



Transforming the in-house tax function in China through technology

A practical guide to 2020



Part B

Now let's begin our journey

Starting on a journey to embrace technology, even on an incremental basis, is necessary to keep up, and also maintain or even enhance the value of the tax function to the organisation it serves.



So by now we have hopefully helped you to understand some of the problems within your organisation which tax technology may help you to fix; we have shared with you a framework through which to consider how most tax technology solutions fit; we've discussed the need to consider incremental change, and acknowledged the need for realism (and patience).

Now we move into the really important aspects of tax technology, and given our emphasis on keeping this simple, we've broken down the issues into their most fundamental building blocks. Specifically:



Why would you do it? In other words, why do you wish to transform your in-house tax function to be ready to embrace technological change?



What should you do? That is, what types of tax technology do you need in your organisation?



Who should help you to do it? What people will you need?



How should you do it? That is, how should you prioritise between different types of technology solutions, and how should you build a business case to do this?



Does it work in China? These are specific issues to troubleshoot before deploying any tax technology solution to serve your business needs in China.

In the following sections we explore each of these questions in turn.



Section 2

What should you do?

Once you know the answer as to “why” you would choose to embrace technological change in your in-house tax function, you then need to consider “what” you will do. To help to answer this question, we have returned to our four ‘buckets’ or categories of tax technology solutions, and our

aim here is to provide you with insights into some of the tax technology solutions which are available, and aspects which we see as being “core” to your business needs, or “optional” depending upon your specific organisational risks, efficiencies, or business activities.

Category 1 – Automating the tax compliance process

The main purpose of tax compliance solutions are to improve efficiency in generating tax returns as well as the accuracy of those returns.

These kind of solutions leverage data which has already been collected as part of the core business processes carried out by the finance function, namely procure-to-pay, order-to-cash and record-to-report (general ledger accounting). In those processes a variety of data is captured in the ERP system.

Let’s take the example of the order-to-cash process. Sales persons initiate sales orders in respect of the sale of products or services. Information about the nature of these transactions (goods or services) and critical location information such as ‘ship-to’ and ‘ship-from’ countries are captured as part of this process.

ERP systems support these processes and help to automatically calculate (indirect) taxes as well as reporting revenue for CIT purposes on an accruals basis, based on the business characteristics of the transaction. In the case of automated tax determination software, these decisions are made based on what information is captured – for example, the product code or service code may determine the applicable VAT rate, or whether the sale is to be exempted or zero rated. In the case of manual tax decisions, these decisions are based on the level of tax expertise of the users that capture these transactions.

Now getting back to the tax compliance process itself, in order to generate a tax return, the outcomes of the

key business processes relevant for tax are used to map these tax outcomes to the relevant sections / boxes in a tax return. As such, the key features of any tax compliance technology solutions are to: (1) collect the relevant tax information from the various data sources in an organization; and (2) make sure that this information is automatically mapped to the tax return.

The core intelligence of these solutions sits in the underlying logic that bridges relevant tax data with tax return requirements. Furthermore, but we’ll discuss this later as part of Category four below, by deploying appropriate infrastructure or technology components, additional benefits beyond merely automation may be created by means of visualization (to enhance user experience and oversight), central data storage and even workflow.

As mentioned earlier in this publication, it is highly unlikely that tax returns will be generated straight from ERP data, at least for the foreseeable future. This is because of two main factors: (1) the way the data in an ERP system is entered will need to be ‘sliced and diced’ differently from the way it needs to be presented for tax return purposes; and (2) because ERP data is not the sole source of information for tax return purposes – other sources and indeed manual interventions may be needed.

By way of example, in China data such as from Customs or the Golden Tax System is needed for VAT return preparation, and for reporting such as Country-by-Country reports (CbC), employee or Human Resources related

data may be needed. As such, the role of tax compliance solutions are to serve as a channel or funnel to bring together these different data sources, to 'slice and dice' the data in a way which is needed for tax reporting purposes, and to serve as a prompt for any necessary manual adjustment processes.

