



TAX

Proposals to apply VAT to the financial services sector in China

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The Chinese Government is embarking upon an ambitious reform program, which will result in Business Tax (BT) being replaced by a Value Added Tax (VAT) across the entire services sector of the economy. The first phase of the VAT reforms commenced on 1 January 2012 in Shanghai with the introduction of VAT for the transportation and 'modern services' industries, before nationwide expansion on 1 August 2013.

The government is now turning its attention to the financial services sector, with several major Chinese banks recently invited to provide feedback to China's Ministry of Finance (MoF) on the potential impact of VAT on the financial services sector, as well as practical implementation issues that industry will face in the transition to VAT. KPMG is assisting a number of those banks in responding to the MoF, and this report is intended to highlight many of the policy issues being considered.

The introduction of VAT will have a profound impact on the financial services sector both in China and internationally for a number of reasons. First, China's Big 4 domestic banks (Industrial & Commercial Bank of China (ICBC), China Construction Bank (CCB), Agricultural Bank of China (ABC), and Bank of China (BoC)) are all amongst the largest 10 banks in the world by market capitalisation.

Second, the table below (derived from publicly available information) highlights the amount of BT currently paid by these banks, as a percentage of their net profits in China.

	ICBC	CCB	ABC	BoC
Business tax & surcharges (RMB million)	35,066	30,233	25,374	22,925
Net profits (RMB million)	238,691	193,602	145,131	145,522
Business tax & surcharges as a percentage of net profit	14.69%	15.62%	17.48%	15.75%

Source: respective 2012 annual reports

Any variation to either the rate of VAT (when compared with the current BT rate), or the tax base under a VAT (when compared with BT) may have a substantial impact on the profitability of Chinese banks.

Third, financial services are consumed by virtually all individuals and businesses in China. Given that BT is a tax on business, whereas VAT is a tax collected by business but imposed on the end consumer, the transition to VAT will have a wide-ranging economic impact.

Fourth, the financial services sector in China is undergoing significant regulatory change, with a series of steps towards interest rate liberalisation progressing. Furthermore, the percentage of gross revenue from non-interest income in China continues to grow, reflecting the greater diversity and increasing sophistication of the financial services sector in China. The VAT reforms will need to cater for the longer-term impact of these regulatory and commercial changes.

This special VAT publication examines many of the issues that the financial services sector will need to consider in the transition to VAT, based on feedback recently provided by the MoF as well as KPMG's practical experiences in implementing VAT (or GST) for the financial services sector internationally.

This publication is divided into four main issues, which mirror the categories of financial services that are the subject of the study by the MoF. Those categories are:

- Financial intermediation services – e.g. lending, deposit-taking
- Fee-based services – e.g. electronic banking, agency services, settlement services, advisory and consulting services, custody services, asset management
- Other margin-based financial services – e.g. trading in shares, bonds, derivatives, foreign exchange
- General commodities trading services – e.g. precious metals trading.

KPMG has already released a special publication on the VAT issues for the insurance sector - "Proposed Introduction of VAT for the Insurance Sector in China", which you can access [here](#).

Background

Historically, most countries exempt financial services from a VAT based on two main principles:

- 1 **The difficulty in measuring the ‘value added’ to financial services on a transaction-by-transaction basis.** For example, when an individual deposits an amount of RMB 10,000 into a bank and is paid 2 percent per annum interest rate, the bank does not subsequently lend that same fixed sum amount to a borrower at say 5 percent per annum of interest, for precisely the same period of time. In practice, the 3 percent ‘value added’ by the bank in return for its services to each of the borrower and the deposit holder cannot be measured on a transaction-by-transaction basis.
- 2 **Financial services facilitate the buying and selling of goods and services.** The granting of an exemption from VAT recognises that lending and deposit-taking are merely the means by which businesses and individuals fund consumption activities – that is, lending to facilitate the early purchase of goods or services upon which VAT is then levied, and deposit-taking to facilitate the deferred purchase of goods and services upon which VAT is then levied.

The principle of exempting financial services from a VAT has been applied consistently throughout the European Union (EU) which is where VAT emanated from for many years. However, over time, banks have increasingly lobbied internationally to have VAT apply to many of their financial services in preference for exemption. While this may seem a counterintuitive outcome, there are sound reasons for this:

- Under a VAT exemption, the bank is effectively treated as the ‘end consumer’ for VAT purposes, meaning they are unable to claim input VAT credits on their expenses. Consequently, VAT on their expenses is absorbed as part of their cost structure.
- VAT is a tax which is collected by the service provider, but is intended to be passed on to the end consumer. Where a bank charges a fee or provides a service which is subject to VAT, they are better able to pass on the VAT charge to the service recipient where it applies explicitly in a transparent way.
- Where a bank provides a financial service to a business customer who is a general VAT taxpayer, the business customer is ordinarily able to claim an input VAT credit. However, in the situation where a VAT exemption applies, the VAT becomes embedded in the supply chain and acts as a deadweight cost for business.

More recently, countries such as Australia and South Africa have adopted ‘modern VAT’ systems. They differ from the EU system in that they seek to apply VAT to a broader base of services. Over time, these modern VAT systems have increasingly sought to tax many financial services under a VAT.

Moving towards applying VAT in China

Early indications from the MoF suggest that they will be adopting the modern principles of VAT to the system in China, and seeking to apply VAT to many types of financial services. Potentially, the VAT system to be applied to financial services in China may be amongst the broadest in the world.

Summary of principle guiding the MoF

The MoF is seeking, so far as is possible, to apply normal VAT principles to the financial services sector in China. Consequently, the VAT system in China may be influenced by the systems in place in both Australia and South Africa, each of which taxes some financial services. However, there are no major developed economies which tax interest income under a VAT – China would be the first!





Part 1 - Financial intermediation services

As a starting point, it is necessary to give some sense of the size or scale of financial intermediation services in China. KPMG's 2012 Mainland China Banking Survey of 197 banks (representing 88 percent of all banking assets in China) shows that over 80 percent of all revenue derived by the banks in China in 2012 was from interest income. Plainly, the VAT treatment of interest income therefore represents the most significant area of focus.

Currently, interest income derived by the banks in China is subject to BT at the rate of five percent. The tax base applicable to interest income is gross revenue – in other words, no allowance is made for the borrowing costs incurred by the banks in deriving that revenue, or bad debts. While the tax base is gross revenue, both interbank lending and interest paid to deposit holders are exempt from BT.

The reach of the BT system in China is very broad as BT applies if either the lender or the borrower is in mainland China. Consequently, interest on loans made by Chinese banks to consumers and businesses outside of mainland China are subject to BT.

Can 'normal' VAT principles be applied to financial services in China?

By contrast to the breadth of the BT system, internationally there are no OECD countries (of which we are aware) that tax interest income under a normal VAT (or GST equivalent) system. While countries such as Argentina apply VAT to the interest payable on many types of loans (excluding home mortgage loans), and grant input VAT credits to business borrowers, the tax base in Argentina is gross interest income. Israel also taxes financial services under a VAT, but it is computed on the basis of the banks' total wages and profit (in preference to the traditional 'subtraction method' of applying VAT), with no input VAT credits granted to business borrowers. South Africa also taxes many types of financial services, but is still mostly limited to situations where there is an explicit fee or charge, rather than a margin.

