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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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Lawyer' View:

Tax Planning and Enterpriser Morality

Many enterprises are doing well in tax planning, but they are usually unwilling to disclose this to the public. Besides being afraid of making troubles, most enterprisers still don't think it honorable to reduce their payment by tax planning. So, it is obvious that enterprisers are lack of recognition on tax planning in their moral level.

1, Development is the fundamental requirement of "enterpriser morality"

For long time, the dominant thinking in our ideology is that paying tax is an honor for citizens. In the Planned Economy System, enterprises are of the state, and taxes are also paid to the state, that's why people said the money "is moved from the smaller pocket to the bigger one of the same person". It is true that the enterprises and the nation belong to the same economic interest. The process of tax collecting only affects the place where capital appears, so there is no need for tax planning to exist. On the other hand, the amount of tax paid is a key element to measure whether an enterpriser is successful and outstanding. So the enterprisers' sense of morality is developed upon this thinking.

However, in the Market Economy System, enterprises are no longer part of the extension of state-owned departments. The task of enterprisers are thus no long paying more taxes, it has been switched to survive and develop themselves in crucial competitions. Making profit will have priority in decision of enterprisers. The sense of responsibility and morality of the enterprisers should also be to bloom the entity that he is running. They are entitled and obliged to bring through and develop the enterprise by all means (using both legal and economic measures) allowed by law. Otherwise, it will be violation of moral standard for an enterpriser. Tax Planning is surely a direct and efficient method of making use of legal resources. It matches "enterpriser morality" in the market economy.

2, From Political State to Civil Society

Making use of economic resources by enterprises will inevitably affect the environment for example. However, if the company obeys environment legislations, the enterpriser won't have moral pressure because of this kind of usage.

Comparatively, tax planning, which is making use of legal resources, will necessary affect the tax income of the state. Although it is legal, there is still 'moral confusion' for those enterprisers who applied this method.

Why both legal behaviors will lead to opposite feelings? The reason is simple: tax planning concerns a special element, the state. Then what roll on earth should the state have in a market economic system? Should it have a special position?

For long time since the foundation of People's Republic of China, the state has been the unique dominant fact in politics, economy, culture and other social elements. In such a

highly politicalized country, the differences between state and society, politics and economy, politics and culture on their structures and functions have been neglected and assimilated. For economic aspect, the politicalization on economic structure and administrativelization on economic entities had deprived entities' self-governing function and their energy herewith.

Since the Third Plenum of 11th Central Committee of CCP (1978), the traditional socialism mode has been modified and the Socialist Market Economic System has been established. And the Market Economy is always accompanied by "Civil Society", a realm for individual activities, which is a definition contrasts to "Political State", a realm where individual freedom, character and rights are greatly realized. The establishment of Civil Society in China requires the state, as the owner of public powers and the protector of private rights, to restrain from participating in market activities. This contains natural ethic requirement comes from standard of individual rights. And it will be the process of China's transforming from a power dominating society to a right dominating one.

How to regulate the interest conflict between enterprise and the state? It has been proved that Civil Society will have a better effect on this issue than the administration by governmental wills.

The development of market economy will promote the maturity of the Civil Society, in which Political State will no longer have a special position. Only under this circumstance, the enterprisers can take it easy on matters in regard to the Political State, instead of having these and those moral confusions.

Legislations:

1, Notice about further enhancing the tax administration upon foreign contractors (No.Guo Shui Fa 5 [2004], Jan 8, 2004)

This notice provides that contractor must write invoices to contract-issuing party when they get payment. For foreign invoices, a local one must be obtained correspondingly for them from competent tax administration. And the foreign invoice must be stuck to the back of Chinese invoice, together as the voucher for settlement. The contractor should be paid according to the sum borne on the Chinese invoice by contract-issuing party.

2, Notice about problems of levying income tax on interest income from personal settlement accounts by State Administration of Taxation (No.Guo Shui Fa 6 [2004], Jan 12, 2004)

Interest generated from *Personal Bank Accounts For Settlement* after Sep 1, 2003, should be taxed as 'interest, dividend and capital bonus income'. The tax will be withheld by the bank when settling interests.