Another key aspect of high quality tax compliance solutions are the functionality to run "**trend analysis**" by comparing key indicators of the current return against previous periods. If say the total throughput VAT (i.e. the sum of VAT output and VAT inputs) in the current period is significantly higher (>20 percent) than for the previous period or significantly greater than for the comparable period 12 months ago (for seasonal businesses), this might be an indication that something is wrong in the

source data or some unusual transactions have taken place. Similarly, an organisation will want to monitor its effective tax rates for CIT purposes, or its proportion of entertainment expenses to ensure it is properly capturing this information given the propensity for tax authorities to monitor non-compliance.

The core intelligence of tax compliance solutions sits in the underlying logic that bridges relevant tax data with tax return requirements.

A concrete example of a tax compliance solution is **KPMG's Technology Enabled Compliance Solution for Tax**. This solution is a KPMG in-house developed software solution for VAT and CIT compliance purposes developed specifically for the Chinese market. It has all the components described above, generating VAT and CIT returns in four simple steps: (1) data upload, (2) data consistency checks, (3) manual adjustments and (4) return preparation. As part of the fourth step (return preparation), the KPMG solution has trend analysis functionality with 40 (VAT and CIT) key indicators that can be used to identify potential errors, risks or anomalies. And as noted earlier, the tax authorities in China are already deploying similar tools which allow taxpayers to voluntarily check for errors in their CIT returns, through the use of automated tools – see SAT Announcement [2017] 10.

Finally, on the topic of tax compliance solutions, as noted previously it is not simply the ability to produce the final VAT or CIT return which is the end of the process. Consider the other features of KPMG's Technology Enabled Compliance Solution for Tax which highlight the need not only to consider the end product, but also the means to that end, as well as the other interdependencies with other categories of the solution:

Key features of KPMG's tax compliance solution

- **Automated** VAT and Corporate Income Tax returns ready to file, together with **local tax and surcharge calculations**;
- **Flexibility** to be provided as either an outsourced service where returns are prepared by KPMG, or for your in-house use;
- **Trend analysis** which allows you to highlight potential risks, errors or anomalies, before you file the return;
- Interface which can **switch between simplified Chinese and English** at the click of a button;
- **Visibility** over the current status of each return and relevant due dates, with control and approval functionality;
- Data storage flexibility utilizing either the **cloud or within your secure environment**;
- Uploading of invoices validated through the **Golden Tax System**;
- Solution specifically developed for the **Chinese market**;
- Specialist **VAT compliance modules** for complex taxpaying industries such as trusts, funds, and organizations operating in the free trade zone; and
- Dedicated telephone contacts to provide **user support** for your compliance needs.

Category 2 – Solutions which provide greater insights

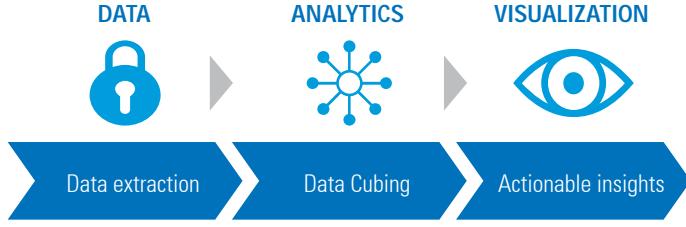
The second category of solutions are those solutions which typically aim to show you data, information or outcomes which you need to know but may not have been able to see before. The main idea here is to **transform data into insights**, which can then deliver value to your organisation.

In the data driven world in which we now live, these solutions potentially have the greatest propensity for growth over the coming years. If you consider the operation of Moore's Law,⁹ which is the observation that the number of transistors in a dense integrated circuit doubles approximately every two years – a theorem which is now routinely applied to data too, then it's axiomatic that the growth of data and therefore the need to be able to analyse it and identify trends or insights from it, will also grow. It is truly amazing how much information and value may be concealed in your data, which can be unlocked if you deploy data and analytics solutions.

Solutions which provide insights into data typically have three main aspects to them:

- (1) **data extraction** – that is, where the data comes from and how it gets into the solution;
- (2) **data transformation** (or cubing) – which we colloquially call 'slicing and dicing', or more accurately, is where the data points are transformed, dissected, amalgamated or cleansed; and
- (3) **data visualization** – this is what you (the user) sees and are able to generate insights from.