What follows from this is that there is little by way of international precedent for taxing financial services under 'normal VAT' principles. Notwithstanding this, the noted academic, Professor Alan Schenk, has devised a series of principles, which could be used to develop a system of taxation of financial intermediation services. A selection of those principles appears below:

Number	Principle	What it would mean if applied in China?
1	VAT should be imposed on the intermediation service component of finance charges on loans, and of interest payments on deposits, with appropriate value allocated to depositors and borrowers.	Interest income derived by banks would be subject to VAT based on the 'value added'. The 'value added', broadly being the interest income received less interest expenses, would need to be divided between the service provided to the borrower (subject to VAT) and the service provided to the depositor (not subject to VAT).
2	The intermediation services rendered by financial institutions should generally be subject to the same tax treatment as other taxable goods or services, whether these financial services are imported, exported, or for domestic consumption.	The export of financial services should be exempt or zero rated, consistent with the way other modern services are treated in Circular Caishui [2013] 37. The import of financial services should be subject to VAT withholding.
3	Businesses rendering taxable financial intermediation services should receive the same VAT treatment of their business inputs on a transaction-by-transaction basis as other businesses making taxable sales.	Financial institutions should be able to claim input VAT credits for their expenses, similar to other businesses making taxable sales.
4	The value of financial intermediation services should be taxed only once – the cascading of VAT should be avoided. Business users of financial services should receive a tax benefit for the actual tax component in the cost of the intermediation services if they use these services in making taxable sales of goods or services, but not if they use these services in making exempt sales.	General VAT taxpayers paying interest on business borrowings should be eligible to claim input VAT credits.

What is interesting about this table is that this is consistent with many of the principles currently being considered by the MoF.

Gross or net basis

One of the critical issues for the financial services sector to consider is whether the tax base under VAT will effectively be the 'gross revenue' derived from lending transactions, or the 'net margin'. In theoretical terms, if VAT is to apply to financial services, then as a 'value added' tax, it should be applied on a net margin basis only. To achieve this, the Chinese Government could adopt one of the following options:

- Allow a 'deemed input VAT credit' for the interest expenses paid by financial institutions to deposit holders – this approach would be comparable to the position which currently applies to the finance leasing sector in Caishui [2013] 37, where loan interest expenses are deductible in calculating output VAT
- Allow either a 'deemed input VAT credit' for the interest expenses paid by financial institutions to other financial institutions (assuming the existing exemption from BT for interbank lending is to continue to apply under a VAT), or allow an actual input VAT credit (if interest on interbank lending is subject to VAT)
- Apply VAT to the gross interest revenue derived by financial institutions, but apply a lower VAT rate which acts as a proxy for the VAT rate on a net margin basis. For example, applying say a 6 percent VAT rate on a gross basis may be equivalent to an 11 percent VAT rate on a net basis.

In theory, financial intermediation services could be taxed under a VAT system on a net or margin basis, effectively adopting a 'cash flow' model to the interest amounts. That is, in each month, a bank would need to calculate the interest income it is entitled to receive, and offset that against the amount of interest expenses it pays to deposit holders and other banks. The difference represents a measure of the 'value added'. Although it must be recognised that this approach does lead to an element of overtaxing because theoretically, the net margin derived by the bank represents the 'value added' for both the services it provides to the borrower, and the services it provides to the deposit holder. Furthermore, the banks incorporate a premium for the risk of default on the loan into the interest rate, and that component should also not attract VAT.

To illustrate how this might work, consider the following example:

Assume the benchmark one-year lending rate is 6 percent, and the one-year deposit rate is 3 percent. If we take the example of a loan of RMB 1,000,000, which is subject to simple interest on an annual basis, at the end of year one, the bank would have:

Interest income 60,000

Interest expense 30,000

If we assume the objective is to maintain the same revenue under VAT as under BT, then the revenue collected under BT currently is:

$5\% \times 60,000 = 3,000$

To convert this to a VAT rate on a net or margin basis, it would be as follows:

$3,000 = \text{VAT rate} \times (60,000 - 30,000) = 10\%$

In other words, in this example a 5 percent BT rate assessed on gross revenue would equate to about a 10 percent VAT rate assessed on a net or margin basis. This is because the interest income rate is twice the interest expense rate in this example. Of course, there are a number of assumptions which underlie this approach, such as net margins being maintained at the same level as present, and the attribution of the entire net margin to the services provided to the borrower. It also ignores the entitlement of both the bank and business borrowers to claim an input VAT credit for their respective expenses.

A further issue with this approach is that it effectively overtaxes by not taking into account the time value of money. That is, when a bank lends money at an interest rate, its real return is reduced by the impact of inflation. The above approach taxes the inflation component of any return.

What is the appropriate VAT rate for financial services in China?

In considering the appropriate VAT rate to apply to financial services in China, it is not simply the case of comparing it with the existing BT rate (being 5 percent). That is because the tax base under a VAT differs from that of a BT, and furthermore, in some cases, the BT liability on financial services applies to gross revenue, while in other cases it applies on a net basis.

Clearly one of the key issues which financial institutions will wish to report to the MoF is the potential VAT impact on its overall tax burden at various VAT rates, or using different methods. Financial modelling is critical to this exercise.

We have set out below some general observations about the likely VAT rate to apply to financial services. Under the current VAT pilot program, the State Council has approved two new VAT rates – 6 percent and 11 percent, along with the existing general VAT rate of 17 percent which already applies to the leasing of tangible movable property. Therefore, assuming that the VAT rates for the financial services sector would be selected from among these alternatives, we have rated the likelihood of each rate being adopted as set out below. It is important to recognise the potential for different VAT rates to apply to different types of financial services.

- **6 percent** - this rate currently applies to the modern services industry. In our experience, it has typically been applied mostly to businesses with a high proportion of labour costs relative to goods or fixed assets used in their business. For example, most businesses in the consulting services industry have a cost structure which comprises labour and rent (currently not subject to VAT) as the two major costs of their business. The higher the proportion of labour and rent to the total costs of the business, the lower the benefit of input VAT credits in transitioning to VAT, at least at present while rent is not within the VAT net. The cost structure of a bank deviates somewhat from that of many consulting businesses, by reason of their expenses in borrowing from third party banks, or in paying interest to deposit holders. Moreover, the investment by banks in their IT systems is substantial. We consider it **possible** that VAT may apply to interest income at the rate of 6 percent (without the benefit of deemed input VAT credits for interest paid to deposit holders). We also consider it **highly likely** that VAT will apply to the activities of trusts, and asset management services at the rate of 6 percent, on the basis that their business model is more akin to that of consulting services.
- **11 percent** - this rate currently applies to the transportation sector, and it is expected to also be applied to several other industries yet to transition to VAT, such as telecommunications and real estate and construction services. We consider it **most likely** that VAT will apply to interest income at the rate of 11 percent, but only where the banks can claim an input VAT credit for the interest paid to other banks, and a deemed input VAT credit for the interest paid to deposit holders.

- **17 percent** - this rate currently applies to finance leasing, although there are a broad range of expenses for which a deemed input VAT credit can be claimed, so as to narrow the tax base. While we consider it **highly unlikely** that VAT will apply to the interest income derived by the banks at the rate of 17 percent, the adoption of a different VAT rate will create an inconsistency with the financing treatment of tangible goods.

This analysis simply highlights the difficulties involved in reliably predicting the VAT rate applicable to the financial services sector.

Impact on end-consumers of financial services

From a consumer perspective, a key issue will be whether the VAT rate and the tax base under VAT will differ from that of the BT system. One imagines that if the overall tax burden is greater for the banks under VAT than under BT, then the banks will seek to pass on all or part of that additional burden to consumers.

One issue which currently arises under the existing BT system is that banks are required to account for BT on the gross revenue which is payable by their customers. Where a bad debt arises, there is no ability to recover the overpaid BT. It is hoped that when the VAT system is introduced, the MoF may consider allowing banks to obtain VAT relief from bad debts.

A further VAT issue which can arise is when a bank repossesses a property, and sells the property to repay the debt. In many countries there are specific VAT provisions, which ensure that the bank is placed in the same position with respect to paying VAT on the sale of the property as if the property had been sold by the individual in default. Once the VAT reforms are extended to the real estate sector, this issue will need to be considered.

