



The purpose of this brochure is to set out the different types of services that KPMG China is providing to its clients in relation to the Value Added Tax (VAT) reforms. This list of services is only a reference, and is intended to provide our clients with a range of alternatives to prepare for, implement and comply with the VAT reforms, and can be tailored to your specific needs.

### **Why does it matter?**

China has had, for many years, a dual system of indirect taxes – VAT applicable to the goods sector and Business Tax (BT) for the services sector. These reforms are intended to replace BT with a VAT, such that there is a single indirect tax system applicable to both goods and services.

The VAT reforms commenced with a pilot program in Shanghai on 1 January 2012. They have been progressively rolled out across all cities and provinces in mainland China and expanded to include many additional services sectors. As of now, there are three main sectors yet to transition to VAT – real estate and construction, financial services and insurance and lifestyle services.

The transition from a Business Tax (BT) system, which effectively taxes the turnover of a business, to a VAT system with inputs, outputs, exemptions, in-scope and out-of-scope services, and multiple rates, represents a serious challenge. The commercial and tax risks are ever-present:

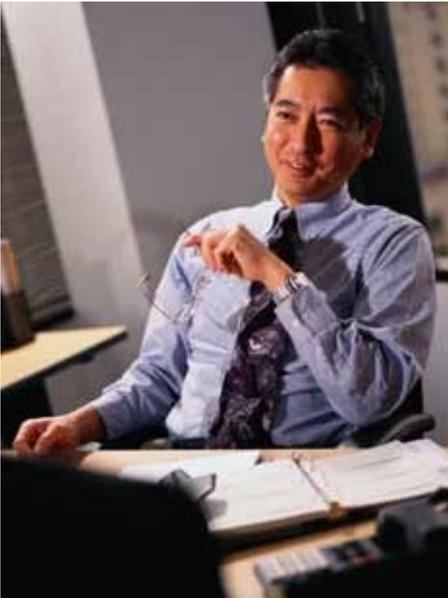
- Contracts which do not allow for VAT to be recovered from customers
- Suppliers who do not pass on savings arising from the abolition of BT
- Misclassification resulting in the overpayment or underpayment of VAT
- Failure to obtain valid VAT invoices resulting in the denial of valuable input VAT credits
- Interest and penalties arising from systemic processing errors.

### **What services may be needed?**

The simplest way for businesses to assess their needs is by referring to the phase of VAT reforms they need to implement. In each phase, there may be a range of alternative services – businesses may choose to receive some or all of these services, whilst implementing others themselves. These decisions will typically be based on the availability and expertise of internal resources, budgets, timeframes for implementation, and the complexity of the issues affecting your industry.



### Preparation phase



During the preparation phase, the initial focus for many businesses is on the broad financial impact of the reforms – for example, whether profitability will be affected, how prices should change, if expenses will increase or decrease once VAT commences, whether VAT be passed on under existing contracts with customers, and if suppliers will be able to charge VAT under their contracts.

The types of services we frequently provide during the preparation phase of the reforms include:

- **Workshop** – We ordinarily commence by leading and facilitating an intensive workshop with all of the key business stakeholders in attendance. The purpose of the workshop is to ensure all stakeholders have an understanding of the proposed policies for the VAT reforms affecting the business and the areas where uncertainty still remains; an understanding of the major commercial impacts of the proposed VAT reforms on the business, and how best to manage those impacts; and a register of key issues which need to be further analyzed to prepare for the VAT reforms.
- **A financial impact assessment** – Many of our clients want to try and understand the expected impact of the VAT reforms on their profitability. They also want to understand the extent to which prices should be adjusted for VAT; how cost savings from key suppliers can be achieved; whether input VAT credits will be available for the expenses they incur, and if so, to what extent; the likely cash flow impact on the business; and what opportunities there are to mitigate VAT on cross-border transactions, including related party transactions.
- **Contract reviews** – In contract reviews we focus on whether there are provisions under existing contracts in which VAT can be passed on to customers; whether any existing contracts will be eligible for grandfathering relief; what provisions should be inserted into new contracts to enable the recovery of VAT from customers; whether VAT can be passed on by suppliers under their contracts; whether contracts with suppliers can be renegotiated in light of the VAT reforms; and mitigate cash flow impacts arising from the VAT reforms.

### Implementation phase

Once the broad financial impact and key technical issues have been considered, the business needs to implement the reforms. The time period is usually short and many facets of a business will be affected. Our team has experience in managing this challenging process.