Whereas (1) and (3) are mainly components, though very critical, the core intelligence of insights (D&A) solutions is in the data cubing area. This is where the data is transformed into value.



In China the use of these and other ERP systems such as Kingdee, Inspur, Aisino and many other local Chinese systems means there is a need for data extraction to be able to work with virtually any ERP system.

Aspect one – data extraction

An important component of a data insights solution is the availability of sophisticated technologies to facilitate the data extraction process. **Data extraction** is referred to as the process of pulling or obtaining relevant tables and fields from ERP systems, the Golden Tax System, or Customs. As data volumes nowadays are incredibly large, data extraction technologies are essential. The 'old days' of obtaining data through requesting and delivering Excel spreadsheets is well and truly over. If data extraction does not work or takes too much time for the organization's IT department to prepare, insights solutions can simply not be successfully deployed. In other words, data extraction is the foundational component upon which all insights solutions are built. Absent the data, absent the insights!

To take an extreme example, when our KPMG technology leaders recently met with a client from the financial services industry, the client explained that the data to populate their VAT and CIT returns came from 20+ different types of IT systems. This presented many complexities, because the greater the number of systems, the more challenging the extraction process would be. Correspondingly though, the greater the number of systems, the greater the need for insights solutions because their large number of data sources was making normal insights virtually impossible.

Effective data extraction therefore needs to be able to work with **multiple ERP systems**, and in China this process can be complicated further by the fact that there is a much greater variety in the types of ERP systems used by companies in China than in many other countries. For example, across much of Europe and the US, multinational companies will typically use well-known ERP systems such as SAP, Oracle, JD Edwards and similar. Data extraction from these systems will often be pre-configured so that the tax insights solutions can map the data fields from these well-known ERP systems to the tax insights solution. However in China the use of

⁹ Wikipedia, https://en.wikipedia.org/wiki/Moore%27s_law

these and other ERP systems such as Kingdee, Inspur, Aisino and many other local Chinese systems means there is a need for data extraction to be able to work with virtually any ERP system.

Aspect two – data transformation (or cubing)

The data transformation or cubing part is where the various data points are connected to each other so as to build a so-called **tax data warehouse model** which is a model that brings all tax-related data together with the right granularity and a lot of calculated fields that contain critical information, to drive the tax insights solution. As mentioned, this is where the data is transformed, dissected, amalgamated or cleansed. Let's explain what we mean by this.

If you consider a common ERP system may have 50 different data points for every transaction, such as the date the order was placed, the price for the goods or services, the number or quantity or extent of goods or services being sold or purchased, the general ledger account number, details of the seller or buyer, the delivery date, the 'ship from' country, the 'ship to' country and the list goes on. Some of these data points may be relevant for tax purposes for certain insights, but many will not be relevant – so the first objective of data cubing may be to exclude those irrelevant data points for each of the insights which are to be delivered. The second objective may be to aggregate or disaggregate certain data points, or to match different data points from each transaction. Think of it like a very complex series of Excel spreadsheet formulas.

Aspect 3 – data visualization process

This is the end result or product of any insights based solution, and it is what the **user experiences**. Ease of use of any tax insights solution is critical. The tax insights solution needs to be logical, and for those effective solutions, they are often the result of many hours of user acceptance testing, feedback and improvements. It is often said that what makes Apple products so successful in the market is that they are so intuitive, as evidenced by the number of 4 and 5 year old children able to operate products such as iPads and iPhones. Just as these products are intuitive to the user, effective tax technology solutions must be visually appealing, attractive and enticing to the user, and above all else, produce insights which the user can readily see and interpret.

But it is equally important to remember that data visualisation must go hand in hand with proper data extraction and data cubing. For example, we recall seeing for the first time the demonstration of a new tax technology solution developed by a third party software provider – it looked visually very appealing. However, what differentiated those clients without much

technology experience from those with it, is that the former group focused on the 'wow' factor, whereas the latter group focused their questions on the following:

- what data sources did you use in this solution?
- what types of ERP systems can the data be extracted from?
- how is the data cubed?
- what types of analytics tests can be conducted?