Impact on businesses consuming financial services

One of the common problems with VAT exemptions for financial services is that it produces a 'cascading' effect on businesses consuming financial services. That is, the VAT on the inputs of the financial institution effectively becomes embedded as a cost in the supply chain. To alleviate this problem, countries such as New Zealand and Singapore have tried to provide solutions, either by zero rating B2B financial services, or by allowing financial institutions a fixed input VAT credit recovery rate, which is intended to compensate for this effect.

If China is to apply 'normal VAT principles' to financial intermediation services, then this problem of VAT becoming embedded should be largely resolved. The financial institution will provide borrowers who are general VAT taxpayers with special VAT invoices, and those borrowers would then be eligible to claim an input VAT credit.

The sheer volume of banking transactions and therefore special VAT invoices being issued will seriously test the ongoing use of the Golden Tax System. These reforms may provide an important opportunity for the government to reconsider the central function that invoices have in China in administering, and enforcing VAT compliance.

A critical issue which the MoF will need to consider is how the invoicing system would work if the banks are subject to VAT on a net margin basis. Plainly, the borrower cannot be provided with an invoice which shows the net margin because this amount is not calculable by the banks on a transaction-by-transaction basis.

If, however, the borrower is provided with an invoice showing VAT on the gross interest paid, then the borrower would get an input VAT credit which exceeds the output VAT paid by the bank.

Assuming these problems can be overcome, if borrowers who are general VAT taxpayers can claim an input VAT credit, the overall effect should be a reduction in costs of lending/borrowing for both the banks and their business customers. Banks will be generally eligible to claim input VAT credits for their expenses (which was a benefit not previously available); banks will no longer have to factor in the BT cost; and business borrowers will generally be eligible to claim an input VAT credit; so the VAT is not seen as a 'real cost'.

Given these outcomes, pure economic theory suggests that banks should therefore be in a strong position to pass on the VAT cost to business borrowers, given the borrower's ability to claim an input VAT credit. The relative market power of the banks as compared with their business customers would also suggest this outcome should hold true.

Which types of businesses will pay VAT on financial services?

If VAT is to apply to interest income, one critical question is the range of service providers potentially liable to pay VAT on financial services. That is, the extent to which non-banking businesses who engage in providing financial services may be liable for VAT on their interest income. For example, whether VAT will apply to:

- Intra-group lending activities
- The shadow banking sector in China
- Goods or services supplied on credit terms, where interest is payable for late payment
- Related party loans, such as between individuals.

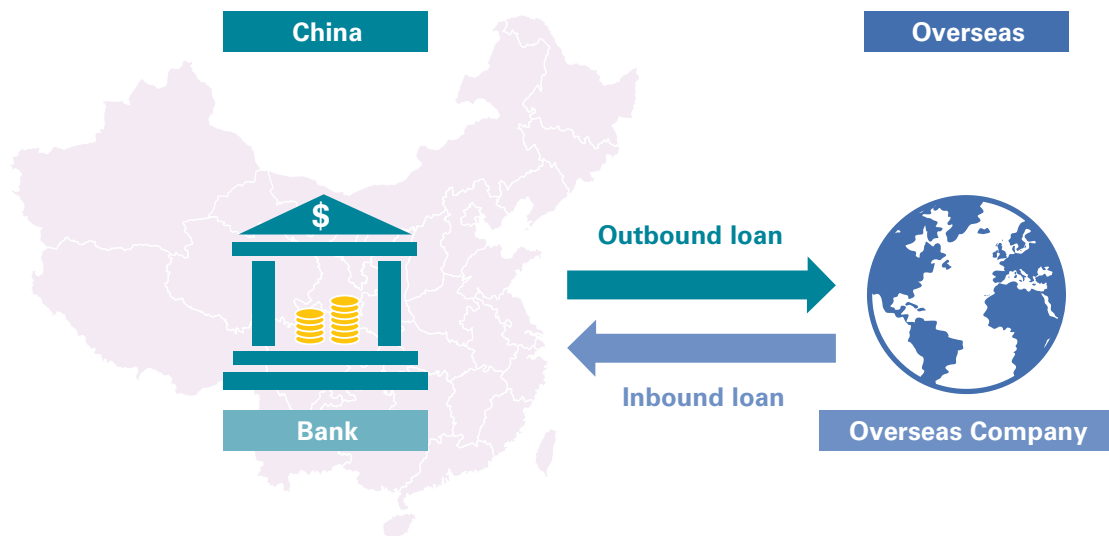
Cross-border lending

The VAT treatment of cross-border transactions is an important area for consideration. It is important because there is the potential for market distortions in the form of either tax advantages, or tax disadvantages, in financial institutions purchasing services from abroad, or in providing financial services to overseas parties.

We have separately dealt with the treatment of services acquired by financial institutions in China from abroad, as compared with financial services provided by financial institutions in China to abroad.

While the export of financial services from China is currently insignificant (in relative terms), the recent globalisation of Chinese financial institutions means that this issue will become much more significant in the near future. Furthermore, the VAT policies governing exported financial services need to contain the ingredients to promote that future growth.

Interest income from cross-border lending



- Outbound loans - if not zero rated or exempt from VAT, may place Chinese banks at a commercial disadvantage relative to foreign banks
- Inbound loans - if VAT withholding applies, the Chinese banks would withhold VAT, and also be eligible to claim an input VAT credit

Financial services provided by overseas lenders to borrowers in China

Under the VAT pilot program, if services are acquired from overseas entities by a business in China, then the VAT liability must be withheld either by an agent or the business purchaser.

There are reasons why this treatment may also be applied to financial services provided from overseas into China. Otherwise, borrowers in China will potentially be advantaged by acquiring financial services from overseas (where VAT would typically not apply), as compared with acquiring services domestically. In this regard we note that the VAT withholding rules work similarly, but not identically to, the reverse charge rules which operate in a number of countries.

If VAT is to be withheld by the Chinese banks borrowing from overseas, then it will be necessary for the overseas lender to include VAT 'gross up' provisions in the loan contracts. Where the Chinese bank is eligible to claim an input VAT credit, the position should be revenue neutral for both parties.

One issue which would arise from this approach is whether interest withholding taxes would be assessed on the VAT-inclusive interest paid by the borrower, or the VAT-exclusive interest. A comparable situation arose previously in relation to the aircraft leasing industry, with SAT Announcement 9 of 2013 ruling that VAT amounts should be excluded from the calculation of Corporate Income Tax (CIT) withholding on rent and royalties.

Financial services provided by banks in China to overseas

The flipside is that where financial institutions in China provide financial services to overseas entities, i.e. an export of services, then these services should be zero rated. The zero rating of exported financial services is generally consistent with international practice. The reason why this is considered necessary is to ensure that the export of financial services by Chinese financial institutions is internationally competitive.

Even if zero rating cannot occur, then at the very least, financial services which are exported should be eligible for exemption from VAT, in much the same way as various modern services under the pilot program are eligible for exemption, as set out in Circular Caishui [2013] 37 and SAT Announcement 52 of 2013.

The difficulty introduced by only allowing for VAT exemption, instead of VAT zero rating, is that the banks in China would need to apportion or 'transfer out' their related input VAT credits.

Simplified VAT method

At an earlier stage of the VAT reform process, the government was considering applying a 'simplified VAT method' to financial services. Under this method, the following would have applied:

- Financial institutions would have been liable for output VAT in respect of their services
- Businesses purchasing financial services would not have been eligible to claim input VAT credits for the services they purchased, (e.g. interest expenses would not have been eligible for input VAT credits)
- Financial institutions would not have been eligible to claim input VAT credits for the expenses they incurred.

