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China Law Highlights

Policy on Deduction of Enterprise Income Tax on Income Earned Abroad

Recently, the Ministry of Finance and the State Administration of Taxation print and distribute the Circular on Some Questions concerning the Levy of Enterprise Income Tax on Income Earned from Abroad. The Circular specifies related items involved in the enterprises' deduction of income tax on income earned abroad, and defines the amount of deducted income tax by country (region) and the method of deduction quota. Meanwhile, according to the Circular, once an enterprise can't accurately calculate such an amount, the tax paid in the related country (region) shall not be deducted from its tax payable in the current period, nor deducted from its annual tax amount. The Circular has become effective since January 1, 2008.

The Circular, first of all, stipulates that an enterprise shall determine its pre-tax income earned abroad in accordance with Article 7 of the Implementation Rules of the Enterprise Income Tax Law and calculate the amount of income tax payable for income earned abroad as defined in Article 78 of the Implementation Rules according to Item 5 of the Circular. Next, the Circular defines the amount of deductible income tax on income earned abroad as the tax payable and actually paid for the enterprise income earned abroad according to China's overseas tax laws and relevant regulations. The Circular also specifies six types of taxes that don't fall into the category of deductible enterprise

income tax on income earned abroad. Thirdly, the Circular stipulates the formula for the enterprises to calculate the amount of deductible tax quota. Finally, the Circular also stipulates two types of enterprise conditions in which taxation authorities approve the use of some simple methods for calculating the amount of income tax paid for income earned abroad.

According to the Circular, the enterprise income tax on income earned from Hong Kong, Macao and Taiwan shall be levied according to the Circular. If the tax agreement between Chinese government and foreign government differs from the Circular, the former shall prevail. The Circular also furnishes in the form of attachment a list of fifteen countries as sources of income earned abroad with much higher statutory tax rate the that of China, such as the U.S., France and Japan.

Notice on Issues Concerning House Tax And City And Town Land Use Tax

CAISHUI [2009] No.128

Nov. 22, 2009

To: General offices of Finance (Bureau) of provinces, autonomous regions, municipalities directly under the central government and cities specifically designated in the state plan, local taxation bureaus, taxation bureaus of Tibet, Ningxia and Qinghai Autonomous regions and the Bureau of Finance of the Production and Construction Corps of Xinjiang:

In order to improve the policies for house tax and city and town land use tax and plug the leaks on tax collection and control, we hereby clarify the following issues concerning house tax and city and town land use tax:

1. Issues concerning house tax for the rent-free use of real estate of other units :

Taxable units and personnel, for rent-free use of the real estate of other units, should pay house tax on the basis of the residual value of such real estate.

2. Issues concerning house tax for the pawned real estate.

For real estate with pawned title, the pawnee should pay house tax on the basis of the residual value of such real estate.

3. Issues concerning house tax for real estate under financial leasing.

For real estate under financial leasing, the pawnee should, in the month following the starting date agreed upon in the financial leasing agreement, pay house tax on the basis of the residual value of such real estate. Where no starting date is specified in the agreement, the pawnee should, on the

month following the date on which the financial leasing agreement is signed, pay house tax on the basis of the residual value of the real estate.

4. Issues concerning city and town land use tax for underground building land

For any underground building land separately built which is within the incidence of the city and town land use tax, such city and town land use tax should be collected according to relevant stipulations, where a land use right certificate is obtained, tax should be calculated according to the confirmed acreage recorded on the land use right certificate. Where such land use right certificate is not obtained or the acreage of land is unspecified, tax should be calculated according to the vertical projected area of the underground building.

50% of the tax accrued should be temporally levied as the city and town land use tax for the above mentioned underground building land use.

5. This notice will come into force as of Dec. 01, 2009. Article 7 of the Interpretation and Interim Provisions of The General Tax Bureau of the Ministry of Finance for Specific Issues Concerning House Tax (86) CAISHUIDI No.008 and item 2 of the Reply of the State Administration of Taxation on Several Issues Concerning House Tax Business of Anhui Province (GUOSHUIHANFA [1993] No. 368 will become annulled at the same time.