3, Notice about problems of dealing with the income tax on advertisement income of broadcast and television and income of CATV fee (No.Guo Shui Han 86 [2004])

It is stated in this document that for the development of broadcast and television industry, the rules in No.Guo Shui Fa 15 [2001] will continue to be in effect. That is, the advertisement income of broadcast, television and CATV fare income won't be taxable at least by the end of 2003.

4, Notice about inspection of tax preferences for development zones by State Administration of Taxation (No.Guo Shui Fa 9 [2004], Jan 16, 2004)

This notice stipulates that all local administrations should immediately stop carrying out the tax preferences made by local authorities in *ultra vires*. The authority-exceeding departments shall be advised to correct themselves. Otherwise, they will be reported to the State Administration of Taxation level by level. With respect to those preferences in violation of regulations, they must be corrected firmly and the reduced tax amount in year 2003 must be called back. The enterprises that make use of tax preferences to dodge and wangle taxes should be prosecuted. The principals and directly responsible personnel for misconduct should be punished.

5, Notice about personal income tax problems in experimental areas of rural taxation reform by Financial Ministry and State Administration of Taxation (No.Cai Shui 30 [2004], Jan 17, 2004)

During the experimental period of rural taxation reform, after Tax on Agriculture Special Products is canceled and Agriculture Tax is reduced or exempted, those income from planting, cultivation, breeding and fishing by personnel and individual households, which fall into the scope of Agriculture Tax (including Tax on Agriculture Special Products) and Stock Raising Tax, will be free from personal income tax.

6, Notice about problems of VAT 'Refund after Collection' treatment upon urea products by Financial Ministry and State Administration of Taxation (No.Cai Shui 33 [2004], Jan 17, 2004)

From Jan 1 to Dec 31 of 2004, for urea products produced and sold by urea producing enterprises, the VAT should first be collected, and 50% of them will be returned to taxpayers thereafter.

7, Notice about treatment on bad debts of foreign invested enterprises which is dealing with telecom businesses by State Administration of Taxation (No.Guo Shui Han 90 [2004], Jan 17, 2004)

From Jan 1, 2004, for those foreign invested enterprises who is dealing with telecom businesses, the arrears of its clients which are over one year can be deemed as bad debt.

8, Public Notice about Carrying Out Opinions of CCCPC and State Council about the Policy of Promoting the Increasing of Peasants' Income and relevant preferences by State Administration of Taxation, Jan 20, 2004

This notice provides that peasant's income from plantation, aquaculture, fishing doesn't need to pay individual income tax after Tax on Livestock Farming and Tax on Agriculture are levied. Meanwhile, the income from sales of aquatic products, livestock products, vegetable, fruit, grain and other agriculture products, which are less than RMB 5,000 per month or RMB200 per day or each time, is free from VAT.

9, Notice about personal income tax policies on prizes in the form of ‘free travel’ given to salesmen by Financial Ministry and State Administration of Taxation (No.Cai Shui 11 [2004], Jan 20, 2004)

In commercial sales industry, for the travels organized for outstanding salesmen in the name of training class, proseminar or working investigation, in which travel expenses are exempted as a reward granted to outstanding sales achievements, all expenses occurred should be included in the taxable base for personal income tax of the salesmen. And this part of tax should be withheld by the related enterprises.

10, Notice about tax-free treatment upon the winner’s prizes of “2nd Environment Reward of China” by State Administration of Taxation (No.Guo Shui Han 145 [2004])

According to Paragraph 1, Article 4 of Personal Income Tax Law of PRC, which concerns tax-free treatment on prizes for environment protection granted by State Council, the prizes given to winner and other candidates of “2nd Environment Reward of China” should be free from personal income tax.

