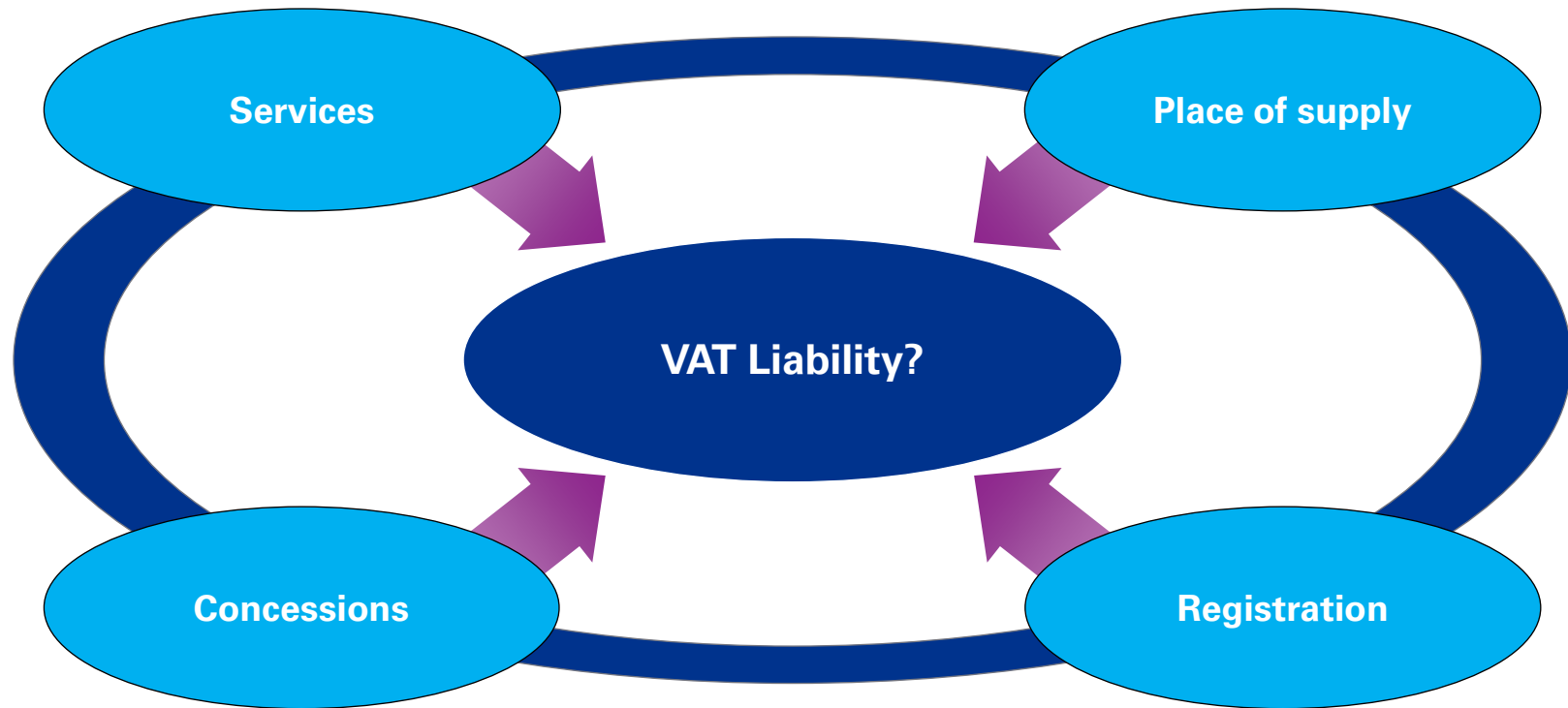
Entertainment

Post &  
Telecoms

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# VAT reform decision matrix





# VAT pilot scheme – industry & rate

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

# VAT pilot scheme – scope of services

Industry	Scope
R&D and technical services	Includes R&D services, technology transfer services, technical consulting services, energy contract management, engineering, reconnaissance and exploration services
IT related services	Includes production, collection, processing, storage, transportation and distribution of information, including software services, circuit design, information systems
Cultural & creative services	Includes licensing or transfer of trademarks, patents, copyrights etc, and transfer of goodwill Includes advertising services Includes exhibition services
Intercompany services	Includes internal management services, finance, tax, operations and process management

## Place of supply - domestic

Location of supplier	Location of services	VAT or BT
In Shanghai	In Shanghai	VAT
In Shanghai	Elsewhere in China	BT, but credit allowed against VAT payable (very limited application in practice)
Elsewhere in China	In Shanghai	BT
Elsewhere in China	Elsewhere in China	BT

**Rule of thumb: If you paid BT in Shanghai previously, and those same services are now within scope of the pilot program, then you pay VAT in Shanghai. It does not matter where the customer is located in China.**

# Place of supply - cross border

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

## Registration

**Compulsory**

**RMB 5 million  
(US\$800,000)**

**Optional**

## Merger of BT with VAT – concessions

Concession	VAT treatment	Input VAT credits
Technology transfers by pilot taxpayers	Exempt from VAT	No
Offshore outsourcing services by businesses registered in Shanghai	Exempt from VAT	No
Pipeline transportation services	VAT levy first and refund later for VAT burden in excess of 3%	Yes
Approved finance leases	VAT levy first and refund later for VAT burden in excess of 3%	Yes

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# Industry specific rules

## General rule:

Income	VAT liability
VAT payable	Output VAT – input VAT
Output VAT	Gross basis: Gross revenue x 6% VAT

## Specific rule for advertising / exhibition services (and others who paid BT on net basis):

Income	VAT liability
VAT payable	Output VAT – input VAT
Output VAT	Net basis: $(\text{Gross revenue} - \text{allowable deductions}) / (1 + \text{VAT rate}) \times \text{VAT rate}$



