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# China: Country VAT / Business Tax Essentials Guide 2015

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# CHINA: COUNTRY VAT / BUSINESS TAX ESSENTIALS GUIDE 2015

## INTRODUCTION

THE 2015 EDITION OF THE CHINA COUNTRY VALUE ADDED TAX (VAT) AND BUSINESS TAX (BT) ESSENTIALS GUIDE PROVIDES AN OVERVIEW OF THE INDIRECT TAX SYSTEMS IN MAINLAND CHINA. IT IS INTENDED TO ASSIST COMPANIES DOING BUSINESS IN OR WITH CHINA TO NAVIGATE THE INDIRECT TAX SYSTEM.



**Lachlan Wolfers**

Leader, Centre of Excellence, Indirect Taxes  
KPMG China

✉ [lachlan.wolfers@kpmg.com](mailto:lachlan.wolfers@kpmg.com)

☎ +852 2685 7791

## Background

For many years, China has operated a dual system of indirect taxes, with VAT applicable to the sale and importation of goods, typically at the rate of 17 percent. By contrast, most services were subject to BT at rates of either 3 percent or 5 percent.

This dual system of indirect taxes is being reformed into a single system, with VAT to apply to all goods and services.

The reform program commenced in January 2012 with the introduction of a pilot program in Shanghai, replacing BT with a VAT for a number of services sectors.

The reforms are taking place because BT is generally regarded as an inefficient turnover tax, which taxes business – that is, it effectively taxes each stage of a supply chain, irrespective of the profit or ‘value added’ by each business in that supply chain. By contrast, VAT is a tax collected by business, but effectively intended to be borne by the end consumer.

## Expansion

On 1 January 2012, China commenced a VAT pilot program for the transportation and modern services industries in Shanghai, replacing BT, and in the process, introducing two new VAT rates – 6 percent (modern services) and 11 percent (transportation).

The pilot program has been progressively rolled out across all cities and provinces in mainland China and expanded to include many additional services sectors. A number of services sectors are still to transition to VAT, including financial services, insurance, real estate and construction and lifestyle services such as hospitality, food and beverage. The changes will unify the VAT system applicable to the goods sector with that of the services sector, and in so doing, remove inefficiencies in each system.



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# TAXES

## SIGNIFICANT INDIRECT TAX DEVELOPMENTS AT A GLANCE

**Have any significant changes occurred in your country over the past few months?**

Yes. The Chinese government is in the process of replacing BT with VAT for the services sector. This is occurring on an industry-by-industry basis from 2012 and is expected to be completed in 2016.

**Are any significant changes expected over the coming months?**

Yes. The Chinese government is in the process of replacing BT with VAT for the services sector. It is anticipated that some or all of the remaining parts of the services sector still paying BT will transition to VAT over the next 12 months. As at the date of this publication (September 2015), the main services industries still paying BT include real estate and construction services, hospitality and food and beverage services, financial services and insurance services, and a general 'catch-all' of any other services not already transitioned to VAT.

The Consumption Tax (CT) system is also anticipated to be the subject of reforms over the coming months, which may potentially alter the categories of goods subject to CT, the applicable rates and the point of imposition and collection.



# SCOPE AND RATES

## What supplies are liable to VAT/Business Tax?

There are three main forms of indirect taxes in China - VAT, BT and CT. Indirect taxes in mainland China are currently subject to significant reforms and therefore this information may be outdated very quickly.

VAT currently applies to the sale of goods, the importation of goods, and the provision of repair, replacement and processing services in China. VAT in China exhibits some of the features of other VAT regimes throughout the world (albeit with some uniquely Chinese characteristics), in the sense that it taxes final private consumption expenditure (as well as some public expenditure), by generally relieving the burden of VAT on transactions between businesses through the input tax credit mechanism.

CT applies to the manufacturing, processing, importation or selling of 14 different kinds of goods in China, principally luxury goods.

BT applies to the provision of all other services, the transfer of intangible assets and the sale of immovable property. BT is a type of turnover tax - it is not creditable and therefore cascades throughout a supply chain. It can also apply to both the export and import of services.

In 2012 the Chinese government started an extensive indirect tax reform process. The reforms introduced a VAT pilot program which replaced BT with VAT for the transportation, asset leasing and modern services sectors. 'Modern services' includes research and development and technical services, information technology services, cultural and creative services, logistics and ancillary services, certification and consulting services, radio, film and television services, postal and telecommunications services. It has been foreshadowed that the VAT pilot program will be expanded to other industries in 2016, with expectations that BT will be wholly replaced by VAT.

The VAT, BT and CT comments in this document relate to mainland China only, and do not include the Special Administrative Regions of Hong Kong and Macau. Currently, neither Hong Kong nor Macau impose indirect taxes such as a VAT. Given that indirect taxes in China are subject to significant reforms, we recommend you contact a KPMG China advisor for the most up-to-date advice.



### What is the standard rate of VAT/Business Tax?

The standard rate of VAT is 17 percent for general VAT taxpayers.

VAT also applies at the rate of 17 percent for asset leasing, 11 percent for transportation services and some telecommunications services, and 6 percent for modern services which are subject to the VAT pilot program.

The rate of BT generally ranges from 3 to 5 percent, although the exception is entertainment services, which can be as high as 20 percent.

CT rates differ depending upon the stage of production at which the sale occurs, type, weight, or capacity. Given the application of CT is both limited and specific to the type of goods being sold, it will not be discussed further.