In effect, the simplified VAT method would have applied many of the same features of the current BT system. Given that the VAT reforms are being implemented to remove tax cascading and other inefficiencies arising under the BT system, then the adoption of a simplified VAT method would have undermined those efforts.

Based on recent discussions with the MoF, the simplified VAT method now seems less likely to be implemented.

Other VAT methods – exemption or zero rating

While VAT exemption is the most common system applicable internationally, the prospect of it being applied in China seems highly unlikely. Put simply, there would be a significant loss of government revenue given that BT is currently collected in relation to the provision of most financial services in China.

For similar reasons, VAT zero rating may not be considered as a likely scenario in China. What is interesting to consider is the potential impact the VAT treatment of financial services may have on the international competitiveness of the financial sector in China. Given recent government proposals to establish a free trade zone in Shanghai, which is the financial services hub in China, the importance of any VAT liability being creditable to businesses that borrow, will be critical to its success. The prospect of VAT being embedded as a real cost to business may seriously affect its competitiveness relative to other locations such as Hong Kong, London and New York.



Part 2 – Fee-based services

BT currently applies to the provision of most financial services, which are remunerated on the basis of a 'fee'. When referring to fee-based services, this would include situations not only where a fixed amount of remuneration is payable, but also where a commission or contingent amount may be payable.

From a VAT perspective, a number of jurisdictions currently exempt many fee-based financial services from a VAT. The basis upon which they are exempted from a VAT is that they are treated as services involving 'arranging' financial services. A theoretical basis for their exemption lies in the fact that if margin-based financial services are exempt from VAT, then applying VAT to fee-based services can lead to a cascading of tax. Alternatively, it can lead to a situation where the form in which the service provider is remunerated may dictate the VAT treatment, rather than the underlying nature of the service being provided. One of the problems with VAT exemptions for 'arranging' financial services is where to precisely draw the line between those services which are exempt, and those which are not. For example, if an investment bank assists in advising on an IPO, this may be regarded as an 'arranging' service; however, the services of the lawyers or accountants who also act in relation to the sale may not be similarly treated.

Notwithstanding these challenges, countries such as Australia and South Africa have generally moved towards taxing many fee-based financial services from a VAT. In Australia, this is done by provisions which tax 'financial supply facilitators', and exempt 'financial supply providers'. In South Africa, it is done by taxing explicit fee-based services, and exempting margin-based services.

From the perspective of the reforms taking place in China, the inherent nature of many of these fee-based services is that they share strong similarities with the consulting services industry, which is subject to VAT at the rate of 6 percent. The similarity they share is that the essential nature of what is provided to the customer is a service of advising, managing or assisting the customer in a transaction, in return for which a fee is paid. Typically, the service provider will not be the 'risk

taker' in the transaction, such that they do not have ownership of the underlying financial product or transaction taking place. Given that the major costs of businesses providing these advisory-type services typically consist of salaries or wages of personnel, and rental of office premises, there are good policy reasons for VAT being applied at the same rate as consulting services, namely 6 percent. If a different (higher) rate is chosen, the likelihood is that there will be very real classification difficulties in distinguishing these services from normal consulting services.

Below we have outlined some brief commentary in relation to the likely VAT treatment applicable to different types of advisory type service providers in the financial services sector. The likely VAT treatment is based on the principle that the MoF will be seeking to apply 'normal VAT principles' to the financial services sector, in so far as this may practically be implemented.

From a regulatory perspective, it is important to note that trusts, asset management and brokerage services are ordinarily conducted by non-banking financial institutions in China, which are regulated by the China Securities Regulatory Commission (CSRC).

Electronic banking

The use of electronic banking facilities such as ATMs can attract fees to customers. For example, if a customer of one bank uses their card to withdraw cash from an ATM of another bank, the customer may be charged a fee. Some of the complexities in this area include:

- The customer may hold a card issued by Chinese Bank A, and be charged a fee by Chinese Bank B (debited from the bank account held with Chinese Bank A) for using Chinese Bank B's ATM
- The customer may hold a card issued by Chinese Bank A, and be charged a fee by Foreign Bank C (debited from the bank account held with Chinese Bank A) for using Foreign Bank C's ATM located outside of mainland China.

Some of the issues this raises are whether the supply of the ATM service is provided by the bank to the customer, or by the bank to another bank. Where the ATM used by the customer to withdraw funds is outside of mainland China, it may be argued that the service is effectively consumed outside of mainland China and therefore should not be subject to VAT.

One question which is raised by the MoF's reference to electronic banking services is whether they also intend for VAT to apply to other banking services for which specific fees or charges are payable, e.g., if a bank charges a fee for using a credit card; a fee for a dishonoured payment; a fee for opening or closing a bank account; or a fee for facilitating a foreign exchange transaction. The approach of applying VAT to explicit fee-based products in the banking sector is used in South Africa, and its implementation in China would certainly go some way towards achieving the objective of having VAT apply to as many different types of financial services as is practicable.

Asset management services

Asset managers provide their services to a range of investors. The essential nature of their services is an advisory service. While they may assist in executing the relevant transactions, they do so for the benefit of the investors.

Similar to the position in Australia, VAT may be readily applied to the provision of asset management services. The asset manager may be remunerated in the form of a fixed fee, percentage fee, or bonus entitlement, which is dependent upon the performance of the underlying investments they are managing. The key to understanding the VAT treatment is to focus on the characterisation of the service, rather than the specific fee being charged.

The asset manager would remit output VAT in relation to their services. Where their service is provided to a general VAT taxpayer, a special VAT invoice may be provided. A problem which can arise is where the investor is trading in financial products, which are exempt from VAT. In that situation, the payment of the asset management fee by the investor would not ordinarily be creditable for VAT purposes. This can lead to a cascading of VAT.

Some asset managers may be remunerated in the form of a carried interest. One of the difficulties this raises is whether the carried interest is simply to be treated as additional remuneration for their services (and subject to VAT), or as a financial product in its own right (and ordinarily not subject to VAT).

Trust services

The trust industry in China is, relative to many common law countries, in its infancy. The essence of a trust is that it is a relationship between trust property (i.e. assets), a trustee (i.e. an entity who holds the trust property), and beneficiaries (i.e. the persons for whose benefit the trust property is held).

Australia's tax system effectively treats a trust as a separate entity, which can register as a taxpayer, pay output tax and claim input credits for its expenses. This fiction is necessary to ensure that the management fees and other forms of remuneration payable to the trustee company for its services in managing the trust's assets are subject to VAT. Likewise, it ensures that when the trust buys assets, those investors in the trust effectively get the benefit of the input VAT credits, and similarly when the trust sells assets, those investors bear the liability to pay output VAT. In the absence of these rules, a trustee company acting as trustee for numerous trusts could mix all of the output VAT, and all of the input VAT together, which may benefit some investors to the detriment of others.

There is currently a degree of uncertainty about whether BT applies to trusts in China, and if so, how. The introduction of the VAT provides a means by which many of these uncertainties may be resolved. Potentially, these reforms may increase the indirect tax burden for trusts, which may impact on the future growth and increased sophistication of the trust industry in China.