# Basic VAT concepts impacting on cross border services

## Exports:

	Output VAT	Creditable input VAT
Zero - rating	No	Yes
Exempt	No	No

Identify and track input VAT credits and apportion any expenses which have a duality of purpose or function

## Imports:

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

If purchaser can claim an input VAT credit, then overseas supplier should seek to gross up price for VAT purposes

# Exported Services – Circular 131

Industry	VAT treatment	
	VAT zero-rating	VAT exemption
<b>Leasing of tangible movable property</b>		<ul style="list-style-type: none"> <li>Leasing of tangible movable property with the object of the lease being used outside the PRC</li> </ul>
<b>Transportation services</b>	<ul style="list-style-type: none"> <li>Qualified international transportation</li> </ul>	<ul style="list-style-type: none"> <li>Unlicensed international transportation</li> </ul>
<b>Research and development (R&amp;D) and technical services</b>	<ul style="list-style-type: none"> <li>R&amp;D and design services provided to overseas entities</li> </ul>	<ul style="list-style-type: none"> <li>Engineering as well as exploration services with the related project or mineral resources located outside the PRC</li> <li>Technology transfer, technology consulting, energy management services (except where the object of the energy management contract is located in the PRC) provided to overseas entities</li> </ul>

# Exported Services – Circular 131

Industry	VAT treatment	
	VAT zero-rating	VAT exemption
<b>Information technology (IT) services</b>		<ul style="list-style-type: none"> <li>Software services, circuit design and testing services, business process management services provided to overseas entities</li> </ul>
<b>Cultural and creative services</b>	<ul style="list-style-type: none"> <li>Design services provided to overseas entities (except for design services in relation to immovable property located in the PRC)</li> </ul>	<ul style="list-style-type: none"> <li>Convention and exhibition services located outside the PRC</li> <li>Trademark and copyright transfer services, intellectual property services provided to overseas entities</li> <li>Advertising services where the related advertisement is released outside the PRC</li> </ul>

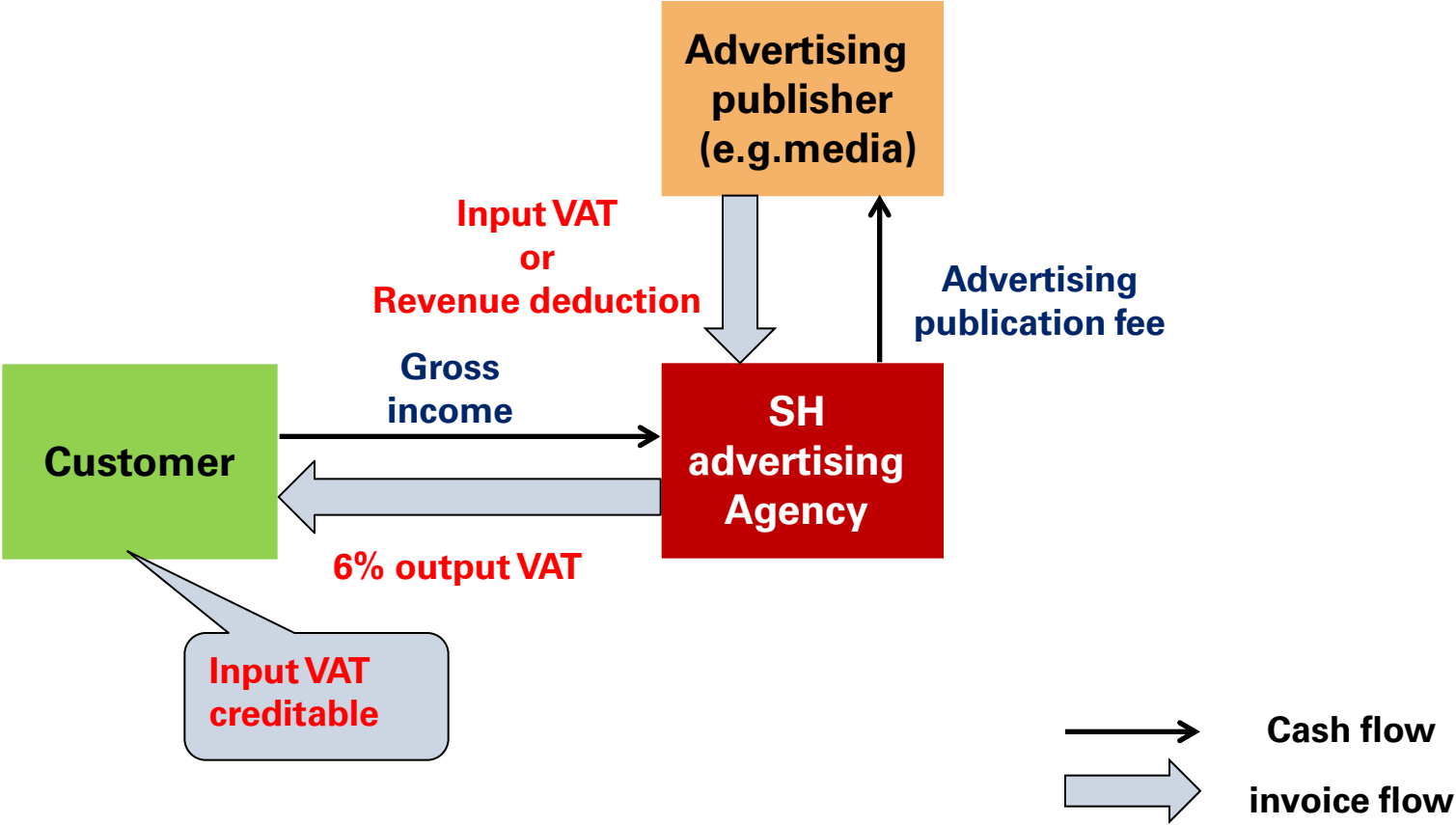
# Exported Services – Circular 131

Industry	VAT treatment	
	VAT zero-rating	VAT exemption
<b>Logistics and ancillary service</b>		<ul style="list-style-type: none"> <li>• Warehousing services where the location of the warehouse is outside the PRC</li> <li>• Logistics and ancillary services provided to overseas entities (except warehousing services)</li> </ul>
<b>Certification and consulting services</b>		<ul style="list-style-type: none"> <li>• Certification, verification and consulting services provided to overseas entities (except for services in relation to goods or immovable property located in the PRC)</li> </ul>