### Are there any reduced rates, zero rates, or exemptions?

Yes. In terms of VAT, the following are the main examples of exemptions and reduced rates:

- a narrow range of goods are exempt from VAT, including agricultural products, contraceptive drugs and devices, antique books, and other items declared by the State Council as being exempt
- exports of certain services under the VAT pilot program
- 'small scale taxpayers', being those without sophisticated business, accounting and auditing systems, and whose turnover is below certain thresholds (ranging from RMB 500,000 to RMB 800,000 of annual turnover, and RMB 5,000,000 for businesses which are subject to the VAT pilot program) pay VAT at the rate of 3% and are ineligible for input tax credits on purchases
- a reduced rate of 13 percent applies to the sale of food grains and vegetable oils, heating, air-conditioning, certain gas supplies, books, newspapers and magazines.

The main category of zero rated goods is exports (discussed below further). However, unlike in many other countries, the refund provided on zero rated goods is, in many cases, less than the amount of VAT paid.

In relation to BT, the main exemptions are for:



- services subject to the VAT pilot program so as to avoid double tax
- services provided by employees to their employers
- waste disposal services
- certain other services which are specifically exempt (e. g. nursing services, medical services, educational services)
- certain offshore outsourcing services and technology transfers.

Generally, BT applies to the turnover of a business - however, for certain types of transactions, tax is payable on the “margin” (for example, foreign currency trading).

### What are the other local indirect taxes beside VAT/BT?

Other indirect taxes include:

- customs duty
- stamp duty
- various local levies, such as the Urban Maintenance & Construction Tax and Education Levy
- various real estate specific taxes, motor vehicle taxes and mining specific taxes.



## KEY FEATURES OF CHINESE VAT

**China's VAT system uses multiple VAT rates rather than a single VAT rate for all goods and services – commonly used rates are 3%, 6%, 11%, 13% and 17%.**

# REGISTRATION



## Who is required to register for Chinese VAT/ Business Tax?

Generally speaking, foreign entities are not eligible to register as general VAT taxpayers in China. Instead, foreign entities wishing to enter the Chinese market typically do so through the establishment of a Chinese foreign invested commercial enterprise (FICE), wholly foreign owned entity (WFOE) or a joint venture, or they may operate within a free trade zone (or equivalent). The tax system in China is more or less linked to the business licensing/registration system and to foreign currency controls, so practically there are real limitations on foreign entities wishing to do business in China without a local presence. There are exceptions to these principles, such as representative offices which may be able to operate, albeit with limited functions.

The remaining discussion relates primarily to Chinese entities.

There are two separate concepts relevant here - thresholds for liability for VAT purposes, and the separate threshold for registration as a "small scale taxpayer" or "general VAT taxpayer".

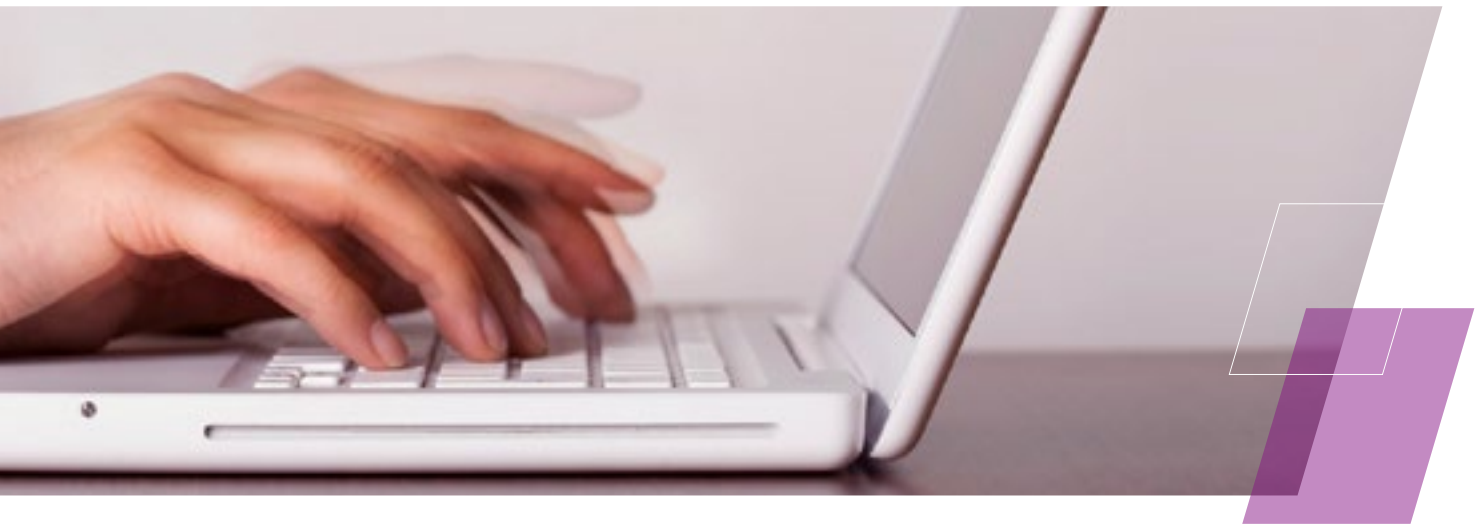
The VAT thresholds for liability apply only to individuals. Businesses and other "units" automatically have VAT liabilities on their taxable transactions, irrespective of turnover. However, even for individuals, the thresholds are very low - ranging from RMB5,000 - 20,000 per month of sales, or RMB300 - 500 per transaction in the majority of provinces in China.

"Small scale taxpayers" are those with annual sales turnover of not more than:

1. RMB 800,000; or
2. RMB 500,000 if engaged solely or mainly in the production of goods or provision of taxable services not subject to the VAT pilot program; or
3. RMB 5 million if providing services which are subject to the VAT pilot program.

Registration as a "small scale taxpayer" or "general taxpayer" determines whether:

- VAT is payable at 3 percent, with no eligibility for input tax credits on purchases (small scale taxpayers) and no eligibility to issue VAT invoices; or
- VAT is payable in the usual way with input tax credits generally available for business purchases.