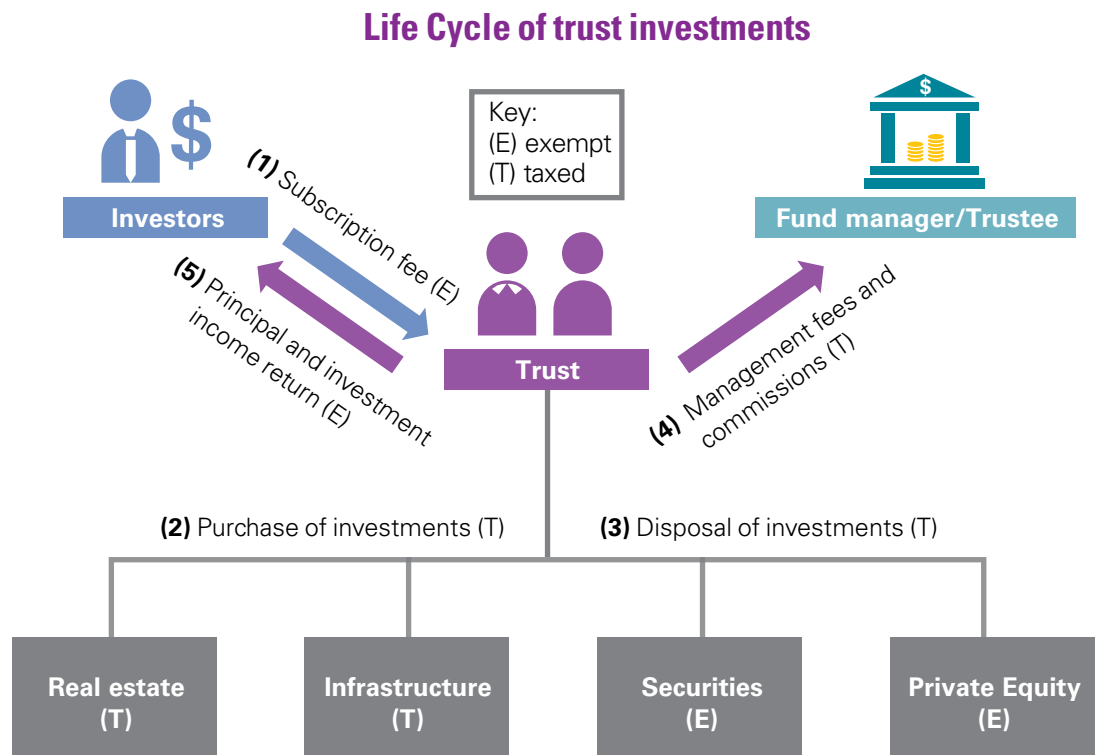
If a trust is to be treated as a separate VAT taxpayer in China, then this would pose administrative challenges for trustee companies – they have to maintain separate VAT registrations for each trust they manage, prepare separate VAT filings for each trust, and perhaps most significantly, differentiate expenses, obtain special VAT invoices and claim input VAT credits appropriately for each trust. The Australian experience has highlighted some of the challenges trustee companies face in ensuring invoices are appropriately addressed to the trust which has actually

incurred the relevant expense, and in differentiating between expenses of the trust company in its own right, and those of the trust for which it is acting. The regulatory nature of the invoicing system in China suggests these challenges may be even greater still.

While the MoF may be seeking to apply VAT to as broad a range of financial services as is possible, some exclusions for trusts are necessary. For example:

- When an investor contributes funds to invest in a trust, VAT should not apply. A VAT is, as its name suggests, a 'value added tax', not a wealth tax
- When an investor receives distributions of income from the trust, such as rental income, VAT should not apply. If the trust has already paid output VAT on the rental income, double tax would apply if the investors are again required to account for VAT. Similarly, if dividends and interest on deposits are exempt from VAT, that exemption also needs to apply to the distribution of those amounts to investors
- When the trust's assets are sold and the investors receive a distribution on winding up of the trust (or the exit from their investment), no VAT should apply. That is because the trust should already be accounting for VAT on the disposal of the underlying assets of the trust.

The diagram below highlights many of the money flows commonly applied in the trust sector, and the suggested VAT treatment:



Agency and brokerage services

Agents are often employed to facilitate the sale of financial services. For example, an agent may assist in selling insurance products. The agent may be remunerated either by way of a fixed amount, or a percentage of the sale price of the products sold.

An important issue is to recognise that the agent is typically not a party to the underlying financial transaction in its own right. For example, the agent does not have an ownership interest in the insurance product being sold. Consequently, from a VAT perspective, the only revenue which should be included in the VAT return of an agent is the fee or commission income they derive.

Brokerage services are similar in that a broker may charge a fee or commission for undertaking a trade in a financial product. Again, the broker is not the seller or the buyer of the financial product itself – instead, the broker's role is to facilitate the transaction for the benefit of the seller or the buyer. The fee they collect for facilitating the financial transaction can be subject to normal VAT principles.

Similar to the position of other advisory services, it is submitted that the most appropriate VAT rate for these services provided by general VAT taxpayers would be 6 percent. That is because their cost structure would be similar to that of other consulting services businesses, and the nature of their services is also very similar. In practice, many agents or brokers may be regarded as small scale VAT taxpayers, in which case a 3 percent VAT rate assessed on a gross revenue basis would apply.

Two practical issues commonly arise in relation to the activities of agents and brokers under a VAT. First, an agent or broker may provide their services to one party, but be paid for their services by another party. For example, an insurance agent may be engaged by a customer to identify and recommend appropriate insurance policies, but then their commission is paid by the insurer whose policy the customer ultimately buys. Second, agents or brokers are often on the 'front line' in terms of service delivery for the principals they represent. In many VAT systems around the world, the agent or broker is entitled to issue special VAT invoices on behalf of the principal they represent, as though it was an invoice of the principal. In China, this may be challenging to apply given the strict regulation of invoices.

Advisory and consulting services

General advisory services can take many different forms, e.g., in advising a company about to undertake an IPO or a financial advisor recommending specific financial products. In either case, the nature of the service is similar to that of a consulting service.

Under the VAT pilot program, consultancy services are currently subject to a 6 percent VAT rate. Consistency of treatment should result in advisory services also being subject to a 6 percent VAT rate. This rate should apply to advisory services provided in return for a specific fee, as well as services provided for commission.





Part 3 – Other margin-based financial services

The types of financial services which are included as part of this category include Treasury bonds and other bonds, foreign exchange transactions, and financial derivatives, including trading in securities.

Each of these financial services typically (but not necessarily exclusively) derive revenue from the margin between the buy and sell price.

Current BT system

Under the BT system, gains from trading activities (e.g. listed shares), as compared with investment activities (e.g. private equity), are subject to BT on a net or margin basis, based on Circular Caishui [2002] 191. Gains from such trading activities must be separated into one of four different categories, as follows:

- (1) Shares
- (2) Bonds
- (3) Foreign exchange
- (4) Other.

Importantly, for those financial products which fall within one of the above categories, any gains or losses must be segregated within those categories. A gain may only be offset against a loss from the same category of financial product within the same income year, although from 1 December 2013, this policy has been repealed by SAT Announcement 63 of 2013. From 1 December 2013 onwards, gains and losses within the same year may be offset between different categories.

The principle of applying BT on the gains derived from trading in these types of financial products is readily achievable. BT is a tax which is imposed on business, such that if the business derives a gain, it has a liability to pay the tax at the time of disposal. It is not a tax which is creditable to a purchaser. Consequently, the

residency status of the counterparty is irrelevant to the seller's liability to pay BT. Similarly, if a business purchases a financial asset from an individual, the fact that the individual may not be a BT taxpayer is irrelevant in determining the margin on a later disposal by that business.

Challenges in applying VAT

The problem with applying VAT to many financial products like derivatives is that the fundamental nature of a VAT is quite different from that of BT. VAT is a tax where the liability has implications for both the seller and the buyer (in terms of input VAT credits), whereas BT is a turnover tax where the liability solely rests with the seller.

From a policy perspective, VAT is a tax which is intended to apply to consumption; not the gross price of the financial instrument. As Professor Schenk notes¹:

“For most transactions involving the transfer of financial instruments, the supply of the principal of the instrument is not includible in the tax base. That transfer is merely the transfer of purchasing power, not the exercise of the purchasing power to acquire goods or services.”