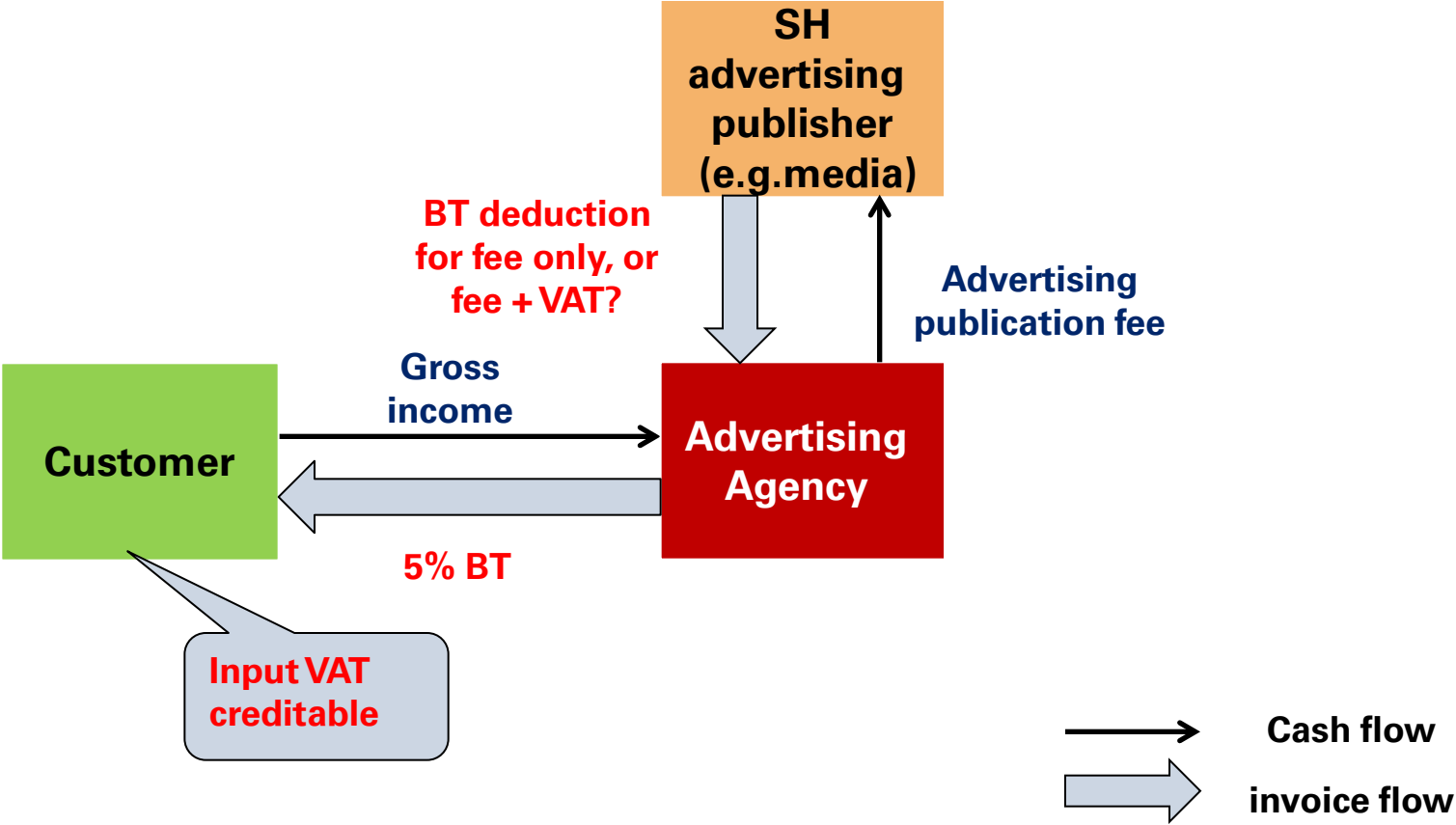
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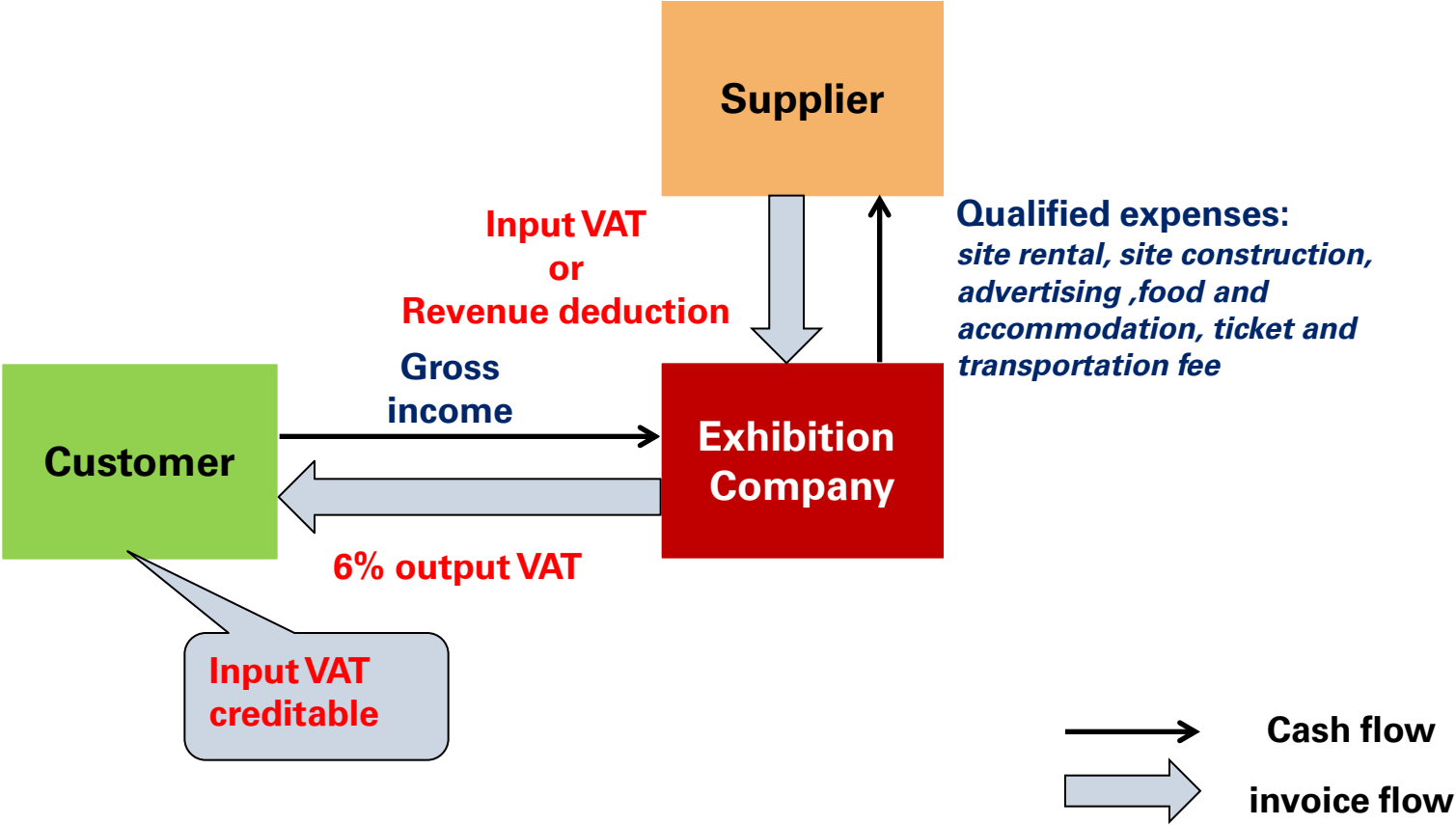
# For advertising agency in SH