It is possible for taxpayers that would otherwise be “small scale taxpayers” to register as “general VAT taxpayers.” They need to demonstrate a “sound accounting system” and provide accurate tax information, as well as having a fixed place of business in China.

For BT purposes, there is a threshold beneath which no BT liability arises. For individuals, the threshold is set very low – RMB300 - 500 per day where tax is paid on a transaction basis, or RMB5,000 - 20,000 per month where tax is paid on a fixed period basis. For businesses and all other types of units, there is no minimum threshold.

### **Are there penalties for not registering or late registration?**

As noted above, the concept of registration for VAT purposes is, in practice, really more applicable to registration as a “general VAT taxpayer.” General VAT taxpayers are required to register, by filing the form for the “Approbation of General Taxpayers of VAT” within 40 days after a tax period during which they were required to register. Separate procedures apply for “small scale taxpayers” in terms of the documentation which must be filed.

There are penalties for failing to register, which include fixed amount fines and fines which are a combination of interest and penalties. The tax authorities have the authority to revoke business licenses for failing to register.

### **Is voluntary VAT/ Business Tax registration possible for an overseas company?**

Generally, no. Foreign companies cannot generally register for VAT purposes in China. Instead, they typically establish FICEs, WFOEs or enter into joint ventures, as a means of doing business in China. Where foreign entities wish to purchase goods for use outside of China, they often buy goods for export in Free Trade Zones as a means of ensuring they do not incur irrecoverable VAT.



**Is there any other kind of VAT/Business Tax registration?**

Generally, no. However, non-residents engaged in contract construction/engineering, or the provision of services in China, are required to register in the place where the project/service is provided, within 30 days after the relevant contract is signed.

**Can businesses recover input VAT/Business Tax incurred prior to the registration?**

No.

**Are there any simplifications that could avoid the need for an overseas company to register for VAT/Business Tax?**

As noted previously, foreign entities cannot generally register for VAT/BT in China.

Please note that the answer to this question depends, to a significant extent, on regulatory issues which impact on the way in which foreign entities can do business in China, not merely VAT or BT issues.

Where an overseas company provides services which are subject to BT or VAT (in the case of taxpayers subject to the VAT pilot program), and it does not have a trading establishment in China, its representative in China is the withholding agent. If the overseas company does not have an agent in China, then the purchaser is the withholding agent. This is particularly relevant where an overseas company without operations in China makes supplies subject to BT or VAT to another entity in China.

**Does an overseas company need to appoint a fiscal representative?**

No, see above. If an overseas company has an agent in China, then the agent may be liable. Alternatively, the liability falls on the purchaser.

**What documentation does an overseas company need for the VAT/Business Tax registration?**

N/A.

**What rules must be complied with in order for the triangulation simplification to be applied?**

N/A.

**Is call-off stock implemented in your country?**

No.

**Is consignment stock implemented in your country?**

No.

**Consignment stock simplification**

In China, the consignment of goods is regarded as a 'deemed sale' for VAT purposes. This means that VAT is payable on the 'sale' by the consignor to the consignee, and then again by the consignee to the customer. There is a mandatory 4 percent VAT rate applicable to the sale of goods by consignment shops.

### How the supply of goods installed or assembled is treated?

The supply of installation and assembly services, in addition to the supply of goods, may be regarded as a “mixed sale” activity.

If the unit selling the goods and providing the services is regarded as being engaged principally in the production, wholesale or retail sale of goods as their main business, then the installation and assembly services will be treated as being subject to VAT.

However, if the unit is not engaged principally in the production, wholesale or retail of goods, then the supply of installation and assembly services may be treated as a separate supply of services (and subject to BT) from the supply of the goods themselves (subject to VAT).

### Is a foreign company who is supplying goods locally liable to register for VAT/Business Tax?

Please note that the answer to this question depends, to a significant extent, on regulatory issues which impact on the way in which foreign companies can do business in China, not merely VAT issues.

From a regulatory perspective, ordinarily foreign companies doing business in China who operate through FICs or WFOEs can register as general VAT taxpayers provided they meet certain conditions. However, if the foreign company itself conducts business in China which is subject to VAT, but does not have a trading establishment in China, then its local agent (or in the absence of an agent, then the purchaser) is liable for VAT.



## KEY FEATURES OF CHINESE VAT

- **VAT registration occurs at the branch level, not the legal entity level. Consequently, a single company may have multiple VAT registrations around China. Supplies between branches may be taxable. Consolidated VAT filing between branches of the same legal entity can be difficult to obtain, and between related companies in the same corporate group rarely occurs. One underlying reason for this is that consolidation would alter the share of tax revenues (and budgets) reported by each of the different provinces or cities.**
- **Foreign companies generally cannot register for VAT and claim input VAT credits.**



# VAT GROUPING

## Is VAT/Business Tax grouping possible?

No - grouping of different legal entities is not generally possible in China.

Moreover, in many cases, branches or offices of the same legal entity may be required to separately account for transactions, particularly where they operate in different provinces. Transactions between head office and a branch may even be subject to VAT or BT.

A regulation has recently been issued which would allow branches of the same legal entity that are subject to the VAT pilot program to seek approval to group for VAT purposes. The specific implementation rules under which this framework will be operational at an administrative level are yet to be generally introduced.

## Can an overseas company be included in a VAT/Business Tax group?

N/A.



# RETURNS

**How frequently are VAT/  
Business Tax returns  
submitted?**

VAT returns must be submitted either every one day, three days, five days, 10 days, 15 days, one month or one quarter, depending on the taxpayer's activities. Likewise, BT returns must be submitted every five days, 10 days, 15 days, one month or one quarter.

While these timeframes may be imposed, in reality most taxpayers lodge monthly.

**Are there any other  
returns that need to be  
submitted?**

No.

