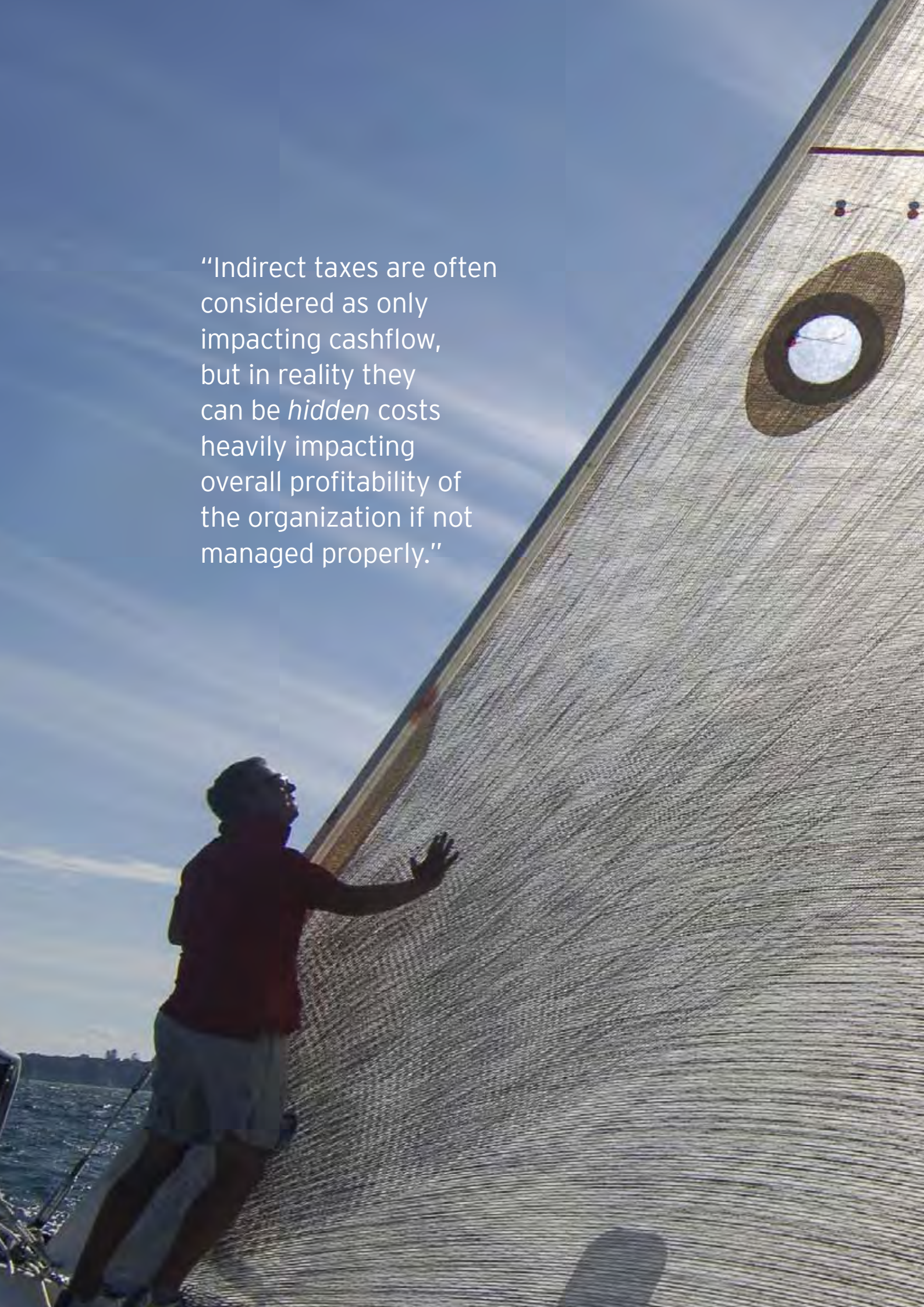




“Indirect taxes are often considered as only impacting cashflow, but in reality they can be *hidden* costs heavily impacting overall profitability of the organization if not managed properly.”



## Foreword

Indirect taxes (specifically Value Added Tax, business tax, customs duty and consumption tax) play an important role in China, accounting for almost 60% of the government's tax revenue. Newly revised regulations are changing how indirect taxes are treated in China. But these are often the forgotten tax on business. Tax directors may overlook these costs as they are above the line and usually not directly visible within the accounts or financial statements.

We are often surprised to learn that many companies have yet to grasp the significance of the indirect taxes passing through the organization. More often than not, indirect taxes are viewed as process-oriented throughput costs rather than as a direct charge to the bottom line that should be managed through proactive and concerted efforts. It is not common for companies in China to employ dedicated resources accountable for the risks and costs that arise from processing indirect taxes. This approach creates risks and results in missed savings opportunities.

Among those with responsibility for indirect taxes, many tend to focus only on the indirect tax payable without consideration of the total turnover and throughput volume (which can equate to multiples of the amount ultimately payable) processed through the system. It is our experience that indirect tax costs, which originally could have been recoverable or avoided, may "leak" out of the system. Even minor errors in tracking, processing and recovering indirect taxes can quickly add up. Consider a relatively low error margin rate of only 3% on the entire value and volume of transactions pushed through the

system and it could result in significant sums being lost each year.

China has recently promulgated substantial changes to the Value Added Tax and Business Tax Provisional Regulations that will impact companies doing business in and with China. The changes have created an environment where it is more important than ever for companies to completely understand the impact to their organization and implement strategic plans accordingly. The magnitude is amplified during difficult economic times as indirect taxes continue to be paid irrespective of an entity's profitability and due to decreases in the government's share of profit based revenues.

Ernst & Young has been working with the Authorities and companies on indirect tax issues during this time of regulatory change. We have dedicated resources closely monitoring the changes and are frequently asked by companies how to proceed. In order to benchmark the impact of the changes and how companies are responding, we conducted a survey of over 200 professionals in China. This report summarizes the key findings from the survey as well as our observations regarding the current and future state of indirect taxes in China.

We hope the report and survey results are of interest to you and illustrate Ernst & Young's in-depth knowledge, understanding and thought leadership in the area of China Indirect Taxes.

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