# For advertising agency outside SH

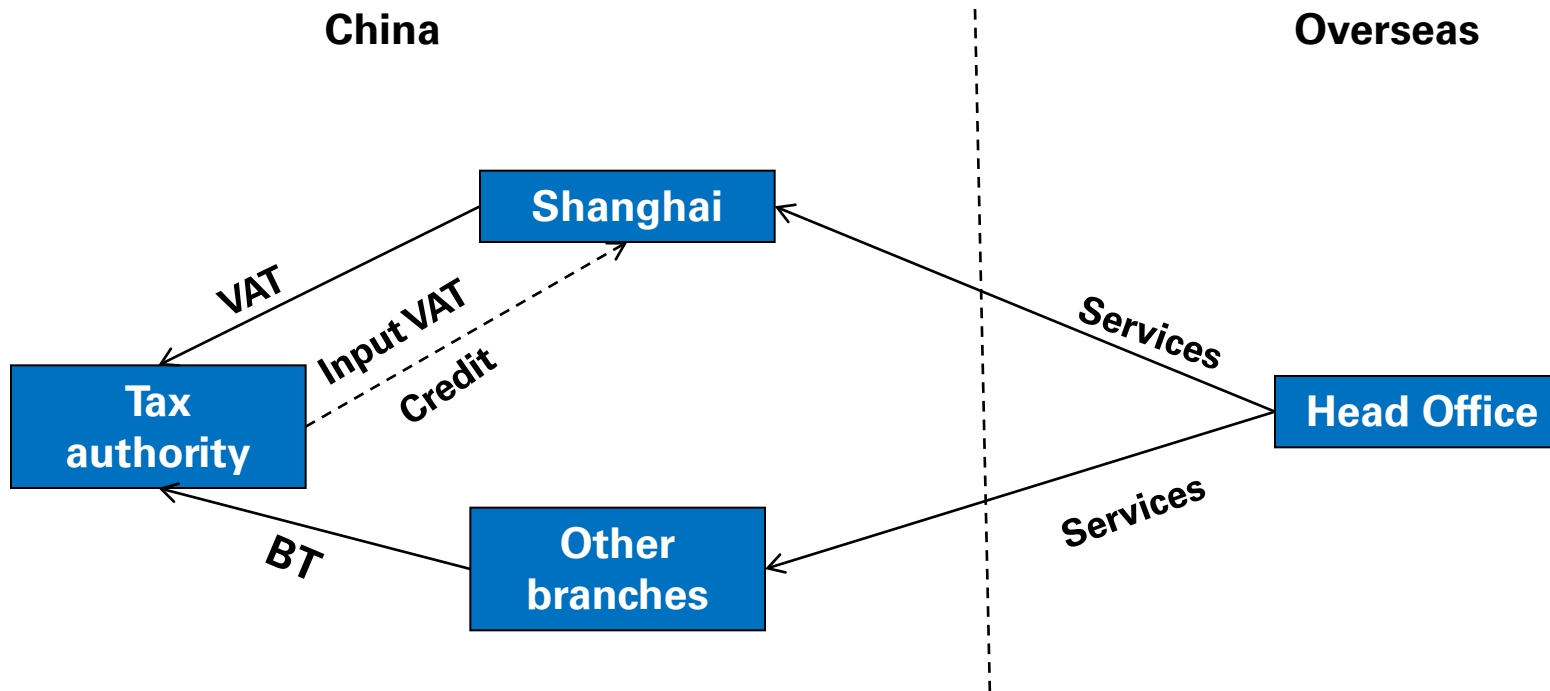


# For exhibition



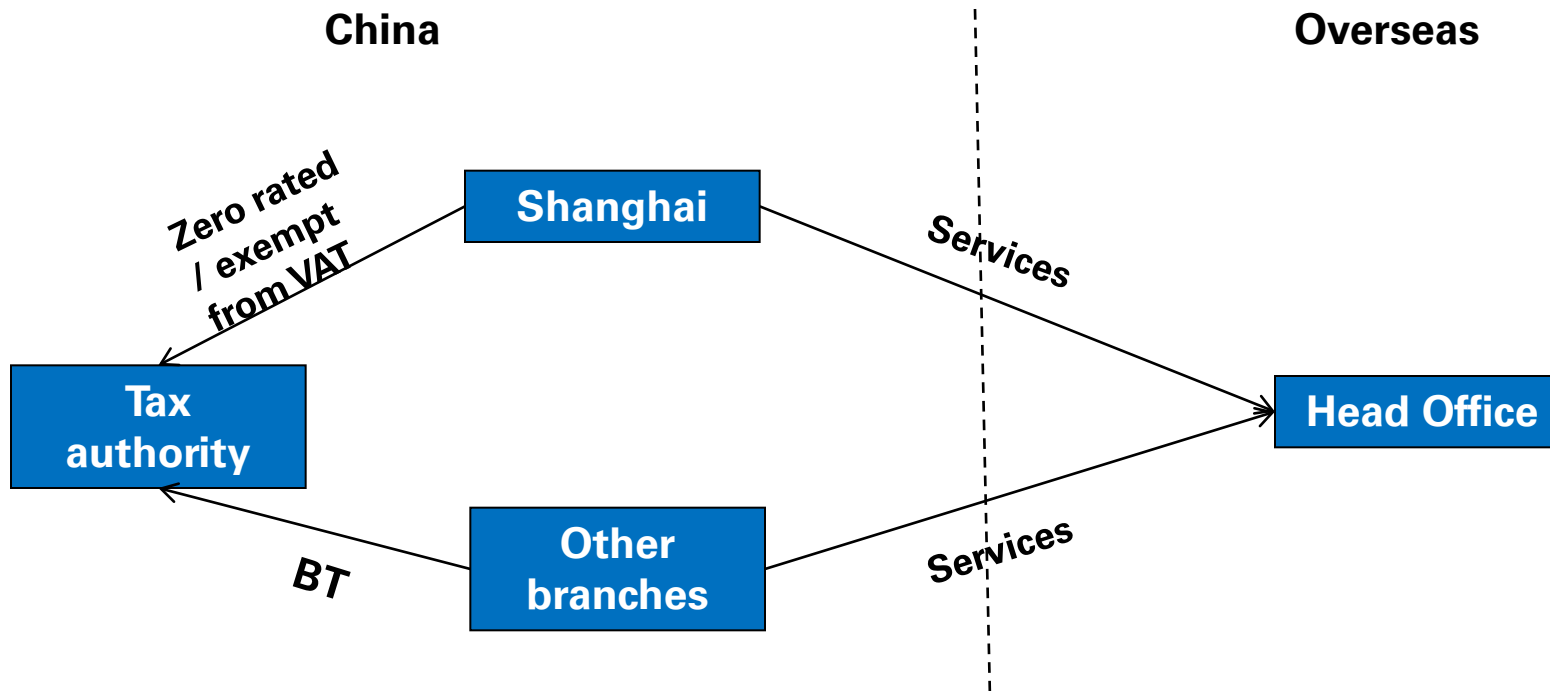


# Intercompany support services - cross border - imports



**Issues:** Need to ensure service within scope  
Gross up for VAT withholding  
Meet documentation requirements for claiming input VAT credit  
Interaction with transfer pricing

# Intercompany support services - cross border - exports



**Issues:** Need to ensure services within scope of pilot program  
Service must not relate to goods or real estate in China  
Comply with procedures for claiming exemption  
Transfer out input VAT  
Interaction with transfer pricing

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# Impact of VAT reforms on profitability - example

	BT Regime	VAT Regime
Sales Revenue (\$)	100	?
BT payable @ 5%	5	N/A
VAT – output (\$)	N/A	?
Costs of Sales(\$)	80	?
VAT - input(\$)	N/A	?
<b>Profit(\$)</b>	<b>15</b>	<b>15</b>

Seek to pass on VAT to customers

Ensure cost savings of suppliers is passed on

Maximise input VAT credits

# VAT implications – Input VAT creditable

Local Cost/Expenses	Input VAT or deduction
Advertising publication fee	6% input VAT or claim for deduction
Royalty fee	6% input VAT, or deduction if exempt (e.g. technology transfer)
Overseas IT support services, administration services, etc	6% input VAT
Domestic transportation fee	11 % input VAT with valid VAT invoice; or 7% input VAT if small scale taxpayer
Equipment/goods purchase and repair services	17% input VAT with valid VAT invoice
Consulting services (such as KPMG service fee)	6% input VAT with valid VAT invoice
Advertising expenses	6% input VAT with valid VAT invoice or claim for deduction
Utility fee	17% input VAT for electricity fee, 13% input VAT for water expenses

# VAT implications – not creditable

Local Cost/Expenses	Not deductible
Salary expenses and allowances	Not creditable
Rental fee (property)	Not creditable
Banking service fee	Not creditable
Entertainment fee	Not creditable
Travel expenses	Not generally creditable
Other expenses	Scrutinize whether deductible
Items	Input VAT transfer-out
If used for non-taxable items, such as staff welfare	Not deductible; transfer out input VAT