**If a business receives  
a purchase invoice in  
foreign currency, which  
exchange rate should be  
used for VAT reporting  
purposes? (E. g. central  
bank's exchange rate  
applicable on the date of  
the invoice)**

It is common practice that taxpayers in China convert any foreign exchange balances using the middle exchange rate published by the People's Bank of China either on the day the transaction is recognized for accounting purposes, or on the first day of the month in which the tax is paid on the transaction. Taxpayers are not entitled to switch methods within the course of a year.



# VAT RECOVERY



**Can a business recover VAT/Business Tax if it is not registered?**

**Local/established businesses which incur VAT**

No, a business must be registered as a general VAT taxpayer in order to claim an input VAT credit. Refunds of excess input VAT credits are not generally given (except for certain exports) – instead, the credit balance may be carried forward (potentially indefinitely) and used to offset output VAT.

**Overseas businesses with no local presence and no local VAT/GST registration**

No - only businesses registered as general VAT taxpayers are eligible to claim input tax credits for VAT purposes, and overseas businesses will not generally be allowed to register. Businesses must obtain a 'special VAT invoice' and take it to the tax authority for verification before an input VAT credit can be claimed.

BT is a turnover tax and therefore there is no BT recovery mechanism. However, for some industries, the revenue which is subject to BT is calculated on a 'net' basis.

**Does your country apply reciprocity rules for reclaims submitted by non-established businesses?**

No.

**What are the general conditions for claiming a deduction of input VAT/GST?**

In order to claim input VAT credits in China, the business must be registered as a general VAT taxpayer, they must obtain a special VAT invoice which is ratified by the tax authorities, the expense must relate to deriving taxable revenue which is subject to VAT, and the special VAT invoice must be ratified within 180 days of its receipt.

### Are there any items that businesses cannot recover VAT/Business Tax on?

For VAT purposes, there are a number of restrictions on the recovery of input tax credits, the most significant of which is that only general VAT taxpayers are potentially eligible to claim and that claims must be supported by special VAT invoices. Special VAT invoices are highly regulated in China. As such, assuming the taxpayer is a general VAT taxpayer and holds a special VAT invoice, then further restrictions include an inability to claim for:

- inputs related to activities subject to BT
- inputs related to the simplified levy method of calculating VAT
- inputs related to the sale of tax-exempt items
- inputs related to group welfare activities (e. g. employee canteens and employee benefits)
- those for personal consumption
- inputs used in deriving extraordinary or abnormal losses.

For completeness, it should also be noted that many exports of goods do not result in full recovery of VAT - that is, there may be leakage in export VAT recovery. For BT purposes, there is no concept of input tax recovery.

There is a time limit of 180 days after the VAT liability arises within which the recipient can claim input tax credits on VAT invoices.

### Can businesses recover input VAT/Business Tax on certain employee expenses?

Most of the items listed below are subject to BT (for which there is no recovery mechanism) rather than VAT. However, for those few items subject to VAT, as a general proposition, in considering the categories of expenses below, it is assumed that:

- the taxpayer is a general taxpayer
- the taxpayer is a domestic Chinese entity
- the expense are not related to a "group welfare activity"

#### Domestic Air Travel

Domestic air travel within China has been subject to VAT nationwide from 1 August 2013. Under a special rule in the VAT pilot program, businesses are not generally eligible to claim input VAT credits for their employees' business travel.

#### International Air Travel

International air travel is generally zero rated for Chinese airlines but exempt from VAT for international airlines (typically because the international airlines do not have the appropriate legal structure or licenses that would allow them to zero rate).

#### Rail Travel

Railway travel has generally been subject to 11 % VAT from 1 January 2014. However, under a special rule, businesses are not eligible to claim input VAT credits for their employees' business travel.

**Taxi Fares**

Not applicable. Currently subject to BT, not VAT.

**Car Rental**

Not applicable. Currently subject to BT, not VAT.

**Fuel**

VAT recovery is not available where such expenses are regarded as related to welfare and private consumption. However, if such expenses are incurred for business purposes, and assuming the employee could obtain a special VAT invoice, then an input VAT credit may be available.

**Car parking**

Not applicable. Currently subject to BT, not VAT.

**Hotels**

Not applicable. Currently subject to BT, not VAT.

**Client Entertaining**

Not applicable. Currently subject to BT, not VAT.

**Staff Entertaining**

Not applicable. Currently subject to BT, not VAT.

**Client Meals**

Currently subject to BT, not VAT.

**Staff Meals**

Currently subject to BT, not VAT. In any event, employee canteens are considered group welfare activities and therefore ineligible for VAT recovery.

**Telephone Calls**

Telecommunications services became subject to VAT from June 2014 onwards. An employee's telephone calls in relation to a landline or a mobile phone account in the employee's name would not be recoverable for VAT purposes. However, if the landline or mobile phone account is in the employer's name and the employer is registered as a general VAT taxpayer and obtains a special VAT invoice, then an input VAT credit should be available.

**Can expenses related to only partially taxable business be deducted?**

Yes. For fixed assets, the VAT recovery rules for general VAT taxpayers in China are relatively generous. Provided the asset is not solely used for a non-creditable purpose (e. g. in providing services subject to BT, or in group welfare activities, or in activities exempt from VAT), then full input tax credit recovery is available.

For goods other than fixed assets, VAT may be recovered on an apportionment basis, depending on the use of the goods. A direct attribution is required, and for any remaining items, apportionment is generally conducted on a revenue basis.

Where input tax exceeds output tax in any given period, generally the excess may be carried forward indefinitely rather than resulting in a refund. The main exception to this is for exports of goods, and those exported services which are zero rated under the VAT pilot program, such as international transport, research and development and design services. Initially eligible businesses can be required to wait for six months or greater before they receive the refund.