The SAT Promulgates National Implementation Scheme on Type Simplification and Pattern Unification of Plain Invoices

The State Administration of Taxation (SAT) recently promulgated the National Implementation Scheme on Type Simplification and Pattern Unification of Plain Invoices. According to the Scheme, the types of plain invoices currently in use will be significantly simplified, and the specification and patterns of plain invoices will be subject to uniform standards. Upon simplification and unification, plain invoices will be divided into three categories, i.e. general printed invoice, general handwritten invoice and general quota invoice, based on the way of invoicing. It is learned that the new plain invoices will be put into nationwide use on January 1, 2011, and the old ones will be abolished at the same time. The scheme marks the most far-reaching reform of plain invoices of the country since 1949 which covers the broadest geographic dimension.

Currently plain invoices are featured by different types and patterns with divergent specifications and anti-counterfeiting measures across various regions. This has proved to be inconvenient for tax authorities to implement standardized administration and meant difficulty for taxpayers and the general public to utilize invoices and discern the authenticity of invoices. With increased operational costs of taxpayers and lowered efficiency of tax administration, the multi-type of invoices has

become a major bottleneck for the informatization of invoice administration.

According to an official with the Technology Department of Tax Collection and Administration of the SAT, the reform is implemented in line with the general idea of "simplifying invoice types, unifying invoice patterns, establishing uniform platform and invoicing via network". The reform attempts to design the type and pattern of invoices on a scientific basis through which the existing types and patterns will be significantly simplified and optimized. Efforts will be made to enhance the standardization and informatization of administration of plain invoices by promoting the use of printed invoices, greatly reducing the use of handwritten invoices, as well as establishing a platform for invoicing of plain invoices, acquisition and inquiry of relevant information. In this way, tax authorities will be able to progressively approach the goal of administrating tax based on information flow as an substitute to the current invoice-based administration, hence further strengthen the monitoring and control of tax sources and improve taxation services.

Given that some types of invoice are needed to be reserved for the time being, the STA has decided to keep the use of these invoices which include: itinerary/receipt of e-ticket for air transportation, uniform invoice for motor vehicles vendition, uniform invoice for second-handed motor vehicles vendition, uniform invoice for goods transportation with roads and rivers, uniform invoice for construction business, uniform invoice for real estate vendition, and the certificate for exchange of invoice. Park entrance tickets that cannot be classified as general invoices will also be reserved.

It is learned that the simplification and unification will be set into motion from the end of 2009. The year of 2010 is set as a period for implementation and transition, during which the new invoices and old ones can be used in parallel. From January 1, 2011 the new plain invoices will be put into use nationwide and the old ones will be abolished and put out of service.

In order to facilitate the implementation, the SAT requires that tax authorities in various regions should further promote the use of printed invoices. Efforts should be made to guide those taxpayers with large turnover or conducting management via computer to use printed invoices. Tough restrictions should be imposed on the use of handwritten invoices. Efforts should be made to progressively reduce or terminate the use of handwritten invoices, based on the development of economy. Efforts should be made to use quota invoices in a reasonable manner and restrict the use to taxpayers other than fiscal cash register and internet invoiced invoices with small volume of invoices and amounts, or those not suitable with machine invoiced invoices. Efforts should also be made to further standardize titled invoices, the anti-counterfeiting measures of plain invoices and the coding of plain invoices.

The official emphasizes that the simplification and unification of plain invoices are concerned with the vital interests of each taxpayer as well as the invoice administration of tax authorities. Therefore, tax authorities at all levels should make conscientious efforts to relieve taxpayers' costs of invoice use through the implementation. Tax authorities should enhance the publicity and training on the use of new invoices, make sure that all taxpayers apprehend and grasp the significance and procedures for use of new invoices, and make taxpayers fully aware of the convenience brought by the simplification and unification.