11, Notice about problems of enhancing administration on special payment paper or custom input VAT and invoices for scrap trade (No.Guo Shui Han 128 [2004], Jan 21, 2004)

When selling scraps acquired, recycle stations should stamp the relevant normal invoice (not a VAT invoice) with their financial seal and Issuer’s Special Seal. Those invoices without Issuer’s Special Seal can’t be used to credit input taxes.

12, Urgent Notice about Using VAT Invoice authentication information to check and examine export tax refund by State Administration of Taxation (No.Guo Shui Han 133 [2004], Jan 21, 2004)

State Administration of Taxation has decided to deal with export tax refund using VAT invoice authentication information after Jan 1, 2004 (decided by the date shown on the refund page of Custom Declaration Bill for Exportation)

13, Notice about problem of punishment on violation of stamp rules by State Administration of Taxation (No.Guo Shui Fa 15 [2004], Jan 29, 2004)

Behaviors of not to paste or under-paste taxable certificates, or not to mark the pasted

stamps as used, should be treated according to Article 64 of Law of People's Republic of China to Administer Levying and Collection of Tax.

14, Notice about tax-free treatment on subsidies given to foreign people who live in HK and Macao by Financial Ministry and State Administration of Taxation (No.Cai Shui 29 [2004], Jan 29, 2004)

For foreign people who work in mainland while live in HK and Macao SAR, traveling between those parts every day, their non-cash subsidies and reimbursements for housing, food, laundering shall be free from individual income tax.

15, Notice about promoting the recognition work of enterprises with enlarged VAT deduction extension by State Administration of Taxation (No.Guo Shui Han 143 [2004], Jan 29, 2004)

If the products of certain taxpayer belong to "Eight Industries", the producer should filling in the Recognition Table for Enterprises to Enlarge the Scope of VAT Deduction and submit it to the local SAT (State Administration of Taxation). Those who don't submit the application are not allowed to carry out the expansion on scope of VAT deduction.

16, Notice of further enhancing the administration on stamp duty collecting by State Administration of Taxation (No.Guo Shui Han 150 [2004], Jan 30, 2004)

All local tax administrations should enhance the administration on enterprises who pay stamp duties regularly and in a gathered basis. A license should be granted to enterprises that pay stamp duty in this way. Those enterprises should also be required to submit regular report on stamp duty's "gathered payment". Furthermore, the taxpayer should be inspected regularly by tax administration for its "gathered payment" of stamp duty.

Q&A:

1, Can through transport invoices be used for deduction?

Q:

Our company is an agent in goods consignments businesses. I'm always confused by the following taxation regulations and they've brought me many difficulties during works.

1, Our company is using the National Universal Invoice for Through Transportation Industry. I'd like to know how the shipper should state the expense on their account and how to deduct the input tax?

2, The document "Issues about calculating input tax with transportation costs" (No. 598 Guo Shui Han [1999]) provides, "Through transportation invoices of road and railroad can not be used as voucher to deduct input taxes. These invoices are usually issued by the transportation agents and its value often contains service fees." What does these words mean? Is it lawful for Local SAT of Xiamen to refuse our clients to deduct input taxes using our invoices in the name of this regulation ?

A:

Paragraph two, Article One of Notice Concerning Issuing Explanation to VAT Questions (part one) by State Administration of Taxation (No. 288 Guo Shui Han [1995]) provides, "The transportation expense may be deducted is the transportation fees and construction funds clearly identified on the vouchers issued by the transporting enterprises, not including the loading and unloading fees, insurance fees and other expenses." Based on this principle, here comes the No. Guo Shui Han 598 [1999] document, in which more clear provision are given. That is, through transportation invoices can't be used to deduct input taxes because the borne value may include services fees of transportation agents. For this reason, there aren't illegal elements for Local SAT of Xiamen to do so.

2. Do I have to pay the deposit for invoices?

Q:

I am a private industrialist from Ganjiang, Jiangxi Province. I went to other provinces temporary to promote my sales. Since the customers requested invoices during transactions, I went to the local SAT to buy normal invoices. When applying, the administration required a deposit of RMB 5,000. Aren't deposits for invoices prohibited by State?