# Agenda

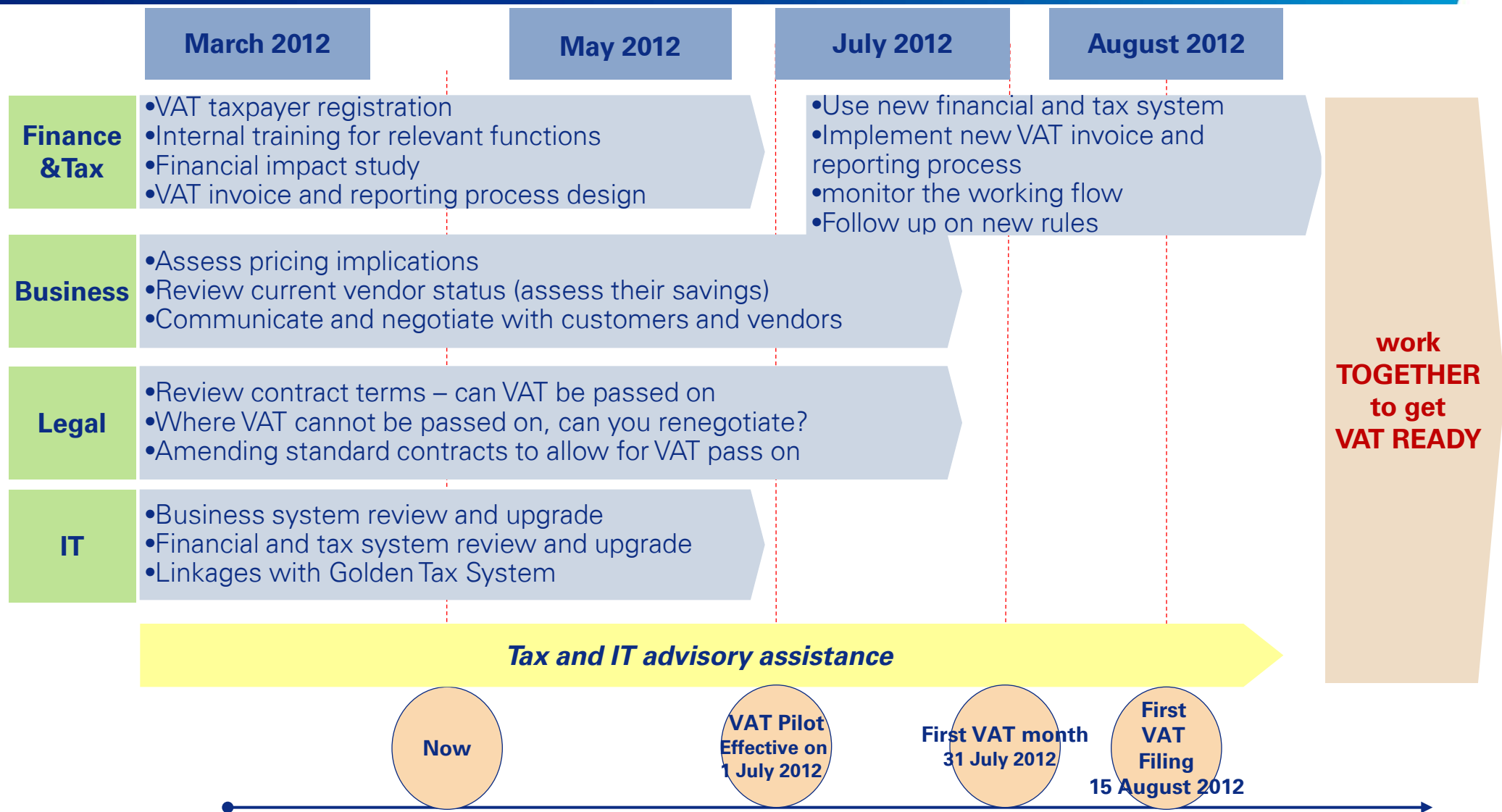
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# VAT Ready

