



Time to take stock - 2011 mid-year China tax checklist

Background

Time flies, and we are already in the middle of 2011. The Chinese authorities have issued numerous important tax regulations over the past six months. The State Administration of Taxation (SAT) has provided some guidance on some specific tax issues in respect of tax collection and administration on non-residents, which, to a certain extent, helps reduce the uncertainties surrounding the tax treatment of those issues. The National People's Congress finally adopted an amendment to the Individual Income Tax (IIT) law, which raises the standard monthly deduction from RMB 2,000 to RMB 3,500. Certain Corporate Income Tax (CIT) practical issues such as interest deduction on inter-company loans, deductibility of expenses with supporting documentation pending have also been clarified. To help corporations keep track of these changes and take the necessary action on a timely basis, we set out below a 2011 mid-year China tax checklist.

The checklist below consists of two parts. Part One covers **general tax issues** relating to investment & funding, operation, profit repatriation and business restructuring. Part Two focuses on new developments specific to the relevant industries i.e. **real estates, information, communications and entertainment, energy and natural resources** as well as **leasing**.

When going through the checklist, it is important to note that it does not purport to be an exhaustive list of key China tax and regulatory matters and is not intended to address the circumstances of any particular individual or entity. In addition, there may be variations among local tax authorities regarding the implementation of the rules.

Part One - General

Key points	Action	Effective date	KPMG publications	Y	N	N/A
1.1 Corporate structure						
<u>Gong Shang Wai Qi Zi [2011] No.26 and No.27</u>						
<ul style="list-style-type: none"> All representative offices are required to carry out re-certification with the local offices of State Administration for Industry and Commerce¹ The tax status of representative offices will be subject to close scrutiny 	<ul style="list-style-type: none"> Consider the pros and cons of representative office model and wholly foreign owned enterprise model and decide whether to restructure accordingly 	1 March 2011	China alert, Issue 8, 2011 China alert Issue 4, 2010	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1.2 Investment & funding						
<u>SAT Announcement [2011] No.34</u>						
The taxpayer is required to provide <i>Statement on the Interest Rate Applicable to Loans of the Same Period and Category Made by Financial Institutions</i> to the tax authority in charge when it first pays the interest on inter-company loan and claims the interest deduction for CIT purposes	<ul style="list-style-type: none"> Prepare and submit the supporting claim on interest rates for inter-company loans to tax authorities within the specified timeframe 	1 July 2011	China alert Issue 20, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>Yin Fa [2011] No.145 and Announcement [2009] No.10 issued by six ministries</u>						
Foreign investors may utilise their legally obtained RMB to invest in China	<ul style="list-style-type: none"> Consider taking advantage of the rules of investment in RMB Have relevant documents ready for application for investment in RMB 	3 June 2011 / 1 July 2009	China alert Issue 21, 2011			
<u>Hui Zi Han [2011] No.7</u>						
A CHC may only invest in the subsidiaries in China after it has increased its registered capital accordingly (uncertainties still surround this new rule)	<ul style="list-style-type: none"> Clarify with local tax authorities on the need to pay withholding tax on the "increased" registered capital of a Chinese Holding Company as a result of reinvestment Consider whether it is necessary to restructure investment in China as a result of the new rules 	1 April 2011	China alert Issue 21, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

¹ The deadline for re-certification is 30 June 2011. If it is necessary to extend the time of re-certification process, the completion date should not be later than 31 August 2011.