A:

According to Article 19 of Administrative Measures For Invoices of PRC, tax administrations may require a guarantor or a deposit according to the quota of invoice's face value (but totally less than RMB 10,000) from enterprises and persons from other area (provinces, autonomous regions and municipalities directly under the central

government) for temporary business activities. And the enterprises and persons are required to submit their unused invoices for destruction regularly. The tax administration should also give receipt for deposits.

So, it is legal for the tax administration to require a deposit in this case.

3. Is it possible to deduct if the titles are different on Sales List and Invoice?

Q:

A company purchases some goods. Because of the other party's mistake, the name of the goods on the sales list and invoice are different. Can the input tax of these good still be deducted?

A:

According the provisions of Temporary Regulations of VAT, when issuing VAT invoices, a sales list issued and sealed with finance or invoice specialized seal by the seller is a must. The sales list should bear both parties' name and the title of goods or services. So the titles on the sales list and invoice must be the same, otherwise the tax can't be deducted.

4. What to do if the seller doesn't issue VAT invoices to the buyer?

Q: The seller doesn't issue VAT invoices to the buyer (with a huge transaction amount). If the buyer exposes and reports this to the administrator, will the seller be force to reissue the voice while being punished for its tax dodging behavior?

A: First, there are two preliminary requirements to issue a VAT invoice: 1, both sides of the transaction are Normal Taxpayer; 2. The goods in the transaction are taxable.

Second, failing to issue a VAT invoice doesn't by all means constitute tax dodging. It also depends on whether a normal invoice is issued and whether the goods are declared for taxation.

Third, if the seller, a normal taxpayer, neither issues an invoice, nor declares the goods, the buyer may expose it to the tax administration. The administration may punish him and force him to make up the invoices.

5. How to issue VAT invoices in the conditions of paying a debt in kind?

Q:

Company A and our company are both normal taxpayers of commercial enterprise VAT. Last October, our company borrowed an amount from A, and we were unable to repay it later on. After negotiation, we agreed to pay the debt in kind. Then A consigned the goods to the price administration to evaluate and sell them to another normal taxpayer, Company B. At last B Company claimed VAT invoice against us. We thought these activities didn't

constitute distribution and refused. Company A was also unable to issue the invoice because the goods were out of its scope of operation and there were no input tax can be deducted. I'd like to know how shall the three parties do in this situation, please.

A:

The said situation is one form of paying debt in kind. According to the provision of Notice concerning several problems of administration on VAT collection by State Administration of Taxation (No. Guo Shui Fa 155 [1996] on Sep 9, 1996), in cases of paying debts in kind by commercial enterprises, the buying company may declare to the administration to deduct the input tax, whose amount is based on the agreement of repayment and relevant VAT invoices and transportation fee's invoices. In this transaction, your company and A were both trading goods. The VAT invoices should be issued in this way: first your company should issue invoices to A, as its voucher to deduct input tax. Then A should issue invoices to company B, who will use it to deduct his input tax.

Cases:

Reciprocal Issuing of VAT Invoices Shall Beware of Criminal Consequences

Company A is a VAT normal taxpayer. Because of the industrial recession, this company had a very low turnover value in 2001. By December, it had only issued VAT invoices with a total value of RMB 100,000. According to the rules from the local tax administration, normal VAT taxpayers who have an annual invoice value under 300,000 will be de-qualified in the next year. In order to keep its qualification as a normal taxpayer, company A turned to two of its business partners for help. One of them (say, company B) therefore wrote VAT invoices with a false value of more than 200,000 Yuan. Then company A issued almost the same value to the other company (say, company C). Again, C issued that amount of false value to B. In this circuit, all input and output value are almost the same, so for each company no tax burden was created. However, company A would greatly benefit from this movement by increasing its turnover value so that it would still be qualified as a normal taxpayer for the coming year. This kind of movement can be called as “Reciprocal (Circuit) Issuing of VAT Invoices”.