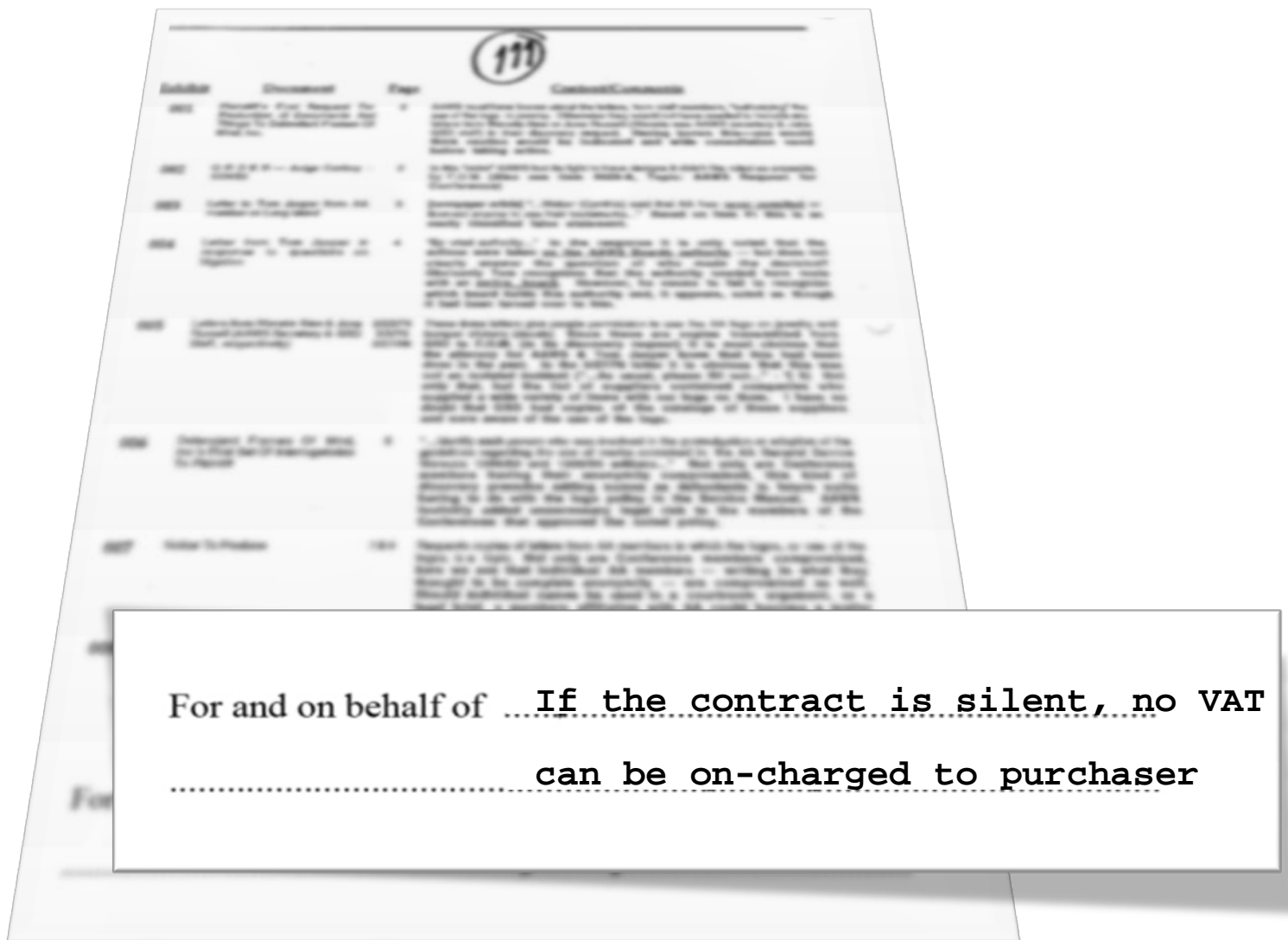




# How do I implement reforms – timeline – Beijing example – assume 1 July 2012 commencement



# Contracts



The image shows a tilted document, likely a contract or a table of contents, with a circular logo at the top center. The logo contains the letters 'KPMG'. Below the logo is a table with columns: 'Section', 'Description', 'Page', and 'Comments/Comments'. The table lists several sections, including 'Introduction', 'Definitions', 'Scope of Services', 'Fees and Expenses', 'Term and Termination', 'Assignment', 'Governing Law', and 'Entire Agreement'. The text in the table is mostly illegible due to the tilt and low resolution.

For and on behalf of ..... If the contract is silent, no VAT  
 ..... can be on-charged to purchaser

# Merger of BT and VAT – contracting and cost saving impacts

## Existing contracts:

- If contracts entered into prior to reforms, and price is inclusive of BT, will supplier have to absorb VAT? Or can supplier pass on VAT?
- Leases of tangible movable property entered into prior to 1 January 2012 – remain subject to BT
- If contract allows for entitlement to pass on ‘indirect taxes’ or ‘turnover taxes’, will supplier be able to pass on VAT?

## New contracts:

- If you are the **supplier**:
  - how do you ensure VAT can be recovered in addition to contract price?
- If you are the **purchaser**:
  - how do you ensure supplier does not simply add on VAT to price which already includes BT?
  - how do you ensure supplier passes on benefit of cost savings arising from removal of BT and availability of input VAT credits?
  - how do you ensure supplier provides you with a special VAT invoice before you pay the VAT?

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会员类型	缴费款项	单位	数量	金 额					备 注	
				百	十	万	千	百		十
高级A类会员	基本费用					¥	1	1	0	此资金不做会员费用, 纯属押金性质, 合作期满押金如数退还
	信用保证金					¥	3	0	0	
合计(大写):	零 百 零 拾 叁 万 壹 仟 壹 佰 捌 拾 零 元	合计(小写):				¥	3	1	1	0

**注 意 事 项**

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- 必须提供不对外转让本公司的会员资料。
- 同意本公司的相关条款规定。

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- 有权对本公司的服务品质进行监督和投诉。
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- 建立与会员沟通的渠道, 并进行会员满意度测评, 听取会员的意见和建议, 自觉改善服务工作。

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为了维护您的权益, 请您确认:

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联系电话: \_\_\_\_\_

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开票人: 王 晓 丽      收款人: 朱 志 鹏

第三联 客户联

# Merger of BT and VAT – registration & invoicing

## Key registration and invoicing issues to consider:

- Is my business registered as a general VAT taxpayer, or does it need to register now?
- If not, is my business turnover sufficient to register?
- Will my business be subject to a monitoring period?
- What equipment does my business need to purchase to issue special VAT invoices? Do my staff know how to use it?
- What is the lead time for registering and obtaining approval and equipment for issuing special VAT invoices? Will my business be ready for 1 January 2012?
- Will my business only deal with other businesses which are registered as general VAT taxpayers?

# Merger of BT and VAT – IT systems

## Key issues to consider:

- Do my IT and accounting systems recognise VAT?
- What tax codes does my accounting system recognise?
- Output VAT codes - 0% (exempt), 2% (2<sup>nd</sup> hand goods), 6% (new VAT rate), 11% (new VAT rate), 13% (foodstuffs and other items) and 17% (general VAT rate);
- Input VAT rates - 0% (ineligible for VAT credit), 6% (new VAT rate), 11% (new VAT rate), 13% (foodstuffs and other items), 17% (general VAT rate), export refund rates
- How do my systems link in with golden tax system?

