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To provide services on tax law enquiries, tax planning, taxation risk preventing and agency in tax suits.

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Beware of Your Taxation Risk, Yao Ming

According to Information Times on October 25, 2003, Yao Ming has signed a contract worth of 18 million US dollars for 4 years. Besides this, an US website which is specified to estimate the income of NBA superstars shown that, the advertisement income of Yao has reached 8 million dollars in the past year. And according to the summary of the last edition of Forbes (Feb, 2004), Yao's annual income has reached RMB 120,000,000. Although Yao has declined the figure brought by Forbes, it is undoubted that Yao has earned extremely much last year.

Yao Ming is worldly known for his wonderful talent, excellent skill, gentle manners as well as his perfect performance on NBA playgrounds. Now he is already a proud of Chinese people and has brought more confidence, respect and intention from the world to this country. For these reasons, Yao absolutely deserves what he has earned for his personal and commercial value. However, as celebrities, Liu Xiaoqing and Mao Aming have brought some pity to their glory because of their taxation disturbances. We just can't help wondering if Yao's huge oversea income has been taxed in China? Should Yao also be taxed in the territory of PRC?

Whether an income should be taxed, refunded or free from taxation, should stick to the relevant legislations. If there is no provision that shows certain income should be taxed, no administration have the right to levy the tax with any reason. On the other hand, if certain income is taxable according to tax law and if there is no exemption conditions described by legislation available, or the income isn't covered by those conditions, then no administration has the right to exempt the tax upon that income. This principle is surely applicable to Yao Ming,too.

Article 1 of The Individual Income Tax Law of People's Republic of China provides, "Individual income tax shall be levied in accordance with the provisions of this Law by individuals who have domicile in China, or without domicile but have resided for one year or more in China on their income derived from sources within and outside China". And Article 2 of The Notice About Issuing Temporary Regulations of Levying Personal Income Tax On Oversea Incomes By State Administration of Taxation (No. Guo Shui Fa 126 [1998] on August 12, 1998) reads, "This Regulation is applicable to individuals who has domicile in China and have income from outside of China", Article 3 says, "All taxable income from outside China should be taxed with personal income tax according to tax law and this Regulation, and The Notice About Issuing Regulations About Several Questions of

Collecting Personal Income Tax By State Administration of Taxation (No. Guo Shui Fa 89 [1994] on March 31, 1994) provides, "The individuals who has domicile in China are those are accustomed to reside in China because of Hu Ji, family and economic interest. Accustomed Residence is a legal standard to recognize taxpayer's identify as resident or not, instead of where he actually residents or stays in a specific period. As for those who stay out of China because of study, employment, visiting and traveling and will have to come back to China afterward, their accustomed residence is still within PRC". According to these rules, All of Yao Ming's oversea income is under Chinese tax jurisdiction.

Can Yao Ming's income from NBA be free of tax? According to Article 4 of Individual Income Tax Law of People's Republic of China, the income of Yao needs to meet at least one of the following two requirements in order to get the favor treatment of tax-free: the income is tax-free according to International Treaties participated by China; or the income is tax-free upon the approval of financial agencies of State Council. As far as the current legal regulations are concerned, there is no regulation stipulating income like Yao's can be tax-free. It is clear that Yao is not covered by the second exemption. Then, can Yao enjoy the favor granted by bilateral tax treaties entered between China and US?

According to Article 13, 14 and 16 of Agreements on Avoiding of Double Taxation and Tax Escaping Between People's Republic of China and United States of America, the US authority is entitled to levying taxes on Yao's wage income from Houston Rockets and incomes from other activities such as making advertisements. However, Chinese authorities also have the complete authority to do so. That is, Yao Ming's income doesn't fall into the first exemption, neither, and he is obliged to pay the personal income tax to Chinese government.

The public will always be somewhat demanding to celebrities, hoping them to be perfect and flawless. However, when busying with their own affairs, they tend to neglect those issues which needs professional assistance. Liu xiaoqing and Mao Aming must be regretful for their negligence in the past. So, as a tax attorney and a fan of Yao, I sincerely wish him far away from any tax disturbance and have a great future in his career and life.