It was only after these questions had been asked that it became clear that the software provider had built what was akin to a brand new car, but without building the engine. In short, what they were showing was a fancy presentation but without the underlying extraction and cubing having been built.

So in short, tax insights solutions will only grow in importance to an organisation's tax function as data expands at an incredible pace, as the demands of tax authorities increasingly shift to real-time reporting, and as the multitude of different reporting obligations continue to expand. But the focus as a buyer or user of these tax insights solutions needs to be on not just the ease of visualising insights associated with these solutions, but also their data extraction and cubing capacities.

Effective tax technology solutions must be visually appealing, attractive and enticing to the user, and above all else, produce insights which the user can readily see and interpret.

If you take a look at a typical end-to-end tax process, tax insights solutions will provide insight into the quality and efficiency of the various steps in the process before the compliance process starts. Typical examples of areas where insights solutions can be of benefit include:

- Highlighting the **accuracy of indirect tax calculations**;
- **Calculating actual gross and net margins** on intercompany transactions;
- Providing an overview of actual **supply chains** based on real transactions;
- Determining **business scenarios which are not reported for tax purposes** (but should have been reported);
- **Managing tax residency risks** through the tracking of employee time in various countries;
- Identifying **anomalies in HS codes** used for goods importations for Customs purposes; and
- Finding **indirect tax savings opportunities** due to the usage of wrong tax codes.

An example of a typical insights solution is **KPMG's Tax Intelligence Solution (TIS)**.

TIS is KPMG's global data and analytics solution for tax purposes.

At present, KPMG has developed specific modules of TIS for VAT, Customs, Transfer Pricing and (soon) for CIT purposes in China.



Key features of KPMG's Tax Intelligence Solution (TIS)

General features

- Built with data security in mind, as the data never leaves the organization's premises;
- Availability of industry-leading data extraction tools which minimizes the burden on organization's IT departments when collecting the data;
- TIS has been developed using a 'common data model', meaning that it works for most ERP systems used in China;
- User friendly data visualisation and reporting tools to allow easy manipulation and refinement of outputs;
- Bilingual user interface in simplified Chinese and English.

TIS VAT features

- 50+ available VAT exception reports adapted for China's VAT system including the recent VAT reforms;
- Visibility over VAT throughput, and whether VAT is overpaid, or under-claiming VAT credits;
- Oversight to reconcile invoices recorded in your ERP system and those sent or validated by the Golden Tax System for analysis;
- Oversight over input VAT transferred out as a result of exempt sales or non-creditable purchases;
- Insights in whether organizations comply with China's deemed sales provisions for accounting for VAT on free gifts and other benefits.

TIS Transfer Pricing features

- Provides valuable insights into the global supply chain, by analysing sales and intercompany transactions;
- BEPS13 module enabling data collection for Master File / Local File drafting, as well as for Country-by-Country reporting;
- Operational Margin Analysis: Calculation of gross margin and net margin by legal entity, product group and SKU level;
- Standard exception reports to test for anomalies in net and gross margin calculations.

TIS Customs features

- Identification of irregularities and inconsistencies in the data reported to the China Customs Authorities;
- Insight in supply chain savings opportunities as well as opportunities for process improvements;
- Ability to highlight different areas (valuation, classification or country of origin) that may have led to over payments of customs duty and value-added taxes;
- The ability to analyze trade & customs data on free trade agreements available based on specific trade lanes and identify untapped trade agreement benefits;
- Data visualization and reporting to allow easy manipulation and refinement of relevant trade data topics. (e.g. tariff classification, country of origin, entry type, incoterm, etc.)

Category 3 – Process management solutions

The third category of solutions is usually referred to as “workflow” solutions since the main purpose of these solutions is to create better controls, governance or efficiencies over the completion of work tasks, usually by ‘enforcing’ a process.