# Merger of BT and VAT – supply chain

## Key supply chain issues to consider:

- Consider current legal structure – what aspects of that structure are superfluous? How could things be rationalised or improved?
- Assuming no cascading of BT, what aspects of my supply chain can now be removed?
- Absent BT, is my supply chain most effective from a trade and customs perspective?
- How does my renewed supply chain impact on transfer pricing?
- Does my supply chain model consider the concept of unbundling non-dutiable costs from my customs value such as commissions or service fees paid to buying agents for the sourcing of products?

# Merger of BT and VAT – cash flow and training

## Key cashflow impacts:

- Can my business fund an increase in VAT on services (up from 3% or 5%)
- What are my payment terms for accounts receivable? Do I pay VAT before I receive it?
- What terms does my business pay accounts payable? Do I get a special VAT invoice at or before I pay the VAT component?
- Is there a net cashflow deficiency?
- When borrowing to fund major acquisitions, will I be able to get short-term financing of VAT component?
- How do the VAT reforms impact on internal budgeting – i.e. VAT inclusive or VAT exclusive?

## Key training considerations:

- Who in my organisation needs to know about these reforms?
- What about impact on staff in finance function? A/c's receivable and a/c's payable function
- For foreign MNCs, what about head office training?



# VAT reforms – practical tips

## Some lessons from other countries:

1. Significant tax reforms like this are a key management issue, not simply a tax issue
2. Need to start preparing now – this includes taxpayers not subject to pilot program - the reforms are inevitable
3. Obtain a budget to prepare for the reforms
4. Put together a key team – project leader + key external advisers
5. Consider impact on IT systems, accounting systems and processes, pricing, contracts, consumer demand, cashflow management
6. Businesses who provide services likely to suffer increased strain on cashflow
7. Financial services and real estate are often problematic under VAT – hence likely to be left until later
8. Transition to new system – always produces winners and losers – the key to being a winner is to be prepared

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# How KPMG is assisting its clients

## VAT Reforms – specific assistance

These are some of the ways we are currently assisting clients

- Providing a report which:
  - confirms your current scope of business is subject to the pilot scheme;
  - reviews key revenue and expense items to identify proposed VAT treatment;
  - addresses the impact of exports of services on the applicable VAT treatment;
  - Analyzes the opportunities presented by reforms – timing issues, fixed assets, acquisitions of services
  - addresses the transitional fees and billing issues for your business.
- Participation in project management teams in your organisation – suitable where you would like to implement reforms, but still obtain benefit of our expertise and experience
- Assistance with completing documentation for registering as a general VAT taxpayer under the pilot scheme and purchase of invoicing equipment; assisting with training on invoice verification
- Preparation of sample letters to key customers explaining the impact of the VAT reforms on your services, and requesting their VAT registration details for issuing special VAT invoices
- Reviewing key contracts to identify if VAT can be passed on under those contracts, and if not, identifying opportunities for renegotiation; updating precedent contracts to allow for VAT pass through
- Assistance with IT systems changes, including linkages with golden tax system
- Preparation of sample letters to key suppliers to ensure they will provide special VAT invoices, as well as passing on any cost savings arising from their entitlement to input VAT credits on fixed assets, goods and other services acquired in their business
- Conducting health checks post-implementation

# KPMG – our credentials

- KPMG is the only firm with a Centre of Excellence dedicated to Indirect Taxes
- KPMG partners on panel of experts assisting Chinese Government (Jean N Li)
- KPMG partners have experience in implementing similar reforms in other countries (e.g. Australia)
- KPMG has provided expert assistance to Governments in a number of countries to advise on similar reforms (e.g. New Zealand, Australia, GCC, US, Hong Kong)
- KPMG hosted Ministry of Finance officials on study tour of Australia in 2010 to discuss implementation issues

# KPMG – our credentials



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## **A global pharmaceuticals company**

### **Tax Advisory Services**

Assistance in claiming exemption from BT for offshore outsourcing services and in transitioning to VAT

2011 - 2012



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## **A HK-listed Company**

### **Tax Advisory Services**

Tax advisory on the proposed restructuring work of its China businesses and assistance in liaison with the PRC tax authorities

2011



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## **An international retail company**

### **Tax Advisory Services**

Assistance in handling a VAT investigation case

2007 - 2011



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## **A global commodities trading business**

### **Tax Advisory Services**

Assistance in implementing VAT reforms and in creating linkages in its ERP systems with Golden Tax System

2011



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## **An international law firm**

### **Tax Advisory Services**

Assistance in implementing VAT reforms

2011 - 2012



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## **A global financial services advisory business**

### **Tax Advisory Services**

Assistance in claiming BT exemptions for certain parts of its operations and in implementing VAT reforms

2011 - 2012



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## **A global asset leasing business**

### **Tax Advisory Services**

Tax advisor on structuring of its business operations in China and liaising with the PRC tax authorities in respect of operation tax issues in China

2008 -



cutting through complexity™

## **A global logistics services provider**

### **Tax Advisory Services**

Assistance in supplier and customer contracting issues, and in pricing impacts arising from VAT reforms

2011 - 2012

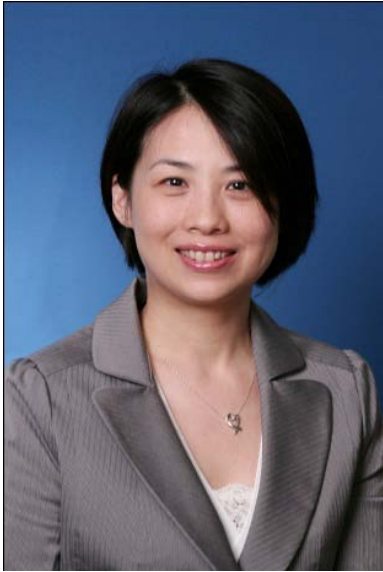
# Contact



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**Thank you**





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