Key points	Action	Effective date	KPMG publication	Y	N	N/A
1.2 Investment & funding (Cont'd)						
<p>A number of recent successful cases in 2011 have borne out practical effectiveness of Hui Fa [2009] No.49</p> <p>This circular provides guidelines for the establishment and operations of cash pooling in foreign exchange for enterprises and their affiliated members in China</p>	<ul style="list-style-type: none"> Consider taking advantage of cash pooling in foreign exchange within corporation group 	1 November 2009	China alert Issue 88, 2009	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<p>Administrative Measures for Investment of Foreign Investment Enterprises by Equity Contribution (draft)</p> <p>These measures set rules for contributing equity interests in one enterprise as capital of another enterprise</p>	<ul style="list-style-type: none"> Keep close watch on the issuance of final measures Start planning to take advantage of corporate restructuring via equity contribution 	N/A	China alert Issue 15, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1.3 Sales of goods & provision of services						
<p>Cai Zong [2010] No.98 and local circulars</p> <p>All companies and individuals (including foreign investment enterprises (FIEs), foreign enterprises and foreign individuals) shall be subject to the Local Education Levy at a flat rate of two percent of Value Added Tax (VAT), BT and Consumption Tax payable</p>	<ul style="list-style-type: none"> Declare and settle Local Education Levy due 	Effective dates specified in local circulars	PRC Tax Dashboard Issue 3, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<p>Guo Fa [2010] No.35</p> <p>FIEs, foreign enterprises and foreign individuals shall be subject to the UMCT and Education Levy</p>	<ul style="list-style-type: none"> Declare and settle Urban Maintenance and Construction Tax (UMCT) and Education Levy due 	1 December 2010	China alert Issue 15, 2010	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<p>Cai Shui [2011] No.50</p> <ul style="list-style-type: none"> This circular clarifies circumstances under which IIT liability will arise on gifts to customers so that the enterprises have to withhold and remit the tax This circular clarifies how the value of gifts shall be determined for IIT purposes 	<ul style="list-style-type: none"> Assess potential tax exposures of the current sale promotion model Consider adjusting sales promotion model to mitigate potential exposures 	9 June 2011	China alert Issue 19, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Key points	Action	Effective date	KPMG publication	Y	N	N/A
1.4 Assets and expenses						
<u>SAT Announcement [2011] No.25</u>						
<ul style="list-style-type: none"> This announcement has removed the requirement for obtaining prior approval from the tax authorities for deduction of asset losses The reporting requirements are divided into non-itemised reporting and itemised reporting The rule broadens the scope of deductible asset losses 	<ul style="list-style-type: none"> Become familiar with new asset loss claim process and documentation requirements and ensure compliance Prepare detailed relevant accounting and tax information in anticipation of tax audits 	1 January 2011	China alert Issue 13, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>SAT Announcement [2011] No.34</u> Enterprises can provisionally deduct costs and expenses in quarterly CIT filing with documentary support pending, but they should provide the valid support by the end of the annual CIT filing						
	<ul style="list-style-type: none"> Take advantage of the relaxation of deduction rules Make sure valid documentary support for the relevant costs and expenses are provided by 31 May 2012 	1 July 2011	PRC Tax Dashboard Issue 6, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1.5 Human resources						
<u>Sixth Amendment to the IIT Law of the PRC</u>						
<ul style="list-style-type: none"> Standard monthly deduction on employment income is increased from RMB 2,000 to RMB 3,500 Number of brackets is reduced from nine to seven with 15 percent and 40 percent brackets removed 	<ul style="list-style-type: none"> Assess impacts of changes on employment costs Ensure compliance with new rules 	1 September 2011	China alert Issue 16, 2011 China alert Issue 24, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>SAT Announcement [2011] No.28</u>						
<ul style="list-style-type: none"> This circular clarifies the IIT calculation methods where employers agree to bear part of the tax liabilities of the employees in respect of their annual one-off bonus If the employer records the tax borne as items other than wages and salaries, the tax borne will not be deductible for CIT purposes 	<ul style="list-style-type: none"> Review the accounting treatment of the IIT borne for employees to assess risk of non-deduction for CIT purposes Consider the need to change accounting treatment to mitigate exposures 	1 May 2011	China alert Issue 14, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Key points	Action	Effective date	KPMG publication	Y	N	N/A
1.5 Human resources (Cont'd)						