**Can a VAT registered business claim a refund of input VAT/GST paid where the input VAT/GST exceeds the output VAT/GST payable or is it obliged to carry the excess credit forward and set it against future output VAT/GST payable?**

VAT taxpayers are not generally eligible to claim a refund of excess VAT credits – instead, the excess VAT credit balance is carried forward (potentially indefinitely) and used to offset output VAT.

The only exception where refunds may be obtained is in respect of exports of goods, and exports of certain services such as international transportation, R&D and design services.

**Are there any other special rules relating to the recovery of VAT/GST in your country?**

No.



## KEY FEATURES OF CHINESE VAT

- **Excess VAT credits are not generally refundable – instead they are carried forward (without time limit) and used to offset output VAT. If the entity still has excess VAT credits when it is liquidated, those VAT credits will be lost.**
- **The Chinese VAT system does not provide for bad debt relief. Moreover, input VAT related to abnormal or extraordinary losses must be denied or ‘transferred out’.**



# INTERNATIONAL SUPPLIES OF GOODS AND SERVICES



## EXPORTS - GOODS

### How are exports of goods and services treated?

Exports of goods, as well as those services subject to the VAT pilot program, are either treated as zero rated or exempt for VAT purposes.

The mechanics of the way zero rating is achieved may differ. For example, exports of goods by manufacturing companies, as well as the export of certain services (such as licensed international transportation services, research and development and design services) which are subject to the VAT pilot program, are subject to what is known as the Export, Credit, Refund (ECR) method. That is:

- exports are exempt from VAT
- input tax on purchases used in exporting is first credited against output tax on domestic sales
- excess input tax is refunded to exporters.

Goods exported overseas by China based trading companies apply what is known as the Levy First, Refund Later (LFRL) method. Under this method, the trading company pays VAT on the purchase, which is passed through by the local supplier. When it exports the products, it is not subject to output VAT on the export, and it can then claim part or all of the VAT on the purchase.

In addition to the above zero rating, many services which are exported that fall within the VAT pilot program are exempt from VAT, including:

- leasing of tangible movable property where the property is outside China
- unlicensed international transportation
- engineering and exploration services where the project or mineral resources are overseas
- technology transfer services
- technology consulting services
- energy management services
- software services
- circuit design and testing services
- business process management services
- convention and exhibition services outside China

- trademark and copyright transfer services
- intellectual property services
- advertising services where the advertisement is outside China
- warehousing services where the warehouse is outside China
- logistics and ancillary services
- certification, verification and consulting services
- international telecommunications services provided by Chinese providers to overseas.

Exports of services which are subject to the BT regime will not generally qualify for exemption. That is because BT applies if either the supplier, or the recipient of the service, is in China.

**Are there any special conditions which must be met in order for favourable VAT/GST treatments to apply to an export of services?**

Yes, there are a number of special conditions which must be satisfied, and the conditions do differ from province to province. Common conditions include:

- exemption or zero rating cannot apply unless the services are provided under a written contract
- there should generally be strict consistency between the parties to the contract, the recipient paying for the services (as evidenced by bank statements), and the recipient being invoiced for the services.



## KEY FEATURES OF CHINESE VAT

**Exports of goods from China are zero rated for VAT purposes. However, a zero rating does not mean the same thing as it does in many overseas countries. Instead, the type of goods being exported (determined by reference to the HS Customs code of the goods) will determine the percentage of input VAT refunded based on a scale with seven different refund rates, ranging from 0% (no recovery) to 17% (full recovery).**

## EXPORTS - SERVICES

### How are exports of services treated for VAT/GST purposes?

Exports of services which are subject to the VAT pilot program are generally exempt from VAT, except for certain services such as R&D, design and international transportation services which potentially qualify for zero rating.

An underlying theme of the rules for claiming VAT exemption is that they do not generally apply where the services relate to goods or real estate in China.

The approach to claiming VAT exemptions and zero rating in China is complex, and the administrative practices from province to province do differ. Generally, exemption or zero rating cannot simply be self-assessed – certain documentation needs to be submitted to the tax authorities in order to be able to do so, and it is commonplace for claims to be scrutinized closely.

### Are there any special conditions which must be met in order for favourable VAT/GST treatments to apply to an export of services?

Yes, there are a number of special conditions which must be satisfied, and the conditions do differ from province to province. Common conditions include:

- exemption or zero rating cannot apply unless the services are provided under a written contract
- there should generally be strict consistency between the parties to the contract, the recipient paying for the services (as evidenced by bank statements), and the recipient being invoiced for the services.



### KEY FEATURES OF CHINESE VAT

**Exports of services are generally exempt from VAT, not zero rated (except for R&D, design and certain transportation services). Exemption from VAT means that related input VAT credits must be denied or 'transferred out'. The exception to this is fixed asset purchases which may be eligible for full input VAT credits even where used in a business making a mix of taxable and exempt supplies.**

## **IMPORTS - GOODS**

### **How are goods dealt with on importation from a VAT/GST perspective?**

Imports of goods are subject to VAT. VAT is payable to Customs.

Overseas companies selling goods to consumers in China (e. g. through online sales) will typically need to appoint a customs agent or broker to handle the VAT payable on importation.

### **How and by whom is VAT/GST paid on imports of goods?**

VAT will not generally be payable on the purchase of goods from abroad, but rather, on importation into China.

VAT on imports is payable to Customs within 15 days of the issue of a tax payment certificate by Customs.

### **How is VAT/GST on imported goods recovered?**

The recovery of VAT on importation is limited to general VAT taxpayers only, and is recovered through the completion of the VAT return.

### **Are there any reliefs/ exemptions from VAT/ GST for imported goods?**

There are reliefs applicable to certain Customs special zones to certain temporary importations.