Tax Case Analysis

T City GH Department Store Co., Ltd. (November 27, 2009)

I. Basic Facts

A. Basic situations of the company:

GH Department Store Co., Ltd. is a small-scale company taxpayer, which is under the jurisdiction of the district branch of T City Municipal Office State Administration of Taxation. Tax ID Number: 370982169627298; Legal Representative: Li X X; Finance Supervisor: Li X; Total Investment Amount: RMB200, 000; Economic Nature: Other limited liability company; Business Scope: Daily necessities, Knitting, Shoes, hats, etc. Mode of Operation: Wholesale and Retail; Applicable Tax Rate: 4%.

B. The main case:

The company did not record part of its retail sales and used off-balance sheet accounts to hide income to evade taxation. The case involves nearly RMB 280,000.

II. Case-source and Analysis before investigation

A. Case-source

When the district branch of T City Municipal Office State Administration of Taxation conducted a routine inspection, they found that GH Department Store Co., Ltd. located in the city's downtown, was operating without showing its business license. Then tax inspectors conducted a tax examination on the company according to established inspection procedures, but found the company's female salesperson to be rude, abusive, and blocking the inspection. The officers attempted to persuade the

employees to be cooperative but were unable to do so. In order to not exacerbate the situation, the deputy director of the district branch office decided to leave the audit site. After receiving the consent of the T City Municipal Office State Administration of Taxation, the tax officer decided to inspect the company using the Inspection Bureau. After receiving the decision of the T City Municipal Office State Administration of Taxation, the Inspection Bureau, in accordance with audit procedure, sent two inspectors, WanXX and TianXX, to GH Department Store Co., Ltd. to release the “Notice of Tax Inspection ”and the“Notice of Transferring the Books of Account Information”.

B. Assessment and Analysis

In 2000, the recorded sales income of T CITY GH Department Store Co., Ltd was RMB 169,711.54; value-added tax paid was RMB 6,788.46; tax rate was 4%. In 2001, the recorded sales income was RMB 148,413.46; value-added tax paid was RMB 5,936.54; tax rate was 4%. In 2002, the recorded sales income was RMB 129,951.91; value-added tax paid was RMB 5,198.08; tax rate was 4%. By analyzing the sales revenue and the taxes paid from 2000 to 2003, as the tax rate remained unchanged, the company's revenue and taxes showed a downward trend year by year. This result was disproportionate to its scale of operations and it was obvious that the taxpayer had made a false declaration. In addition, faced with the tax officers’ audit, the taxpayer deliberately attempted to mislead the tax officers. Though the taxpayer did not welcome the tax officers’ audit, the taxpayer was not openly confrontational. Thirdly, the company was located in the city’s downtown, and it was obvious that income was under-reported based on a comparison of companies of similar scale in the vicinity of the taxpayer. Therefore, the taxpayer was suspected of tax evasion and the government made the decision to seize the books of account and conduct a thorough on-site inspection in order to collect further evidence.

III. Illegal facts, illegal means and inspection methods

A. Hiding of the original retail vouchers

When the inspectors conducted the on-site inspection, they found four cardboard boxes filled with the "Single-commodity sales" invoices and other raw data in the company’s warehouse. Then the company's manager Li XX was asked why he did not submit the information to the Inspection Bureau for reference, he replied that the invoices were all for previous years and useless. While the inspectors were preparing to examine the contents of the boxes, five salespersons immediately rushed in, grabbed the boxes, and besieged the inspectors. The inspectors were calm and informed the manager and salespersons of the legal consequences of obstructing an official tax inspection. After patient persuasion and education, the company employees finally agreed to allow the documents to be inspected. After a review of the documents, the tax inspectors confirmed that a portion of retail sales was not recorded in the sales income and therefore the full tax liability had not

been paid.