<u>Interim Measures for the Participation of Foreigners Employed in China in the Chinese Social Security System (draft)</u> Foreigners shall make contributions to pension as well as medical, injury, unemployment and maternity insurance schemes in China	<ul style="list-style-type: none"> Keep close watch on the issuance on the final measures Assess the potential social insurance contributions required for expatriates and the impact on totalisation agreement 	N/A	China alert Issue 18, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>Circular on CIT treatment of secondment arrangement (expected to be issued later this year)</u> This circular may clarify circumstances under which a foreign employer will be regarded as having a permanent establishment (PE) in China by virtue of the seconded staff and thus liable for CIT	<ul style="list-style-type: none"> Review the current secondment arrangement to assess the tax exposures Consider whether it is necessary to revise the current secondment arrangement 	N/A		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1.6 Profit repatriation						
<u>SAT Announcement [2011] No.24</u> This circular clarifies the timing and calculation method of the CIT treatment of loan interest, rentals, royalties, capital gains and guarantee fees derived by non-resident enterprises from China	<ul style="list-style-type: none"> Review previous contracts and perform backlog filings, if necessary Take into account potential tax exposures in reviewing future contracts 	1 April 2011	China alert Issue 11, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1.7 Restructuring						
<u>SAT Announcement [2011] No.13</u> If conditions prescribed in Announcement 13 are met, certain corporate restructuring involving the transfer of tangible goods will be regarded as falling outside the scope of VAT (uncertainties still surround this rule)	<ul style="list-style-type: none"> Consider taking advantage of potential VAT relief for corporate restructuring 	1 March 2011	China alert Issue 7, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Key points	Action	Effective date	KPMG publication	Y	N	N/A
1.8 Exit						
<u>SAT Announcement [2011] No.24</u> Announcement 24 clarifies certain aspects of the rules on direct and indirect disposal of the Chinese equity interests by non-resident enterprises	<ul style="list-style-type: none"> Take advantage of simplified notification requirements for offshore indirect disposal under Guo Shui Han [2009] No.698 (Circular 698) 	1 April 2011	China alert Issue 12, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>SAT Announcement [2011] No.34</u> Announcement 34 clarifies the CIT treatment of the withdrawal or reduction of capital	<ul style="list-style-type: none"> Assess the tax implications before the execution of capital withdrawal / reduction Consider the pros and cons of capital withdrawal / reduction vs. share transfer in selecting appropriate exit strategy 	1 July 2011	China alert Issue 22, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>News reports on decision by Shenzhen Local Tax Bureau</u> In this report, the tax authority imposed IIT on individuals making offshore indirect disposal of equity interest in a Chinese company (uncertainties still surround the rules in this case)	<ul style="list-style-type: none"> Consider tax risk of offshore indirect disposal by individuals 	N/A	China alert Issue 17, 2011 China alert Issue 23, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1.9 General compliance						
<u>News reports on TCA</u> Tax authorities in certain cities such as Beijing, Qingdao, Wuxi are reported to have entered into TCA with selected corporations	<ul style="list-style-type: none"> Consider taking advantage of the Tax Compliance Agreement (TCA) regime 	N/A	China - Looking ahead (First Edition) – chapter 3	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Key points	Action	Effective date	KPMG publication	Y	N	N/A
1.10 Tax incentives						
<u>Guo Ke Huo Zi [2011] No.123 and local circulars</u> The re-assessment of the first batch of advanced and new technology enterprises recognised in 2008 has started ²	<ul style="list-style-type: none"> Conduct self-assessment on eligibility for incentives Prepare the relevant documents for re-assessment Consider risk of retrospective recovery of tax for not meeting criteria 	Deadline for submission documents are specified in local circulars		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>National Development and Reform Commission Decree [2011] No.9 Guiding Catalogue on Adjustment to Industrial Structure (2011 version)</u> <u>Foreign Investment Industrial Guiding Catalogue (Draft)</u>	<ul style="list-style-type: none"> Keep close watch of changes regarding investment catalogues and the impacts on tax incentives 	1 June 2011		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
The abovementioned catalogues affect eligibility of corporations for customs duty exemption on imported equipment		N/A		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>Guo Fa [2010] No.9</u> Previous CIT incentives available for qualified domestic enterprises and FIEs in western region shall continue to be effective	<ul style="list-style-type: none"> Keep close watch on the detailed implementation rules to be issued by the Ministry of Finance and SAT 	1 January 2011		<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