## IMPORTS - SERVICES

### How are services which are brought in from abroad treated for VAT/ Business Tax purposes?

The general principle in China for both BT and VAT is that tax applies if either the supplier or the recipient is in China.

For services which fall within the scope of BT, services acquired from abroad will generally be subject to BT. This is based on the recipient being in China. If the supplier has no trading establishment in China, then its agent in China pays the BT on behalf of the supplier. However, if the supplier has no agent in China either, then the recipient pays the BT.

For services which fall within the scope of VAT, services which are subject to the VAT pilot program will be subject to VAT. If the supplier does not have a business establishment in China, then the withholding agent or recipient will pay VAT. The recipient in these circumstances will generally be entitled to an input VAT credit if they are registered as a general VAT taxpayer, so that VAT is not a real cost, provided certain documentation requirements are met.

### Who is responsible for paying any VAT/GST due on imported services to the Tax Authorities?

The party liable to pay either BT or VAT on a withholding basis in respect of the importation of services is the agent of the supplier, otherwise the recipient of the supply is liable.

### How is VAT/GST on imported services recovered?

Where VAT withholding has been payable on the importation, then the recipient may claim an input VAT credit if they are registered as a general VAT taxpayer. The input VAT credit is claimed through the VAT return. Certain documentation evidencing the importation and payment must be obtained.

**If the recipient of imported services in your country is obliged to withhold GST/VAT on the service received from the overseas supplier, can the non-resident supplier recover this VAT/GST?**

No. If the recipient of imported services is obliged to withhold VAT, it is only the recipient who can potentially recover this VAT by claiming an input VAT credit.

**Is a non-resident supplier of services required to register and charge local VAT/GST in respect of supplies of services to consumers/non VAT registered customers in your country?**

Generally, no.



## **KEY FEATURES OF CHINESE VAT**

**Imports of services are subject to VAT withholding, not a reverse charge. VAT withholding means that the recipient of the supply must withhold the VAT from the price. Whilst similar to a reverse charge, VAT withholding means that the supplier should include a 'gross up' clause in the contract so as to ensure they are not out of pocket, and the parties may need to put through adjustments in their accounting system to write off the withholding amount in their accounts.**





# AMOUNT SUBJECT TO VAT/GST

## On what amount is VAT/GST charged for domestic supplies?

VAT for domestic supplies is generally payable in respect of the gross selling price payable by the recipient, where the parties are dealing at arm's length. Amounts received from third parties, including subsidies, liquidated damages and similar amounts are potentially subject to VAT.

## On what amount is VAT/GST charged on imported goods?

VAT on imported goods is calculated based on the aggregate of the Customs dutiable value, together with any Customs duty and consumption tax payable.

## On what amount is VAT/GST charged for imported services?

The VAT for imported services is generally payable in respect of the gross selling price, where the parties are dealing at arm's length.

## Adjustments to the chargeable amount such as those required for discounts, related party transactions, supplies below market value etc.

The value upon which VAT is assessed in China may be adjusted in a range of circumstances including:

- where the price is regarded as 'unjustifiably low'
- in practice, where the parties are not dealing at arm's length
- where there is a 'deemed sale' (eg. a gift).

Price discounts may reduce the value upon which VAT is payable, provided it is done in the same tax invoice, otherwise a 'red letter' invoice may need to be issued and this can be a difficult and time consuming process. There is generally limited flexibility in the types of discounts and rebates which may reduce the price upon which VAT is payable in China (as compared with many other countries), so careful attention to these issues is often required.

# TAX POINTS



**When is VAT/GST due on a supply of goods or services?**

VAT is generally payable in China in the tax period in which an invoice is issued, or a payment is received (whichever is earlier).

**Are there any special rules for the payment of VAT/GST on imports of goods or services?**

Not applicable.



# INVOICES



**In what circumstances is a business required to issue tax invoices?**

Special VAT invoices may only be issued by general VAT taxpayers, and even then, only through government issued and regulated anti-counterfeit electronic systems. Those special VAT invoices must contain certain information to be valid.

**Are suppliers required to issue invoices in respect of supplies of services to non-registered persons in your country where the supply is regarded as taking place in your country? If yes, can simplified invoices be issued or are all of the requirements listed in the next section below needed on the invoice?**

Special VAT invoices may only be issued to general VAT taxpayers – so only those form of invoices may be used to claim input VAT credits. For other taxpayers, general invoices may be issued. These ‘general invoices’ are also regulated as to form and content.

**If suppliers are obliged to issue invoices in respect of supplies of services to non-taxable persons in your country, what are the penalties for failing to do so?**

Suppliers are obliged to issue general invoices to all service recipients (including non-taxable persons in China) and non-compliance is potentially subject to a maximum penalty of RMB10,000.



### What do businesses have to show on a tax invoice?

Special VAT invoices, known as “fapiaos”, may only be issued by general VAT taxpayers, and even then, only through government issued and regulated anti-counterfeit electronic systems and on numbered invoicing paper (the system is known as ‘the Golden Tax System’).

To be valid, special VAT invoices must also comply with the following:

- all items in the invoice must be completed consistently with the terms of what was actually supplied
- letters in the VAT invoice must be legible and completed properly
- the invoice must be issued at the time the VAT liability arises

### Can simplified invoices be issued in your country?

A simplified form of invoice, known as a ‘general invoice’ may be issued to taxpayers who are not general VAT taxpayers.

### Can businesses issue invoices electronically?

Generally no. Invoicing in China is done on special machines which contain anti-counterfeit security features and they are issued in paper form. Electronic invoicing is currently being trialed in a limited way, and is expected to be expanded over the next few years.

### Are there any specific requirements for electronic invoicing?

Not applicable.

**Is it possible to operate self-billing?**

No.

**Are there any specific requirements for self-billing?**

N/A.