Putting aside these matters of policy, from an administrative perspective, the application of VAT would also present challenges. For example, if a VAT was to apply, the seller of a financial product would need to determine the residency status of the counterparty, so as to determine whether the sale is exempt or zero rated. Similarly, a buyer of a financial product would need to know the VAT registration status of the seller, so as to know whether a special VAT invoice can be provided and an input VAT credit claimed. For financial products traded on exchanges, the VAT treatment may be a matter of chance rather than good policy design.

The existing BT methodology of separating financial products into four categories, and then restricting the ability to carry forward losses, is also particularly ill-suited to apply in a VAT context. It gives rise to significant compliance costs in identifying the appropriate category of financial product, particularly where new financial derivatives are being created regularly.

All of this may be taken to suggest that there are very real challenges in applying VAT to financial products. Internationally, the vast majority of countries exempt trading in margin-based financial products from a VAT. Put simply, the imposition of VAT may seriously impact the efficient operation of capital markets.

Notwithstanding these challenges, the closest analogy to how this is done internationally is in the VAT treatment of second-hand goods sales. Businesses that buy and sell second-hand goods are often faced with the problem that buying from private individuals means that no input VAT credit can be claimed for the purchase, whereas buying from other businesses means that an input VAT credit may be available. To ensure that distortions in decision-making do not arise, some countries effectively tax the 'margin' on the sale of second-hand goods by dealers.

¹ Schenk, "Taxation of Financial Services (including insurance) under a United States Value Added Tax", 2009.

The way this could be achieved in relation to trading in financial products is:

- VAT would be payable only at the time of the sale of financial products. The output VAT liability would be computed on the basis of the difference between the sale price and the purchase price. In effect, a 'deemed input VAT credit' would be claimed on the purchase price, but only at the time of disposal
- The VAT liability would be payable where the seller is a general VAT taxpayer (or small scale taxpayer), and the status of the counterparty is irrelevant – in other words, if the counterparty is outside of China, VAT would still be payable by the seller if they are in China
- If the seller of the financial product is a private individual, no VAT would be payable
- Given that VAT is typically accounted for on a monthly basis, the approach of segregating gains or losses into different categories would no longer apply.

While this may be technically achievable, there are still some fundamental problems with it. First, VAT is not intended as a tax on business – rather, it is a tax collected by business, but imposed on the end consumer. The above approach effectively taxes the profit or 'value added' by the business, but it is not creditable to the counterparty nor can it be passed on to the end consumer. Second, the VAT invoicing system in China is heavily regulated through the Golden Tax System. The type of documentation needed to claim a deemed input VAT credit may be difficult to provide, and could seriously impact on the efficient operation of capital markets.

In short, the MoF still faces enormous challenges if it wishes to apply VAT to trading in financial products.





Part 4 – General commodities trading services

Commercially, commodities such as precious metals can be traded in their physical form as a consumer good, or as an investment asset, such as in futures contracts. In most VAT systems internationally, there is a need to distinguish the VAT treatment applicable to precious metals as a consumer good (where VAT applies) as compared with its use as an investment asset (where exemption from VAT applies).

The suggested position in China is that the VAT treatment should be consistent with this general treatment internationally for the following reasons:

- Commodities are often traded on international markets, so there is a need for consistency in treatment
- Commodities traded in circumstances where there is no physical delivery are simply a form of an investment asset, and applying VAT to them would be inconsistent with the essential nature of VAT as a consumption tax
- If VAT applies to the sale of commodities with physical delivery, then there is an element of double taxation in also selling commodities in their investment state.

General issues affecting all financial services

In this section of our report, we examine a range of issues which potentially impact all businesses engaged in providing or advising on financial services in China. This list is by no means exhaustive.

IT systems and invoicing issues

Plainly, one of the biggest challenges in implementing the VAT reforms for the financial services sector in China is the application of the Golden Tax System. That is, the regulated invoicing system which governs how output VAT is accounted for, and input VAT credits claimed.

To an international audience, it is difficult to overstate the importance of the invoicing system in China. At the risk of oversimplification, it may be summarised as follows:

- Businesses may only issue special VAT invoices on machines which are purchased from providers approved by the government – those machines are ‘standalone’ machines, which are separate from the IT or accounting systems used by businesses
- Invoices issued through these machines are recorded on an IC card, and the data is transmitted to the tax authorities, and used to reconcile with the output VAT recorded by the business in its VAT filings
- Special VAT invoices must be purchased from the government, and the number of invoices which may be issued by a business, and their maximum value, are strictly regulated. They also contain a number of fraud prevention controls
- Businesses that are general VAT taxpayers in receipt of special VAT invoices may only claim an input VAT credit where the invoice is ‘validated’ with the tax authorities. This process effectively confirms that the invoice is valid and has not been fraudulently issued. In the absence of a special VAT invoice, no input VAT credit may be claimed. The loss of special VAT invoices, or the failure to obtain one, is ordinarily fatal to any claim for an input VAT credit.

This process, when put together, has had the practical effect of elevating ‘form’ over ‘substance’ – that is, if the ‘form’ of an invoice meets the strict requirements, then the addressee of that invoice can ordinarily claim an input VAT credit. Other evidence which may demonstrate the underlying commercial ‘substance’ of the transaction is of secondary importance only.

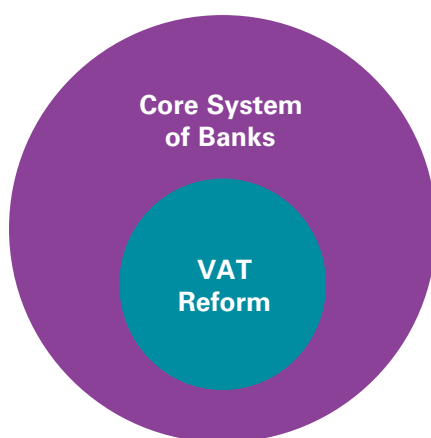
The process of issuing special VAT invoices is highly manually oriented. Concepts of e-invoicing are yet to take hold in any meaningful way in China. Each branch of a business will be required to purchase machines for issuing special VAT invoices, as well as the invoices themselves. Where transactions are later reversed, or the price subsequently adjusted, there is an even more onerous process of issuing ‘red letter’ invoices to effectively correct the VAT treatment based on what actually occurred.

Given the sheer volume and scale of transactions in the financial services industry, the scope of the invoicing issues which must be addressed by the major industry participants is breathtaking. The need to implement controls over invoicing; the amount of data entry required to correctly issue invoices to eligible customers; and the reconciliations required between the Golden Tax System and a company’s own IT systems, are all significant implementation issues of themselves.

Impacts on the IT system

Objective

Identify different parts of the core IT systems of the banks and what may change



Challenge

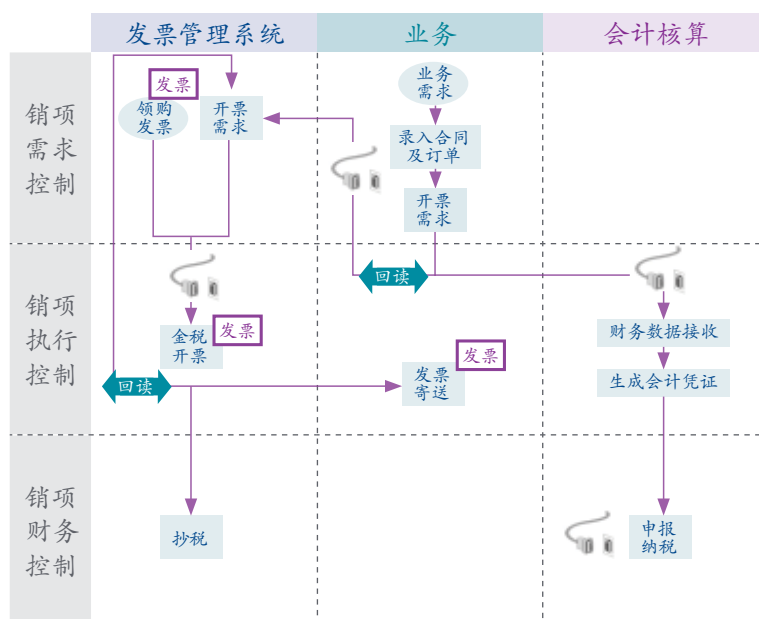
- **1: Impact on IT systems are difficult to address**
 - Uncertainties in the VAT treatment make it difficult to commence with changes. However, should start to identify:
 1. Which part of the system requires revision
 2. How to recognise different income, different tax rates, and how to build an input tax allocation system
 - Which business flows would need to be revised in order to meet the system needs?
- **2: How to improve client and vendor system**
 - How flexible is the current client/vendor system? Need to revise procurement, invoice model?
- **3: Time constraints**
 - Precise system changes need precise policies. However, system changes may require 3 to 5 months. How to ensure a smooth transition to VAT is a great challenge