Taxation Laws and Regulations

1. Notice Concerning Problems about Examination on VAT Invoices' Electronic Information of Output Goods by State Administration of Taxation (No. Guo Shui Fa 1392 [2003])

When examining tax refund application for goods (except 3 kinds) declared to the customs after Jan 1, 2004, the tax administration will no longer review the electronic information of the VAT invoices. Only the paper invoices need to be looked through.

2, Reply to the Problem about VAT exemption on feeding fish oil products by State Administration of Taxation (No. Guo Shui Han 1395 [2003])

It is clear that feeding fish oil, mainly used in aquaculture, is a byproduct that comes from the production of fish meal. It belongs to "Single Staple Feed". And since Jan 1, 2003, the VAT exemption for "Single Staple Feed" also applies to feeding fish oil products.

3, Notice about refund of taxes paid during the construction of Qing-Zang Railroad by State Administration of Taxation (No. Guo Shui Han 1387 [2003])

This notice states that, according to the file No. Cai Shui 128 [2003], all business taxes, VAT, stamp taxes, resource taxes, taxes on usage of land in towns and corporate income taxes by all participating units related to and during the construction, should be exempt from taxation. In the light of this provision, all taxes described in No. Cai Shui 128 [2003] and levied after the start of the project in 2001, should be returned to the taxpayers.

4, Administration Rules for Taxation Registration of PRC (No. 7, order of State Administration of Taxation, Dec 17, 2002)

These rules stipulate the requirements, procedure and required documents to set up, change, pause and resume, cancel taxation registrations and to set up temporary taxation registrations. They also involve the administration of taxation registration licenses and the punishments against the violation.

5. Notice about Taxation Policies on Produce Sales by Individual Businesses by State Administration of Taxation (No.Guo Shui Fa [2003], Dec 23, 2003)

It provides, since Jan 1, 2004, the starting point of VAT taxation for Individual Business who sells or mainly sells aquatic product, livestock product, vegetable, fruit and grain is RMB 5,000 (income per month) or RMB 200 (income per time/day).

6, Reply to the issue that VAT rate applies to natural CO₂ by State Administration of Taxation (No.Guo Shui Han 1324 [2003], Dec 10,2003)

This reply points out that CO₂ is not within the scope of “natural gas”, so the tax rate of 17% still applies instead of the special rate for natural gas.

7, Notice about Giving Out VAT Invoice Printing Plan for First Half of 2004 (No.Guo Shui Han 1321 [2003])

It is clearly stipulated in this notice that, from 2004, VAT invoices will switch to 3 pages for each invoice, consisting of deduction page, invoice page and tally page.

8, Notice about Policies on Stamp Duty During the Transformation of Enterprises by State Financial Ministry and State Administration of Taxation (No.Cai Shui 193 [2003], Dec 8,2003)

It is provided, for newly founded companies comes from formal state owned enterprises after incorporation, the capital borne on the new account books and the capital gain because of the capital relationship of incorporation, are free from stamp taxes if they have already been stamped. The unstamped part and the capital gain afterward should still be stamped according to relevant rules.

9, Notice About Problems Concerning VAT Policies on Publications Such As Technology Standards by Ministry of Finance and State Administration of State (No. Cai Shui 239 [2003], Dec 3, 2003)

All technology standards, criteria, regulations published upon the approval of State Press and Publication Administration with uniform book numbers (including bound editions, separate editions and electronic publications with uniform book numbers), are entitled to the VAT treatments of “refund after collection” granted to science books by document No. Cai Shui 88 [2001].