**Can a business issue VAT invoices denominated in a foreign currency?**

No. A business can only issue special VAT invoices “fapiaos” in Chinese Yuan/ Renmimbi (“CNY” or “RMB”).



## KEY FEATURES OF CHINESE VAT

- **Businesses in China may only issue special VAT invoices on government issued systems, with invoices purchased from the tax authorities. This is known as the Golden Tax System. The Golden Tax System is separate from a company’s own ERP system, which can make reconciliation of transactions difficult, and visibility over indirect tax risks more challenging.**
- **Input VAT credits can only be claimed upon receipt of special VAT invoices which must be verified with the tax authorities on a monthly basis. Electronic invoicing is not widely available.**

# RECORD KEEPING REQUIREMENTS

## How long must the records and invoices be retained?

Account books, vouchers, statements, tax payment certificates and other tax records must be retained for 10 years.

## Can the invoices be stored abroad?

Generally no. In any event, invoices and accounts must be kept in Chinese language, but may be kept simultaneously in another language. Furthermore, the nature of the Golden Tax System is such that invoices can only be issued in China, and invoices received must be validated in China.



# TRANSFERS OF BUSINESS

**Is there a relief from VAT/Business Tax for the sale of a business as a going concern?**

Yes, there is potentially relief available from VAT and BT. However, the concession in China is not as broad as the going concern concession applicable in many other countries.

**Is transfer of business exempt from or out of the scope of VAT/Business Tax?**

Transfers of businesses which qualify for relief from VAT and BT are regarded as exempt transactions, not zero rated or out of scope.

**What are the main requirements for the relief?**

For VAT purposes, SAT Announcement 13 (2011) requires the taxpayer to have (1) transferred goods in a corporate reorganization which takes the form of a merger, de-merger, sale or exchange; and (2) transferred all or part of the tangible assets, and the related debt claims, liabilities and workforce.

For BT purposes, in SAT Announcement 51 (2011)), the SAT has indicated that the transfer of assets, debt claims, liabilities and workforce of an enterprise in their entirety should be outside the scope of BT.

These concessions are very general in their wording and can be difficult to apply in practice.



# OPTIONS TO TAX

## Are there any options to tax transactions?

Yes, there is an option to tax for VAT purposes - it is known as a tax exemption waiver. The tax exemption waiver is general in nature - that is, once waived it applies to all goods and services supplied by the unit, and to all of its customers for a minimum period of three years.



# HEAD OFFICE AND BRANCH TRANSACTIONS

## How are transactions between head office and branch treated?

Transactions between a head office and its branch will generally be subject to VAT or BT.

A regulation has recently been issued which would allow the branches of a single legal entity that are subject to the VAT pilot program to group for VAT purposes, thereby excluding transactions between those branches from VAT. The specific implementation rules under which this framework will be operational at an administrative level have yet to be introduced (except in respect of the airline industry).

Currently in some specific industries, a head office and its branches in the same province may be eligible to report on a consolidated basis, such as occurs with certain merchandise retailers and service station operators. Still, such branches may be subject to separate VAT and BT payment obligations.

# BAD DEBTS

**Are businesses able to claim relief for bad debts?**

Generally, no bad debt relief is available for VAT purposes. For BT purposes, some financial institutions have obtained bad debt relief on delinquent loans.

**What conditions must a supplier fulfill in order to make a bad debt relief claim?**

N/A.

**How does a business make a bad debt relief claim?**

N/A.

**What evidence must a business hold in order to make a bad debt relief claim?**

N/A.

**Is there any requirement to issue a notice to debtor when claiming a bad debt relief?**

N/A.

# ANTI-AVOIDANCE

**Is there a general anti-avoidance provision under VAT/Business Tax law?**

No. However, there are broadly applicable provisions which deal with transactions at less than market value, or an abnormal loss is derived.

# PENALTY REGIME

## What is the penalty and interest regime like?

The penalty and interest regime in China is designed to have a strong deterrent effect.

## What penalties can be imposed as a result of certain errors?

There are several different types of penalty regimes applicable in China. They apply generally to all taxes, not just VAT and BT. They include:

- a default fine applicable to all unpaid taxes, levied at a daily rate of 0. 05 percent (equivalent to 18. 25 percent per year )
- uniform fines of up to RMB 10,000, for failure to apply for, change or cancel tax registration within prescribed time limits, failure to establish or maintain accounting books, failure to maintain supporting documents, failure to submit accounting software to the tax authorities, failure to install tax-control facilities, failure to file tax returns or submit information required to accompany such returns
- penalties ranging from 50 to 500 percent of the tax owed for tax evasion
- various criminal sanctions which may apply, too, with a particular emphasis on VAT invoicing fraud.

## What is the reassessment period?

Generally, it is three years. However, it may be extended to five years where the amount of tax underpaid is greater than RMB 100,000. There is also no limitation in cases of tax evasion.



# TAX AUTHORITIES

## TAX AUDITS

**How often do tax audits take place?**

Audits take place regularly. They tend to be carried out in the form of annual tax inspections targeting specific industries or entities, self-inspections and random audits.

**Are there audits done electronically in your country (e-audit)? If so, what system is in use?**

No, e-audits are not generally used.

## ADVANCE RULINGS AND DECISIONS FROM THE TAX AUTHORITY

**Is it possible to apply for formal or informal advance rulings from the (indirect) tax authority?**

No. However, the Chinese tax authorities are considering implementing an advance tax rulings system by way of a pilot program. The pilot program is initially expected to be limited to large enterprises which have entered into Tax Compliance Agreements with the tax authorities.

The tax authorities in China rarely provide written advice – most interactions are provided by way of informal, verbal responses.

**Are rulings and decisions issued by the tax authorities publicly available in your country?**

N/A for rulings. However, when the proposed advance tax rulings system is implemented it is expected that the rulings will be published on the State Administration of Taxation's website (without disclosing the taxpayer's identity or confidential information).