While there is little prospect of the Golden Tax System being revised in the short-term, one avenue the MoF and the SAT should seriously consider is the introduction of electronic invoicing (or e-invoicing). The concept of e-invoicing is gaining traction in a number of jurisdictions around the world, both in response to the growth of e-commerce and globalisation, and because of the increased emphasis on technology in efficiently managing indirect taxes.

We submit that the financial services sector would be a welcome starting point for such reforms. The financial services sector already invests significantly in data security and in the use of technology to provide services to their customers – electronic banking is an obvious example. Given the investment in data security which is already a hallmark of the financial services sector, the introduction of e-invoicing for this sector in China would be a logical starting point. Until then, the administration of the existing manually driven paper oriented invoicing system remains one of the biggest impediments and costs to the financial services sector in implementing the VAT reforms.

Impacts on VAT invoice administration

VAT invoice control flow (sample)



Challenge

- 1: Controls over whole invoicing system**
 - Manage VAT invoice lifecycle with banking industry features taken into account, and need to confirm invoicing process including obtaining invoices, issuing invoices, voiding invoices, issuing 'red-letter' invoices
 - For the purchase of financial instruments (if using normal VAT method), need to confirm the lifecycle of input tax invoice management, including obtaining, transferring, verifying, rejection of invoices
- 2: How to link the business system to the Golden Tax System**
- 3: It is a big challenge to address the large volume of issuance and verification of special VAT invoices in order to ensure compliance**

Grandfathering relief

One of the critical issues affecting the financial services sector will be in relation to the transition to VAT. For example, whether VAT will apply to interest payments made under a loan contract entered into prior to the commencement of VAT. Alternatively, whether VAT would apply to a margin-based product where the product was purchased under BT, but later disposed of under VAT. Unless these complex issues are resolved carefully, the potential exists either for financial services providers to bear irrecoverable VAT, or for the same transaction to be subject to VAT on a gross sale basis, rather than a margin basis.

Recent history with the VAT reforms suggests that broadly based grandfathering relief is unlikely to be provided. Furthermore, recent history also suggests that the timeframe between the announcement of the VAT rules, and their implementation, is likely to be extremely short.

Put simply, financial services providers need to ensure that they factor VAT into transactions being contemplated now, even though the implementation of VAT may still be over 12 months away. The financial services industry needs to be carefully considering how VAT will impact on their pricing, and on their contracts, now. Failure to do so may result in VAT being an irrecoverable cost.

Consolidated filing, central procurement

In a number of industries, large businesses are often structured with senior management and significant finance and other back office functions centrally located at headquarters. Those staff may also fulfil the role of centrally procuring IT systems, and other major expenditure for the benefit of the corporate group. This process ensures consistency between the operations of the group, as well as cost savings obtained through the scale of any purchases. The financial services sector is no exception.

From a VAT perspective, in China, registration for VAT purposes typically takes place at the branch level. That is, each branch and the respective headquarter are treated as a separate VAT taxpayer. Where a branch has input VAT exceeding its output VAT, such a loss cannot generally be refunded. Instead, the loss may be carried forward indefinitely, and used to offset output VAT.

For businesses with significant back office functions that are centrally located, or with central procurement functions, the problem from a VAT perspective is that the input VAT credit balances may be trapped at the headquarter level, and cannot be offset against the output VAT balances of the branches. This is inefficient. To overcome this problem, the MoF and the SAT have already introduced principles which allow for VAT filing on a consolidated basis. These principles have recently been implemented for the airline industry, including between different legal entities in an airline group, and it is hoped that they will be similarly extended to the financial services sector as part of these reforms. One issue that requires consideration is the impact of allowing VAT consolidation or grouping on the revenues of local governments. The likelihood is that consolidated filing will result in more VAT being paid in first tier cities such as Shanghai and Beijing, and less in other cities and provinces.

Input VAT credit allocation

While the MoF's objective may be to tax as many financial services as is possible, the reality is that not all financial services will be subject to VAT. Inevitably, some financial services such as exported services, securities trading, and some other margin-based financial products are likely to be exempt from VAT.

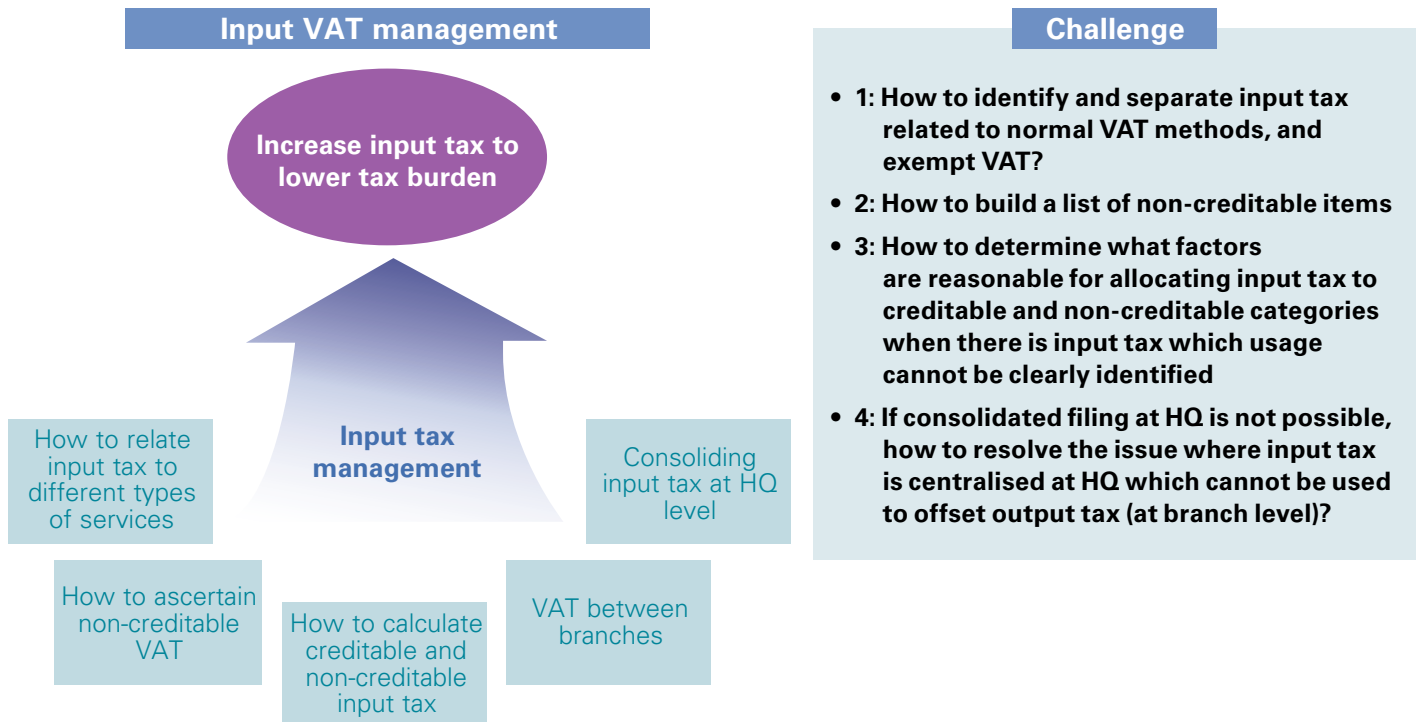
In many VAT systems around the world, one of the most complex and time-consuming issues for financial institutions is in appropriately allocating their input VAT credits between those activities which are subject to VAT (or zero rated), and those which qualify for exemption from VAT. Part of the challenge is that many costs and expenses incurred by financial institutions serve multiple purposes, e.g., overhead costs such as office rental and IT systems.