10. Notice about Promoting the Subsequent Administration on Cancelled Tax Refund Items by State Administration of Taxation (No. Guo Shui Fa 145 [2003], Dec 2 2003)

This notice answers tax policies, including whether to levy VAT and to give a tax refund, the procedure of tax refund, on involved goods in nullified documents of No. Ji Jing Mao 161 [2000], No. Guo Jing Mao Mao Yi 882 [1998], No. Guo Shui Han 649 [1996], No. Cai Shui Zi 119 [1998], No. Guo Shui Fa 079 [1992], No. Guo Shui Fa 279 [1992], No. Guo Shui Han Fa 860 [1992] and No. Cai Shui Zi 14 [1997].

11, Notice about Carrying Out Administrative License Law of PRC by State Administration of Taxation (No. Guo Shui Fa 143 [2003], Dec 1, 2003)

It is pointed out that, tax administrations are very important to national authority. Administrative License is an important method that is used very often. Tax administrations must perform its task strictly stick to the Administrative License Law. After its adoption, tax administrations of all levels do not have the creation right of administrative licenses for taxation any more.

12. Notice about Beginning the Work of Giving Notice to Taxpayers who owes Taxes (No. 1397 Guo Shui Han [2003], Nov 21, 2003)

The local administrations should propagandize the regulations that public notices should be given to tax arrears and the responsibilities should be borne thereafter. Furthermore, notice letters should be specially sent to inform the defaulting taxpayers of the provision that defaulting taxpayers shall be proclaimed and to confirm the amount that is owed.

13. Reply To The Problem of VAT Collection on Construction Materials by State Administration of Taxation (No. Guo Shui Han 1151 [2003], Nov 14, 2003)

According to the notice No. Cai Shui 44 [1995], construction materials made from not less than 30% of gangue, pulverous coal ash or slag are free from value added tax. This ratio can be calculated according to either volume or weight of the adulterant.

14. Notice on promoting the subsequent administration on cancelled administrative examining and approving item on Municipal Construction and Maintenance Tax by Financial Ministry and State Administration of Taxation (No. Cai Shui 230 [2003], Nov 10 2003)

It is assured that after the nullification of No.Cai Shui Zi 1143 [1985], local governments of all level no longer have the examining and approving right for tax relief on Municipal Construction and Maintenance Tax. All local financial and taxation departments may not decide the tax relief on Municipal Construction and Maintenance Tax by themselves.

Q&A

1. How to issue VAT invoices in the situation of returning of goods and discount sales?

A: It depends.

- (1) If the invoice page and deduction page are returned in the month when transaction happens, and the transaction hasn't been processed in account, the seller may nullify the original VAT invoice, by marking the four pages of the invoice with "CANCELLED". Also, he should nullify the record in his VAT issuing system (an authorized PC system which is dedicated to issuing VAT invoices); When the transaction has been already processed, then an invoice with a negative amount has to be issued to credit the output VAT tax. The original issued invoice may not be cancelled anymore. Also it is not allowed to issue a 'red font' normal invoice (a normal invoice, not VAT invoice, which is filled in in red) to credit the output tax.
- (2) If the invoice is returned in the next month after transaction by the buyer, the latter method described in the previous paragraph has to be followed.
- (3) When it becomes impossible for the buyer to return those two invoice pages, the seller shall also follow the second method in paragraph one, given a certificate for goods returning and discounting, which is issued by buyer's local tax administration, is provided.

2. Can' I buy invoices before accepting punishment?

Q:

This is a newly founded computer company. In the beginning of this April, we received a fine of RMB 1,000 for not having our bank account submitted to the local State Administration of Taxation (hereinafter refer to SAT). Also we are ordered to mend this before the end of April. On May 8, when our accountant went to the local SAT to buy the invoices, it is said that we couldn't get them because the bank account and fine hadn't been submitted by that time. The question here is: was the local SAT violating our company's rights by doing so?

A:

The local SAT was doing their job consisting with legislations, and no lawful rights were violated.