² According to the *Audit Results on Tax Collection and Administration of State Tax Authorities* issued by the National Audit Office on 27 June 2011, some previously recognised advanced and new technology enterprises have been found to be not qualified. As a result, tax revenue of RMB 2.665 billion have been / will be recovered from taxpayers.

Part Two - Special industries						
Key points	Action	Effective date	KPMG publication	Y	N	N/A
2.1 Real estates						
<u>Guo Shui Fa [2010] No.53 and local circulars</u> Provisional LAT rates have been increased across China	<ul style="list-style-type: none"> Keep close watch on further adjustments of Provisional Land Appreciation Tax (LAT) rates 	Effective dates as specified in local circulars	PRC Tax Dashboard Issue 2, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2.2 Energy and Natural Resources						
<u>Cai Shui [2010] No.112</u> As a pilot scheme, resource tax in the Western Region is computed based on the amount of sales proceeds from the sales of the oil or gas at the standard tax rate of five percent (as opposed to volume as practised elsewhere in China)	<ul style="list-style-type: none"> Adopt the new calculation method 	1 December 2010	China alert: Energy & Natural Resources Focus Issue 1, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>Guo Ban Fa [2010] No.25, Cai Shui [2010] No.110 and Cai Jian [2010] No.249</u> Qualified Energy Performance Contracting projects are eligible for relevant tax incentives and financial subsidies	<ul style="list-style-type: none"> Take advantage of tax incentives and financial subsidies 	2 April 2010 / 1 January 2011 / 3 June 2010	China alert: Energy & Natural Resources Focus Issue 2, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>SAT Announcement [2011] No.22</u> The provision for abandonment costs made by Oil & Gas companies or the contracting parties in accordance with relevant regulations are deductible in calculating their taxable income for CIT purposes	<ul style="list-style-type: none"> Submit relevant documents on abandonment costs to the tax authority for CIT annual filing and final tax clearance 	21 April 2011	China alert: Energy & Natural Resources Focus Issue 3, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>SAT Announcement [2011] No.26</u> <ul style="list-style-type: none"> Where the enterprises provide for maintenance and safety costs, the provision is not deductible for CIT purposes Maintenance and safety costs actually incurred shall be directly deducted or depreciated / amortised for CIT purposes depending on their nature (i.e. revenue or capital expenditures) 	<ul style="list-style-type: none"> Consider whether tax adjustment shall be made to the maintenance and safety costs in annual CIT filing for the year ended 31 December 2011 	1 May 2011	China alert: Energy & Natural Resources Focus Issue 4, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Key points	Action	Effective date	KPMG publication	Y	N	N/A
2.3 Information, Communications & Entertainment						
<u>Guo Fa [2011] No.4</u> Software and integrated circuit (IC) sectors are eligible for incentives in respect of tax, investment and funding, research and development, imports and exports, industrial talents, intellectual properties and markets.	<ul style="list-style-type: none"> Take advantage of the tax and customs duty incentives 	28 January 2011	China alert: Information, Communications & Entertainment Issue 1, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>General Administration of Customs Announcement [2011] No.30</u> Qualified software and IC enterprises are eligible for import duty and VAT exemptions on relevant imported equipment and parts		12 May 2011	China alert: Information, Communications & Entertainment Issue 2, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2.4 Leasing						
<u>Cai Shui [2011] No.48</u> The circular grants BT exemption to qualified pre-2009 contracts for cross border equipment leasing to the dates on which those contracts expire	<ul style="list-style-type: none"> Lodge a record with the tax authority in charge for obtaining the BT transitional relief by 30 September 2011 Apply for a refund of BT overpaid or over-withheld if it has not been credited by the end of 2011 	1 January 2010	China alert: Financial Service Focus Issue 4, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>Shu Shui Fa [2011] No.88</u> Chinese airlines shall provide customs guarantees when it embarks loan collateralisation and finance lease involving imported aircraft	<ul style="list-style-type: none"> Check the records to make sure belated applications have been made with the customs authorities in charge by 30 June 2011 	1 April 2011	China alert: Financial Service Focus Issue 3, 2011	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<u>SAT Announcement [2010] No.13</u> The "sale" of assets by a lessee in a sale-and-lease back transaction for financing purpose fall outside the scope of either VAT or BT. Hence, it should not be subject to VAT or BT	<ul style="list-style-type: none"> Apply for a refund of taxes overpaid prior to issuance of Announcement 13 	1 October 2010	China alert Issue 13, 2010 PRC Tax Dashboard Issue 14, 2010	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