# MISCELLANEOUS

**In your country, are there unique specific indirect tax rules (regimes) that differ from standard indirect tax rules in other jurisdictions?**

Yes, there are a significant number of special indirect tax rules in China which differ from standard indirect tax rules. Many of these rules arise from the fact that the indirect tax system is often used as a means of carrying out the government's economic and trade policies. The main differences include:

- there are multiple VAT rates applicable to different goods and services, and at present, fine distinctions between whether certain services are subject to BT or VAT
- no ability to claim refunds of excess input VAT credits (except for exporters of goods and certain services)
- registration and tax obligations arise at the branch level, not the legal entity level
- foreign entities cannot generally register as VAT taxpayers
- the invoicing system is highly regulated, both in terms of the supplier's obligations and the recipient's entitlement to input VAT credits
- imports of services are subject to VAT on a withholding basis
- exports of goods are "zero rated," but that does not necessarily lead to full recovery of input VAT incurred.

**Are there indirect tax incentives available in your country (e. g. reduced rates, tax holidays)?**

Generally no, however, the government from time-to-time does introduce various exemptions or concessions with a limited time span. For example, an exemption from BT for certain outsourcing services. Some large companies have historically negotiated to receive reduced BT or VAT liabilities when setting up in a new province or district, but these arrangements are now occurring less commonly - other subsidies may be available instead, and are usually negotiated at a local level.

## Contact us

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



### **Lachlan Wolfers**

Leader, Centre of Excellence, Indirect Taxes  
KPMG China  
lachlan.wolfers@kpmg.com  
+852 2685 7791

### Northern China



### **Shirley Shen**

Partner, Tax  
KPMG China  
yinghua.shen@kpmg.com  
+86 10 8508 7586

### Central China



### **John Wang**

Partner, Tax  
KPMG China  
john.wang@kpmg.com  
+86 21 2212 3438

### Southern China



### **Jean Li**

Partner, Tax  
KPMG China  
jean.j.li@kpmg.com  
+86 755 2547 1128

### Hong Kong



### **Karmen Yeung**

Partner, Tax  
KPMG China  
karmen.yeung@kpmg.com  
+852 2143 8753





## Mainland China

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### Beijing

8th Floor, Tower E2, Oriental Plaza  
1 East Chang An Avenue  
Beijing 100738, China  
Tel : +86 (10) 8508 5000  
Fax : +86 (10) 8518 5111

### Chengdu

17th Floor, Office Tower 1, IFS  
No. 1, Section 3 Hongxing Road  
Chengdu, 610021, China  
Tel : +86 (28) 8673 3888  
Fax : +86 (28) 8673 3838

### Chongqing

Unit 1507, 15th Floor, Metropolitan Tower  
68 Zourong Road  
Chongqing 400010, China  
Tel : +86 (23) 6383 6318  
Fax : +86 (23) 6383 6313

### Foshan

8th Floor, One AIA Financial Center  
1 East Denghu Road  
Foshan 528200, China  
Tel : +86 (757) 8163 0163  
Fax : +86 (757) 8163 0168

### Fuzhou

25th Floor, Fujian BOC Building  
136 Wu Si Road  
Fuzhou 350003, China  
Tel : +86 (591) 8833 1000  
Fax : +86 (591) 8833 1188

### Guangzhou

38th Floor, Teem Tower  
208 Tianhe Road  
Guangzhou 510620, China  
Tel : +86 (20) 3813 8000  
Fax : +86 (20) 3813 7000

### Hangzhou

8th Floor, West Tower, Julong Building  
9 Hangda Road  
Hangzhou 310007, China  
Tel : +86 (571) 2803 8000  
Fax : +86 (571) 2803 8111

### Nanjing

46th Floor, Zhujiang No.1 Plaza  
1 Zhujiang Road  
Nanjing 210008, China  
Tel : +86 (25) 8691 2888  
Fax : +86 (25) 8691 2828

### Qingdao

4th Floor, Inter Royal Building  
15 Donghai West Road  
Qingdao 266071, China  
Tel : +86 (532) 8907 1688  
Fax : +86 (532) 8907 1689

### Shanghai

50th Floor, Plaza 66  
1266 Nanjing West Road  
Shanghai 200040, China  
Tel : +86 (21) 2212 2888  
Fax : +86 (21) 6288 1889

### Shenyang

27th Floor, Tower E, Fortune Plaza  
59 Beizhan Road  
Shenyang 110013, China  
Tel : +86 (24) 3128 3888  
Fax : +86 (24) 3128 3899

### Shenzhen

9th Floor, China Resources Building  
5001 Shennan East Road  
Shenzhen 518001, China  
Tel : +86 (755) 2547 1000  
Fax : +86 (755) 8266 8930

### Tianjin

Unit 15, 47th Floor, Office Tower  
Tianjin World Financial Center  
2 Dagou North Road  
Tianjin 300020, China  
Tel : +86 (22) 2329 6238  
Fax : +86 (22) 2329 6233

### Xiamen

12th Floor, International Plaza  
8 Lujiang Road  
Xiamen 361001, China  
Tel : +86 (592) 2150 888  
Fax : +86 (592) 2150 999

## Hong Kong SAR and Macau SAR

---

### Hong Kong

8th Floor, Prince's Building  
10 Chater Road  
Central, Hong Kong  
23rd Floor, Hysan Place  
500 Hennessy Road  
Causeway Bay, Hong Kong  
Tel : +852 2522 6022  
Fax : +852 2845 2588

### Macau

24th Floor, B&C, Bank of China Building  
Avenida Doutor Mario Soares  
Macau  
Tel : +853 2878 1092  
Fax : +853 2878 1096

[kpmg.com/cn](http://kpmg.com/cn)

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