Article 72 of the newly adopted LAW OF THE PEOPLE'S REPUBLIC OF CHINA TO ADMINISTER THE LEVYING AND COLLECTION OF TAXES provided, "The tax administration may confiscate invoices from or stop selling to taxpayers, who commits violation to this law when manufacturing or running business and refuses to accept the punishment from administrations." It also provides that taxpayers should submit all of their

bank accounts to SATs. The administration may order the violators to mend within a given period and may impose a fine under RMB 2,000. Your company neither reported its accounts to the SAT, nor paid the fine after the penalty was imposed. This constitutes the described situation in the said law as “refusal to comply with the punishment rendered by SAT”. As the result, it is lawful for the local SAT to stop selling invoices to you.

3. What shall I do if the VAT invoice issued by Fake-Preventing Taxation Controlling System (hereinafter refer to FPTCS) is lost?

A: Our company obtained a VAT invoice for ‘taxpayer of small amount’ issued by FPTCS in the local tax administration from another enterprise. Unfortunately, this invoice is lost thereafter. May I credit my input tax using a certification obtained from tax administration along with the print copy of the lost invoice?

Q: According to relevant regulations, tax administration may not issue VAT invoices using FPTCS for ‘taxpayer of small amount’. These invoices can only be issued by hand or by PC. So if your company has lost an invoice for ‘taxpayer of small amount’ issued by FPTCS, this situation is impossible in principle. Please check it carefully again. If it is issued by tax administration for you, it can only be faked. And please report it to the superior administration.

4. May invoices be issued in other cities?

Q:

Recently, one of my customers invited me to settle accounts in his city. I am going to take my invoices and issue them there. So I’d like to know whether I am permitted to issue the invoices in another cities?

A:

According to Article 26 of Administrative Rules of Invoices, invoices can only be issued in the province, autonomous region or municipality directly under the central government of the holder. Article 27 further provides that any entity or person, without approval, are not allowed to take, mail or transport blank invoices out of prescribed area. And Article 37 stipulates that, to those who illegally take, mail, transport or preserve blank invoices, the tax administration shall take over the invoices and confiscate illegal incomes, a fine under RMB 10,000 may also be imposed. So it is clear that invoices can not be issued in other cities.

Delay in issuing value added tax invoices should take the responsibility of compensation

In March of 2003, Company A (Shanghai) bought some raw materials worthy of RMB 5,000,000 from Company B in Xi'an province. After emitting all the payments, A received the VAT invoice. When it came to the local administration to apply for deduction of input tax, it is found that there is some problem with the password borne on the invoice and can't be processed. Later A found out that the invoice was issued in the name of another company (C) instead of B. Then A contacted C and asked it to re-issue the VAT invoice. However, C claimed that they have never issued invoiced for other companies, the invoice held by A was none of their businesses. Under this circumstance, A had to turn to B again, asking them to re-issue the invoice. But Company B ignored them. As the result, the VAT input tax, amounted at RMB 850,000, still can't be deducted now and heavily influenced the capital flow of Company A.

In this case, Company A may ask the local administration in Xi'an to force B to issue VAT invoice by prosecuting it.

However, according to Article 4 of Temporary VAT Regulations of People's Republic of China, when taxpayers provide goods and services, the tax to be levied is the total amount of output tax deducted with the amount of input tax in the current taxation period. The length of a "taxation period" is decided by tax administrations according to the legislation. And only the actually happened input and out put taxes can be calculated in that period. That is, even the input tax has been realized (paid), it can't be deducted if the VAT invoice hasn't been obtained in that period. That tax amount can only be deducted in the coming periods. This kind of delay will surely influence the capital flow of the taxpayer and cause loss to him. If the delay is cause by the opposite party in trading, the injured party is entitled to claim for the lost.

In this case, Company B delayed in issuing the VAT invoice, so the input tax of A couldn't be deducted in time and it's capital flow was frustrated. And the loss shall be compensated by Company B.

Question 1. How should the base for calculating of loss caused by delay in issuing VAT invoice be decided?

According to the way in which VAT is calculated:

The amount of VAT to be levied = output tax – input tax (All amount is of that Taxation Period)

From this formula, the more the input tax is in a period, the less the VAT to be paid. Comparatively, the less the input tax is, the more the VAT will be. With regard to the delay

in issuing, if it involves more than one Period, the amount that is over-paid in the previous period should be the base for calculation of the loss.