KPMG observations

The newly issued and forthcoming regulations highlighted in the above checklist can impact significantly on the profitability and cash flow of businesses. Enterprises should, therefore, seriously consider the implications of these regulations for their operations. Given a December year end in China, it is advisable for enterprises to conduct a review on their operations at this time of year to assess their compliance with the new rules, examine whether it has taken advantage of the opportunities presented by the new rules and check their readiness to fulfil their tax filing obligations at the end of the year.

Contact us

Khoonming Ho

Partner in Charge, Tax
China and Hong Kong SAR
Tel. +86 (10) 8508 7082
khoonming.ho@kpmg.com

Beijing/Shenyang

David Ling

Partner in Charge, Tax
Northern China
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Qingdao

Vincent Pang

Tel. +86 (532) 8907 1728
vincent.pang@kpmg.com

Shanghai/Nanjing

Lewis Lu

Partner in Charge, Tax
Central China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Hangzhou

Martin Ng

Tel. +86 (571) 2803 8081
martin.ng@kpmg.com

Chengdu

Anthony Chau

Tel. +86 (28) 8673 3916
anthony.chau@kpmg.com

Guangzhou

Lilly Li

Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Fuzhou/Xiamen

Jean Jin Li

Tel. +86 (592) 2150 888
jean.j.li@kpmg.com

Shenzhen

Eileen Sun

Partner in Charge, Tax
Southern China
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Hong Kong

Karmen Yeung

Tel. +852 2143 8753
karmen.yeung@kpmg.com

Northern China

David Ling

Partner in Charge, Tax
Northern China
Tel. +86 (10) 8508 7083
david.ling@kpmg.com