During a process a lot of information may be captured and processed by a number of different people. Furthermore, there may be a lot of dependencies between various steps in an end-to-end process. By way of example, the completion of a single tax return may require data to be input by 3-4 different people within an organisation, the tax return may be prepared by one person, reviewed by a second person and ultimately approved by a third person.

In order to facilitate this process, technology solutions may be used. These solutions have modelling capabilities in order to bring in the relevant company-specific process steps, documentation requirements and activity dependencies.

In modern tax functions, process management solutions are being used for:

- **Handling of Research and Development** (R&D) claims (see case study below);
- **Preparation of VAT and CIT returns** (as a component of any tax compliance solution);
- **Transfer Pricing documentation** preparation;
- **Tax invoice handling**; and
- **Global Mobility** process tracking.

In general for all these kind of processes, process management solutions help to **improve the efficiency and transparency of the entire process**. They make sure that information is available on a timely basis and to the right people. The time taken to complete the process may also be reduced because the waiting time due to missing information may be minimized and miscommunication in terms of roles and responsibilities are also clarified.

Workflow management solutions also serve to **better control risks associated with various tax processes**.

For example, the policy of an organization may be that issuing a special VAT invoice higher than RMB 100,000 requires approval from a certain tax manager before issuing it to the customer – a workflow management solution can be used to force these kind of approval steps.

Similarly, company processes which were historically documented and defined using manuals which gathered dust on the shelves can now be embedded into workflow management solutions, so as to ensure clear lines of accountability. An excellent example of this is for companies which deploy the **RACI framework** – this is the framework through which key tax risks or decisions should be assigned based on who is to be “responsible”, “accountable”, “consulted” or “informed”. Now these frameworks can be built into workflow management solutions. User access, approvals or tasks may be assigned to a variety of different users with different profiles (roles and responsibilities).

In practice, we very often see process management solutions combined with compliance or insights solutions, rather than being implemented as stand-alone solutions. In other words, they may be a feature of either Category 1 or Category 2 solutions.



Category 4 – Accessories, components and infrastructure

The last category of tax technology solutions, previously referred to in this article as akin to the “foundation of a house”, are key enablers for all tax technologies. The solutions in categories 1 to 3 simply cannot run without having a proper infrastructure in place to host the technology or to be the visualisation towards the end-user via a user interface.

A key characteristic of any accessories, components or infrastructure is that they are not tax specific in the same way as the core tax intelligence (compliance, insights or process solutions) referred to in categories 1 to 3. Other non-tax technologies used in the business may be able to leverage the same underlying infrastructure, accessories or components.

To use an Apple iPhone analogy, the platform is the iOS that enables all apps (our categories 1-3) to run smoothly and leverage the usage of shared components (storage, visualization libraries etc.)

So in fact this category isn't a solution in itself but rather a part of all the other 3 categories of tax technology solutions, however equally important.

Usually this category contains existing software applications developed by third-party providers, programming language work benches or cloud environments. Let's discuss some specific examples of what types of software are contained this category.

Take the example of a powerful tax insights solution, which needs a **good visualization front-end** in order to make it easy for the end-user to see vast quantities of data, or to identify patterns from that data. Industry-leading Business Intelligence (BI) software providers like Qlik, Tableau or Microsoft have developed applications (QlikView, QlikSense, Tableau or Power BI) that can be used in any tax technology solution. The benefits and importance have already been outlined in the tax insights solution category.

Similarly any tax technology solution that uses data also needs to deal with the process of receiving data and making sure it is loaded into the right format for the solution. The process of moving from obtaining data,

transforming it into a structured format, and then loading it into a database is usually referred to as **Extraction, Transform and Load** (ETL). The ETL process is a very technical process, but critical in the sense that if it isn't done properly, the data engine which contains cubing procedures simply does not work. Once the ETL process has been set-up, usually starting with a one-off definition of the various process steps, it can then be set-up as a repetitive process. This is also an interesting area for the application of Robotics Process Automation (RPA), which is discussed later in Part C of this publication. There are various third-party software solutions available to support the ETL process. The most well-known software applications are Informatica PowerCenter, SAS Data Integration Studio or Oracle Data Integrator.