- **Project management** – Many of our larger clients have chosen to implement the VAT reforms by putting together a project management team, typically comprising personnel from Sales, Marketing, Procurement, Legal, IT, Finance and Tax. KPMG is currently assisting a number of clients by acting as an external adviser on these project management teams. This is a cost-effective and efficient way to access our resources and expertise, whilst retaining the ability to largely implement the VAT reforms in-house.

- **Key supplier arrangements** – We have been assisting clients by preparing sample letters for key suppliers to ensure cost savings are passed on and VAT invoices are provided; undertaking a financial analysis of key contracts with suppliers to determine the likely cost savings; and analyzing the financial impacts under those contracts to assist in negotiations with key suppliers.
- **Key customer arrangements** – We can prepare sample letters for your key customers explaining the impact of VAT reforms on pricing; explain any changes to contracts, including whether there is a possibility of passing on VAT under existing contracts; and obtain data from key customers to enable VAT fapiaos to be issued once the VAT reforms have commenced.
- **Preparation of standard procedures** – For many clients, controls over issuing VAT fapiaos, and their prompt receipt, is fundamental. We prepare standard procedures and controls for use by finance staff to ensure VAT fapiaos are received, processed and coded to correctly claim input VAT credits correctly. We also document procedures for the issuing of accurate VAT fapiaos for the services you provide.
- **Training** – We provide training to key personnel within a business to understand the impact of the VAT reforms; identify issues where risks arise and opportunities can be utilized; produce a project plan to facilitate the prompt implementation of the reforms; give presentations to senior management; and provide training specific to staff in Sales, Procurement, Marketing, Legal, IT, Finance and Tax.
- **IT systems** – Our IT Advisory colleagues are proficient at inputting new VAT codes in ERP systems to cater for new input and output tax rates, as well as developing IT interface solutions between ERP systems and the Golden Tax System.



### Compliance phase

The final phase is compliance – this is where it must all come together. The information filed with the tax authorities needs to be accurate and supported by the appropriate documentation. In China, paying strict attention to the details of documentation is vital – minor errors or defects can invalidate otherwise legitimate claims.

- **Preparation of VAT returns** – We can assist with the preparation of VAT returns or do high-level reviews or ‘sense checks’ of the VAT returns you prepare.
- **Engagement with tax authorities** – There is still considerable uncertainty regarding the way in which the VAT reforms will affect the remaining services industries yet to transition to VAT. Based on our contacts with the tax authorities and the breadth of our experience in resolving issues for our clients, we are well placed to assist you in resolving any contentious issues.
- **Application for VAT exemptions or zero rating for exported services** – The technical complexity of the rules and the detailed procedures for applying for VAT exemptions or zero rating for exported services means that specialist assistance is often required. We have considerable experience assisting clients to apply for these concessions. Utilizing the right expertise to manage claims for these concessions can have a significant impact on bottom line profitability.

## Contact us

If you would like more information on any of the matters discussed on this publication, please contact:



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- **Apportionment of input VAT credits** – For many businesses, the VAT reforms mean that it becomes necessary to apportion input VAT credits. Apportionment arises in each of these examples: for businesses which provide services which are partly in the scope of VAT, and partly in the scope of BT; for businesses which provide employee benefits, or engage in certain undervalued or related party transactions where it may be necessary to transfer out input VAT. We have considerable experience in applying apportionment methods.
- **Post-implementation health checks** – The short timeframes for the implementation of the VAT reforms means that many businesses run the risk of making errors. In our experience, those errors are particularly likely to result in the underclaiming of input VAT credits. A post-implementation health check is a good way to identify any errors, correct them, and most importantly, submit any further refund claims before the time periods expire.

## Next steps

The different approaches above are intended to highlight the breadth of services we currently provide to our clients and the flexibility with which these services may be provided. There are clear options available to meet a broad spectrum of client needs – from those with limited internal resources requiring a more hands-on approach, to those with limited budgets and a desire to manage most of the reform implementation in-house.

We encourage you to consider your needs, based on the range of options presented in this brochure. From there, we can meet with you to prepare a precise scope of work and fee proposal which addresses those needs.

## Our credentials

KPMG has a dedicated Centre of Excellence for Indirect Taxes in China. Our team is experienced in implementing similar reforms, both internationally and locally. KPMG partners were appointed to the panel of experts assisting the Chinese Government with the VAT reforms. We are also currently assisting China's Ministry of Finance and other government agencies on a number of crucial aspects of the VAT reforms.

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