1. “Circuit Issuing” meets the requirements to constitute the Crime of Issuing (Writing) False VAT Invoices.

According to Article 205, Criminal Law of PRC and the related notice (No. Fa Fa 30 [1996]) issued by Supreme People’s Court, Crime of Issuing False VAT Invoices, are activities to issue false VAT invoices for others or himself, or ask others to issue, or introduce others to issue false VAT invoices.

In detail, this crime can be committed by issuing VAT invoices without relevant goods or service turnover.

In Circuit Issuing, there is no actual business turnover, but invoices with similar amounts are issued. Although the total taxes amount to be paid are uninfluenced, however, activities of these three companies, with intentions, to issue false VAT invoices without goods or services flow, have met the requirements to constitute the Crime of Issuing False VAT Invoices.

2. Dealing with Reciprocal Issuing in judicial practice

Academically, there are still different opinions on whether Reciprocal Issuing of VAT invoices constitutes crime. Some scholars believe that the main method of issuing false VAT invoices includes Circuit Issuing and Reciprocal Issuing. On the other hand, some people feel that all input and output VAT taxes can be credited in the ‘circuit’, there is no

tax stealing in these false issuing movement. Furthermore, the parties do not have the intention to escape or steal taxes from the State. So it doesn't have the basic character of the Crime of Issuing False VAT Invoices.

But in practice, most of these movements are held as the Crime of Issuing False VAT Invoices. For example, there was a case brought to People's Court of Baoshan District, Shanghai, in which the motivation of criminal is to enlarge the turnover, instead of stealing taxes from the State, so that it can keep the qualification as a normal taxpayer for another year. Baoshan Court did held this activity as Crime of False Issuing VAT Invoices.

As a conclusion, although there are still arguments on whether Reciprocal/Circuit Issuing constitutes a crime. In practice, there have been guilty sentences in similar cases. Many taxpayers may feel that his behavior neither intends to nor actually causes tax stealing. So even it could be illegal, Circuit Issuing can by no means constitute a crime. With this thinking, they may try to keep their qualification with invoices without real turnovers. Now, the alarm has arisen and people shouldn't risk themselves anymore.

Knowledge:

Tax Burden and Tax Rates

Recently the Sino-US disputes on semiconductors are hotly discussed throughout the country. The United States rebukes that China has applied a VAT policy of "Refund Right After Collecting" on self-produced software and IC products in China. But the VAT rate on income semiconductor is still on 17%. This pushes the US exporters to an unfair position in competition and will constitute violation of WTO rules. The US government has therefore proposed a negotiation under dispute-resolving framework of WTO.

According to relevant regulation, China imposes a VAT of 17% on IC producers, but will return the tax amount which is over Tax Burden of 3%. There are two different definitions of Tax Burden and Tax Rate here. The argument hold by US is comes from the confusion of these two different definitions. In fact, there is great difference between them.

Tax Rate, is for certain stage, the ratio of tax amount compared with the total tax base. It is definitely prescribed by the tax legislation.

Tax burden, which focuses on general perspective, is the ratio of actually paid tax compared with the tax base. It can't be deemed identical with the prescribed Tax Rate.

According to VAT Temporary Regulation and other provisions, for those Normal Taxpayers who produce IC products, the VAT rate will be 17%. That is, when selling their products, 17% of their VAT taxable income should be paid to the state as VAT. However, that amount can be credit with the VAT input tax (which is the VAT tax paid by the previous seller from whom the goods or raw materials were bought). So the actually paid amount is the balance after credit. According to its definition, the Tax Burden should be ratio of that balance compared with the total sales income. And it will surely much less than 17%.

In fact, the preference granted to Chinese IC industry, depends on Tax Burden instead of Tax Rate. The tax returned will not be 14% of their sales income. It is the sales income multiplied with the difference of Tax Buren and 3%. How many Chinese IC companies with tax burden over 3% can actually get tax refund, will be a crucial element to decide whether there is discrimination upon foreign products.