An important quality criteria for third-party providers of hosting and storage services is to provide an environment which is accessible anytime, anywhere and with virtually no down-time.

A third example is related to infrastructure: **hosting and storage**. Any tax technology solution which is provided on a cloud/online basis, needs to use hosting and storage services. Hosting is effectively an online environment where programs can run. Storage refers to the amount of space that is available in that online environment to store data. Users of technology solutions usually only notice hosting and storage servers when they are not working. For example when the server is “down” and they cannot access their programs and data. Or when there is not enough storage to capture data – i.e. the disk is full.

Therefore, an important quality criteria for third-party providers of hosting and storage services is to provide an environment which is accessible anytime, anywhere and with virtually no down-time. Furthermore they should provide sufficient flexibility to scale-up or scale down in terms of data storage, processing power, etc.

in case there are unexpected increases in data volumes which need to be processed. This is indeed one of the key benefits of using cloud services, because most customers pay cloud providers based on an actual cloud “usage” basis, rather than on a fixed license basis. Some major cloud-service providers on a global scale are Microsoft (Azure), Amazon (Web Services) and Alibaba (Cloud).

Although these examples don't seem to have a lot in common at first sight, the real benefits to support tax technology solutions will arise when you start combining and packaging them into a **platform concept**. The term “platform” is, in our view, an often over-used or mis-used term because people associate the success of many e-commerce giants such as Alibaba and Amazon with them having an effective “platform” and therefore others have often tried to mimic this by describing particular solutions as comprising a platform.

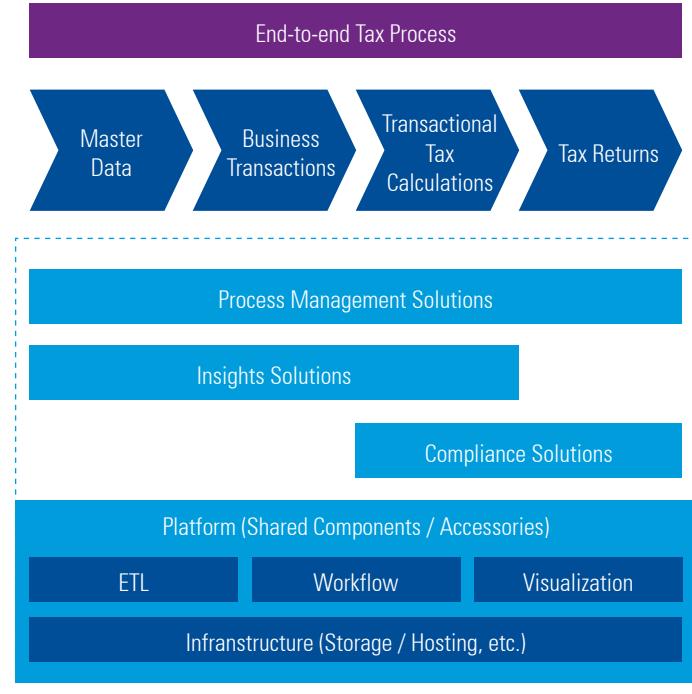
A “platform” is simply the package of solutions, applications or components which all come together effectively for the benefit of its users. The platform may have standard components that may be relevant for each “application”, such as data visualization, ETL, storage, workflow, etc.

The combination of these is what creates a **common platform** on which various solutions (or apps) can then run. With a common platform a lot of benefits can be realized:

- **Uniformity of user experience:** all applications have the same look-and-feel
- **Rapid development and/or deployment of new applications:** components may only need to be set-up once and can be leveraged across new applications
- **Centralization of data storage:** data can be used for multiple purposes across different applications
- **Centralization of user management:** users can access applications via a single login and access is granted based on “need to know, need to have” basis.

So what we have learned is that the accessories, components or infrastructure may not be specific to the tax function, but rather, they typically leverage these within the broader organisation. Their significance is akin to the foundations of a house - they are integral to the success of deploying any tax technology solution.

In the below figure we have outlined a typical client end-to-end tax process and mapped each of our 4 described types of tax technology solutions in order to illustrate where in the process the typical benefits are created.



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