On the other hand, if the seller issues VAT invoice in the next period, as the result, he actually extends the transaction to another taxation period (notice that different taxpayers may have different division in time for taxation periods). With respect to the seller, its output tax will decrease in the first taxation period. That is, certain amount of payment will be delayed until the next period. This same amount is actually paid by the buyer and it will only be refund also until the next period.

To the tax administration, the total amount of tax levied in this period remains the same, and some parts that should be paid by the seller are levied from the buyer. To the state, the total tax income isn't affected. As for the seller, he got some extra fluid capital, and this is based on the loss of the buyer.

So from the perspective of capital flow, the buyer overpaid taxes because he can't deduct certain amount of input tax. This amount is the loss of the buyer and equals to the sum borne on the VAT invoice.

2. How to calculate the loss caused by the delay?

According to the analysis above, the delay causes buyer's temporary loss of VAT tax borne on the invoice which should already been issued. Although this amount will be realized after the invoice is issued later on, the buyer still loses the value this money could have generated during this time. At least the interest profit could have been obtained from the bank at that time. According to some Replies by SPC (The Supreme People's Court of PRC), the compensation should be calculated with a rate of 0.021%/day.

3. How to calculate the time wasted by the delay in issuing?

According to the 23 Article of Temporary Regulations of VAT, if the taxation period for certain taxpayers is divided according to each month, he is obliged to pay that tax in ten days after the due date. From this article concerning VAT taxation period we can know VAT is settled with a specific deadline. Once the deadline has passed, the tax will have to be settled within the next period. So when calculating the time loss, the number of taxation periods elapsed have to be counted and worked upon. For example, if one taxation period is 30 days and one extra period is used, the time loss here will be 30 days. It should be noticed that within a taxation period (before the deadline and thus no extra periods are concerned), even if the invoice is issued late, there won't be any losses to the buyer.

As a conclusion in this case, besides the right to ask Company B to issue a valid VAT invoice again, it is also entitled to claim the loss from other side.

What is VAT of consumption type?

China has decided to switch its VAT from 'production type' to 'consumption type'. This is an important change upon taxation and has been implemented in northeast of China where many capital-intensive enterprises are located. Then what's the difference between these two types of VAT? Why China needs to take this change?

In countries where VAT is adopted, there are three kind of VAT based on whether and how input VAT for purchase of fixed assets is deducted.

A. VAT based on production.

When levying this kind of VAT, the expense for fixed assets can't be deducted. The value added amount includes all newly created value, along with the investment on fixed assets. From the view of national economy, the taxation base generally equals to the GDP, that's why it is called VAT of production type. In this principle, the taxation base is more than the really added value. There is double taxation upon fixed assets. So it is not very advantageous to encourage investing. However, it will be helpful to ensure the tax income of the state. China's VAT temporary regulation provides, the input tax for purchase of fixed assets can't be deducted from the enterprise's output tax. That means, China currently is still using production type VAT.

B. VAT based on income

It means, when calculating VAT, only the depreciated part can be deducted. The taxation base equals to the newly created value. From the view of national economy, it matches the national income. So it is called VAT based on income. In this principle, the taxation base is the real added value. So it is a 'standard VAT'. However, the expense for fixed assets is transformed into the value of products part by part, and there is no voucher for each part of depreciation. So it is hard for the VAT taxation system which heavily depends on invoices. Thus it is not widely used.

C. VAT based on consumption

The expense for fixed assets in that taxation period can be deducted. The taxation base is the total sales income credited with expense of all purchased materials for production. From the view of national economy, the taxation base is limited to the part of means of consumption. Because the deducted amount greatly increases in the period when fixed assets are purchased, the public revenue will decrease herewith. However, it suits the calculation system based on invoices very well. Currently for the counties who employ VAT, most of them have chosen this most advanced VAT system, which based on consumption. For example, all member states of EU have adopted their VAT in this method.