B. Use the computerized accounting software to hide income

When checking the books of account and the original data, the inspectors found a print "operation table" created by the computer, which showed the company used computerized accounting software. The inspection unit immediately checked the company's computer and found that accounting software was being used. All the information was there except for "sales revenue" and the information had been removed on the date of the tax inspection. Therefore, the inspection unit held two discussions with the legal representative. During the first interview, LiXX said that "the company's business is divided into two parts, wholesale and retail. And that it would only be possible to conduct an examination of the retail portion of the business. The taxpayer said that the value-added tax of the wholesale business was small and therefore the wholesale portion of sales was not declared." However, when inspectors asked the taxpayer to provide the books of account for the wholesale segment, the taxpayer said: "I do not understand the tax very well and I thought the information were useless and threw them away." Although the inspectors attempted to persuade the taxpayer, Li insisted that there were nothing he could provide. During the second interview, Li said "in order to manage the business more easily, I bought a computer in June, 2002. But I do not understand the computer, nor am I able to change the file." When asked why all the dates were there except the "sales revenue", he responded that he didn't know. The inspectors repeatedly told Li of the importance of cooperating with the inspection and the serious consequences of secretly changing the tax information. Finally Li admitted that the software was changed by other employees. Under compulsion of the tax inspectors, the taxpayer restored the missing sales data and the tax evasion was exposed.

C. Determining the tax evasion

After ten days of investigation and evidence gathering, the tax inspectors were able to fully understand the methods the taxpayer has used to commit tax evasion. According to the *Tax Collection and Administration Law of PRC* and the related accounting regulations, the taxpayer's tax evasion including:

(1) Tax evasion in the year 2000.

After reviewing the purchased and the sold goods in the seven Commodities Stock Account, the tax inspectors affirmed the sale of year 2000 was RMB 862,311.24, the non-tax revenue was RMB 829,145.42, and the value-added tax payable should be RMB 33,165.82. However, only RMB 6,788.46 had been paid and another RMB 263,77.36 remained to be paid.

(2) Tax evasion in the year 2002.

The tax inspectors reviewed the accounting software of the company and verified the actual sales

value from June to December, 2002 was RMB 5103,836.77. Therefore, the value-added tax payable should have been RMB 196,301.41 [RMB 5,103,836.77 ÷ (1+4%) ×4%].

(3) According to *Sales List* provided by the company, the monthly sales for 2002 was RMB 452,620.12 Yuan in February, RMB 156,817.45 in April, and RMB 392,543.90 in May. The tax officers were unable to locate the *Sales List* of January and March.

The VAT payable for February, 2002 was RMB 452,620.12 ÷ (1+4%) ×4%=17408.47 Yuan.

The VAT payable for April, 2002 was RMB 156,817.45 ÷ (1+4%) ×4%= RMB 6,031.44.

The VAT payable for May, 2002 was RMB 392,543.90 ÷ (1+4%) ×4%= RMB 15,097.84.

The VAT payable of the ten months in total was RMB 234,839.16.

As the tax files offered by the T City GH Store Co., Ltd. were incomplete, the inspectors could not verify the tax payable of the month January and March. Thus the inspectors decided to count the two month's tax payable in accordance to the article 35 of the *Tax Collection and Administration Law of PRC*. As to the examination of existing information and understanding of the situation, the company's original value of fixed assets in 2002 included RMB 1,350,000.00 of buildings, RMB 60,000.00 of automobiles, and RMB 10,000.00 of mobile phones and air conditioners. There were 45 employees with monthly pay of RMB 300 and the average monthly administration cost and financial expense was RMB 1,681.00 and RMB 2,810.38.

According to Article 25 of the *Regulation of Pre-income Tax Deduction*, unless otherwise specified herein, the minimum term of depreciation of fixed assets shall be:

- a. 20 years for houses and buildings;
- b. 10 years for trains, ships, machinery and other production equipments;
- c. 5 years for electronic equipments, transportation means except for trains and ships, as well as production and business-related equipments, tools and furniture. (The residual rate of fixed assets is 5%)

Therefore the company's depreciation for January and March should include the following items: RMB 5,343.75 of buildings, RMB 950.00 of automobiles and RMB 158.33 of mobile phones and air conditioners. The total amount was RMB 24,443.46.