Many large financial institutions employ large in-house teams or external advisers to identify and then allocate input VAT credits. Many different methodologies are used, and some commonly used methods involve the allocation of input taxes based on:

- Direct attribution – that is, attributing expenses to revenue items where there is a direct relationship between them
- Revenue basis – that is, claiming input VAT credits for expenses based on the proportion of taxable (or zero rated) revenue to total revenue
- Head count or time costing
- Floor space.

A critical aspect of any apportionment method for many financial institutions is the need to build in allocation keys into the accounting system.

Impacts on input VAT management



Steps to transition to VAT

There are many tangible steps and questions that financial services businesses need to take into account when preparing for the reforms. These include:

1

Identifying those parts of the business either directly or indirectly impacted by the VAT reforms. This will involve a line-by-line characterisation and location analysis of service flows and revenues from those services, followed by a line-by-line characterisation analysis of expenses from purchases of services.

2

Examining how the reform process will impact the business model. Many financial services businesses operating in China currently have structures designed to minimise the cascading of BT. Would that still be necessary once the reforms commence? Is the business model still the most efficient model?

3

Analysing the impact that the proposed reforms have on the fees, charges and margins that the business derives. Would the business have the legal and commercial negotiating power to ensure that any price reductions are passed on by suppliers? How will fees and charges for services be affected? How will margins be affected? To what extent are there cross-border charges, and how will they be managed? Will the VAT impact on business customers in the same way as individual customers? Will there be cross-subsidisation of the VAT impact between business and individual customers?

4

Checking whether the business is entering into contracts now, which potentially span the introduction of the reforms. If so, are there contractual provisions within those contracts, which would allow the impact of a new tax to be passed on? If the business is entering into contracts for the purchase of goods and services, does the contract enable the supplier to pass on the impact of any changes in tax rates arising from the reforms? What about existing contracts?

5

Investigating whether IT and accounting systems adequately cater for a new tax. Do they enable recognition and claiming of input taxes on purchases that the business makes? Does the business use tax codes, which are suitable for a multi-rate VAT? Are there linkages between the business' own systems and the Golden Tax System?

6

Considering the extent that the business should defer fixed asset purchases to potentially qualify for tax credits. Taxpayers currently subject to the BT regime are unable to claim input credits for fixed assets used in their business.

7

Identifying the invoicing and cash register systems needs, as well as the internal controls. Will the business need to be able to obtain the equipment and information necessary to issue special VAT invoices for each branch, and if so, what controls need to put in place over the issue of special VAT invoices?

8

Examining how the cash flow position will be affected by the reforms, particularly for BT taxpayers where the rate has increased. How will the business ensure it receives payments from customers before it is required to remit VAT, and equally, minimise the timeframe between paying VAT on purchases and claiming input VAT credits?

9

Identifying how many suppliers, either current or potential, will be classified as 'small scale taxpayers' and therefore, unable to claim input taxes. Would you cease doing business with them once the reforms are introduced in favour of businesses that are able to provide you with special invoices that you can claim input taxes?

10

Checking how proficient staff is in dealing with tax issues. Will accounts payable staff have the knowledge and capacity (and relevant training) to ensure that invoices comply and they are able to code invoices accordingly? What policies or procedures might be required to cater for this?

How we can we help

KPMG is currently assisting a number of Chinese and foreign financial services clients in preparing for the introduction of VAT. We have set out below a sample of the types of services we can provide in relation to the implementation of VAT.

Immediate assistance

An important starting point is the assistance we are giving to the banking sector in preparing responses to the MoF's study report. These responses serve several purposes, as follows:

- To potentially influence the shape and direction of the VAT reforms for the financial services sector
- To understand and quantify at a high level the potential financial impact of the VAT reforms, which may be a necessary step to obtain internal resources, budget and leadership support to implement the VAT reforms across the business.

The opportunity to provide input to the MoF's study report represents a critical way in which the financial services sector can influence the shape of the VAT reforms. KPMG has a very successful track record in assisting the MoF and the SAT (on behalf of our clients) in securing changes and policies, which ensure the VAT reforms work most effectively for business. Key areas where KPMG has already provided a leading role in supporting the regulators include:

- **The insurance sector** – KPMG has advised the MoF, the SAT and the China Insurance Regulatory Commission
- **The financial services sector** – KPMG advised both the CBRC and the Shanghai Municipal Government, and in the finance leasing sector where we have been advocating for changes to Caishui [2013] 37 for sale and lease back transactions
- **The transport and logistics sector** – KPMG has been assisting in responding to changes introduced in Caishui [2013] 37, which adversely impacted the tax burden in that industry
- **The export of services** – KPMG has provided the benefit of our international experiences in ensuring the 'destination principle' of VAT concessions is able to be implemented appropriately by multinational companies in the various Circulars and Announcements.

Implementation assistance

The types of assistance which financial services clients may need with respect to the implementation of VAT can vary quite significantly, depending upon the size and scale of their operations in China, the level of complexity of issues, the extent of in-house skills, and the IT systems challenges. Common examples where we provide assistance include:

- **Financial impact assessment study** – undertaking a high level study to identify the potential financial impact of the VAT reforms under different VAT models being considered by the MoF. This study can be very helpful in giving an overall snapshot and to obtain buy-in from key internal stakeholders such as the CFO.

- **Project implementation** – implementing the VAT reforms requires a broad skill set that KPMG Tax and Advisory professionals can provide. For example, we can help to identify VAT issues which may affect the business, resolve and document key decisions, advise on the IT systems changes which may be necessary, prepare key communications with both customers and large suppliers to advise them of the VAT impact of your services, review and assess both the output VAT and input VAT treatment of revenue and expense items, and advise on input VAT credit allocation methodologies.
- **Steering group assistance** – some clients will choose to do aspects of the VAT implementation themselves, for example, by forming a steering group comprising key stakeholders from the business, such as tax and finance teams, legal, and IT professionals. External representation from KPMG on the steering group can provide a ready means to access our expertise, clarify key technical issues on a timely basis, and to share industry best practices with implementing the VAT reforms.
- **Preparation of VAT manuals and process controls** – the implementation of VAT is likely to result in financial services businesses issuing substantial volumes of special VAT invoices every month. The implementation of process controls will be critical in ensuring that VAT risks are appropriately managed. VAT manuals can provide an efficient way for financial services clients to document and then share key VAT impacts for the business across a wide range of internal stakeholders.
- **Training** – the VAT reforms will result in a significant change to the day-to-day business operations for many clients in the financial services sector. Training provides a way to ensure that the knowledge about the way in which the VAT impacts on your business can be shared amongst a broad range of staff, ensure consistency of approach, and to manage risks effectively.

KPMG Tax and Advisory professionals have significant experience in implementing similar VAT reforms in other countries, and for other industries in China.





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