Vaughn Barber

Tel. +86 (10) 8508 7071
vaughn.barber@kpmg.com

Roger Di

Tel. +86 (10) 8508 7512
roger.di@kpmg.com

John Gu

Tel. +86 (10) 8508 7095
john.gu@kpmg.com

Jonathan Jia

Tel. +86 (10) 8508 7517
jonathan.jia@kpmg.com

Vincent Pang

Tel. +86 (10) 8508 7516
+86 (532) 8907 1728
vincent.pang@kpmg.com

Michael Wong

Tel. +86 (10) 8508 7085
michael.wong@kpmg.com

Irene Yan

Tel. +86 (10) 8508 7508
irene.yan@kpmg.com

Tracy Zhang

Tel. +86 (10) 8508 7509
tracy.h.zhang@kpmg.com

Catherine Zhao

Tel. +86 (10) 8508 7515
catherine.zhao@kpmg.com

Hiroyuki Takahashi

Tel. +86 (10) 8508 7078
hiroyuki.takahashi@kpmg.com

Abe Zhao

Tel. +86 (10) 8508 7096
abe.zhao@kpmg.com

Central China

Lewis Lu

Partner in Charge, Tax
Central China
Tel. +86 (21) 2212 3421
lewis.lu@kpmg.com

Anthony Chau

Tel. +86 (21) 2212 3206
+86 (28) 8673 3916
anthony.chau@kpmg.com

Cheng Chi

Tel. +86 (21) 2212 3433
cheng.chi@kpmg.com

Bolivia Cheung

Tel. +86 (21) 2212 3268
bolivia.cheung@kpmg.com

Dawn Foo

Tel. +86 (21) 2212 3412
dawn.foo@kpmg.com

Chris Ho

Tel. +86 (21) 2212 3406
chris.ho@kpmg.com

Sunny Leung

Tel. +86 (21) 2212 3488
sunny.leung@kpmg.com

Martin Ng

Tel. +86 (21) 2212 2881
+86 (571) 2803 8081
martin.ng@kpmg.com

Yasuhiko Otani

Tel. +86 (21) 2212 3360
yasuhiko.otani@kpmg.com

Grace Xie

Tel. +86 (21) 2212 3422
grace.xie@kpmg.com

Zichong Xu

Tel. +86 (21) 2212 3404
zichong.xu@kpmg.com

Jennifer Weng

Tel. +86 (21) 2212 3431
jennifer.weng@kpmg.com

William Zhang

Tel. +86 (21) 2212 3415
william.zhang@kpmg.com

David Huang

Tel. +86 (21) 2212 3605
david.huang@kpmg.com

Amy Rao

Tel. +86 (21) 2212 3208
amy.rao@kpmg.com

Leonard Zhang

Tel. +86 (21) 2212 3350
leonard.zhang@kpmg.com

Southern China

Eileen Sun

Partner in Charge, Tax
Southern China
Tel. +86 (755) 2547 1188
eileen.gh.sun@kpmg.com

Jean Jin Li

Tel. +86 (755) 2547 1128
+86 (592) 2150 888
jean.j.li@kpmg.com

Jean Ngan Li

Tel. +86 (755) 2547 1198
jean.li@kpmg.com

Lilly Li

Tel. +86 (20) 3813 8999
lilly.li@kpmg.com

Kelly Liao

Tel. +86 (20) 3813 8668
kelly.liao@kpmg.com

Angie Ho

Tel. +86 (755) 2547 1276
angie.ho@kpmg.com

Hong Kong

Ayesha M. Lau

Partner in Charge, Tax
Hong Kong SAR
Tel. +852 2826 7165
ayasha.lau@kpmg.com

Chris Abbiss

Tel. +852 2826 7226
chris.abbiss@kpmg.com

Darren Bowdern

Tel. +852 2826 7166
darren.bowdern@kpmg.com

Alex Capri

Tel. +852 2826 7223
alex.capri@kpmg.com

Barbara Forrest

Tel. +852 2978 8941
barbara.forrest@kpmg.com

Ken Harvey

Tel. +852 2685 7806
ken.harvey@kpmg.com

Nigel Hobler

Tel. +852 2143 8784
nigel.hobler@kpmg.com

Charles Kinsley

Tel. +852 2826 8070
charles.kinsley@kpmg.com

John Kondos

Tel. +852 2685 7457
john.kondos@kpmg.com

Curtis Ng

Tel. +852 2143 8709
curtis.ng@kpmg.com

Kari Pahlman

Tel. +852 2143 8777
kari.pahlman@kpmg.com

John Timpany

Tel. +852 2143 8790
john.timpany@kpmg.com

Jennifer Wong

Tel. +852 2978 8288

jennifer.wong@kpmg.com

Christopher Xing

Tel. +852 2978 8965
christopher.xing@kpmg.com

Karmen Yeung

Tel. +852 2143 8753
karmen.yeung@kpmg.com

kpmg.com/cn

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