According to article 35 of the *Tax Collection and Administration Law of the PRC* and the second paragraph of article 47 of the *Tax Collection and Administration Law Implementing Regulations of the PRC*, the VAT payable of the January and March in 2002 was RMB 9,777.38.

(The formula: VAT payable=reasonable cost/ gross margin*tax rates the gross margin is 10%)

In total, the VAT payable of 2002 was RMB 254,393.92 Yuan. However, only RMB 5,198.08 was paid, with RMB 249,195.84 remaining to be paid.

The total unpaid VAT value of the year 2000 and 2002 was RMB 275,573.20.

IV. Result of the case

Based on the amount of tax evasion, the company had committed criminal tax evasion. The case was handed over to the judicial authorities for prosecution.

According to the *Tax Treatment Statement* and *Tax Punishment Statement*, the company paid the VAT tax of RMB 275,573.20, a late penalty payment of RMB 77,340.87 and a fine of RMB 480,923.29, for a total amount RMB 480,923.29. *The* company also adjusted its accounting practices. Those persons who were found to be responsible for the criminal tax evasion have been handed over to the juridical authorities.

Tax News

Hundreds of Animation Companies Will Enjoy Preferential Tax Policies

Source: China Taxation News

Recently, administration work on the certification of animation enterprises has been completed. Among the 303 enterprises that have preliminarily examined and certified by the 23 provincial certification institutions, 100 enterprises have passed the examination and verification by the Ministry of Culture, the Ministry of Finance and the State Administration of Taxation, and have been certified to be animation enterprises which may enjoy preferential tax policies.

Animation enterprises in China's eastern, central and western regions have submitted declarations and been certified. Among them are 26 Beijing enterprises, 15 Jiangsu enterprises, 10 Hunan enterprises, 8 Guangdong enterprises and 7 Tianjin enterprises.

The first certified animation enterprises include not only the domestic large-scale well-known animation companies, but also emerging small and medium sized animation companies. The total certified registered capital of animation enterprises reached RMB 1.13 billion and 34 of these

enterprises had registered capital exceeding RMB 10 million.

It is reported that the certified animation companies may go through the formalities with the relevant tax authorities for preferential tax payment after having obtained the certification to enjoy the preferential policies on value-added tax, corporate income tax, sales tax, import duties, import VAT and other taxes.

At the same time, provincial certification institutions will carry out an annual inspection of the animation enterprises every year from May to July. Animation companies that fail to meet the certification standards shall be disqualified from enjoying the preferential tax policies.

In recent years, relevant departments have implemented a series of important policies for the promoting the development of the animation industry. The Ministry of Culture, the Ministry of Finance and the State Administration of Taxation jointly carry out the certification process of animation companies, which is an important strategy for fully implementing the fiscal and tax supportive policies of animation companies.

Shanghai looks at tax refund for exporters

SHANGHAI is considering introducing a tax refund to exporters of dry bulk goods and containers departing from Qingdao and Wuhan that used Yangshan Deep-Water Port as a transfer hub as it bids to compete with neighboring ports in the Asia-Pacific.

The Ministry of Finance, the State Administration of Taxation and the General Administration of Customs will coordinate the pilot plan which will start in the near future, a government official said at a press conference yesterday.

"Export companies will have their tax refunded as soon as their goods leave Qingdao or Wuhan for Yangshan port, thus speeding up their capital flow," said Wen Xuexiang, vice director of the Shanghai Customs Office.

Previously export companies used Busan in South Korea and other neighboring ports as a transfer hub.

China, British Virgin Islands Sign Agreement on Exchange of Tax Information

Mr. QIAN Guanlin, Vice Administrator of State Administration of Taxation of China, and Mr. Ralph

T. O'Neal, Prime Minister and Finance Minister of British Virgin Islands, on behalf of their respective governments, formally signed the Agreement on Exchange of Tax Information between the Government of People's Republic of China and the Government of British Virgin Islands. This is the second information exchange agreement between China and the off-shore financial centre posterior to the first one with Bahamas on Dec. 1, thus opening a new chapter of successful cooperation in tax negotiation between China and off-shore financial centers.

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