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China Law Highlights

Company Establishment: Capital Injection

Capital injection and verification procedures are similar for a PRC domestic company and a foreign investment enterprise (“FIE”). The injection and verification process for domestic enterprises in China is quite simple and straightforward. An investor shall reserve a company name with the local branch of the State Administration of Industry and Commerce (“SAIC”) and then open a capital account with a bank in the name of the reserved name. Then, the investor could inject cash into the capital account and appoint an independent CPA firm to verify the capital injected. The CPA firm would issue a capital verification report as a supporting document for the investor to obtain/renew the business licence of the domestic company.

For FIEs, care must be taken to determine an appropriate level of total investment and registered capital in preparing the application documents. Subsequent changes of such amounts would require approval by the Government authorities and changes of the relevant registration certificates, which is a lengthy process.

The definitions of total investment and registered capital of an FIE are developed from a cash flow perspective. The maximum cash outflow of a project is defined as its total investment. From a fund usage perspective, total investment of an FIE refers to the sum (total) of the capital expenditure and

working capital required for production scale of the FIE as specified in the article of association. From a fund source perspective, the total amount of investment of an FIE may generally consist of two categories, funds provided by the investor to the FIE (registered capital) and loans obtained in the name of the FIE. The registered capital of an FIE refers to the total amount of capital registered at the SAIC for establishment of the FIE, and it should be the sum of investment subscribed by the investor(s) to the FIE. According to the relevant regulations, the actual loans of the FIE and registered capital should not exceed the approved total investment amount.

Registered capital can be contributed in cash or in kind (such as tangible assets, intangible assets and land use rights). Contribution of registered capital is subject to verification by an independent Chinese registered accountant (“CPA”) firm in China. For loan financing denominated in foreign currency, an FIE has to register the loans with the local administration of foreign exchange. Contribution in kind would require an independent valuation report and may have immediate tax obligations during the contribution process. Different types of assets contributed would be subject to different accounting and tax treatment for depreciation and amortisation purposes. In addition, FIEs are only allowed to repatriate profits once their registered capital has been fully contributed and only after tax clearance has been obtained. It is therefore crucial for foreign investors to understand the capital injection and verification requirements in order to comply with the rules and regulations in China as well as to ensure the contribution method aligns with the overall investment plan.

In general, enterprises contributing tangible and intangible assets as registered capital are not subject to tax. Different types of assets, on the other hand, would have different tax consequences in terms of depreciation and amortisation.

In general, an FIE is required to record its assets based on costs in accordance with the PRC Accounting Standards. The depreciation/amortisation policy for accounting purposes could be different from the tax depreciation/amortisation method adopted. It is advisable to obtain prior consent of the responsible finance and tax authorities in respect of the accounting and tax policies adopted.

Tax Case Analysis

Nantong Modern Communication Equipment Co., Ltd

Taxpayer is a limited liability company located at: No. 98 Kanjiaan Village, Si'an Town, Tongzhou City.

Business Scope: Manufacturing and sales of telecommunication plastic pipes and other plastic pipes and power cable pipes.

According to investigation, the Company has been engaged in the following illegal activities.

1. Urban maintenance and construction tax

The income of 7604.00 Yuan from the sales of wastes in 2006 has not been entered in an account for declaring the value-added tax of 1104.85 Yuan and the urban maintenance and construction tax of 55.24 Yuan.

The income of 9797.00 Yuan from the sales of wastes in 2007 has not been entered in an account for declaring the value-added tax of 1423.49 Yuan and the urban maintenance and construction tax of 71.17 Yuan.

The income of 7275.00 Yuan from the sales of wastes in 2008 has not been entered in an account for declaring the value-added tax of 1057.05 Yuan and the urban maintenance and construction tax of 52.85 Yuan.

The income of 2300.00 Yuan from the sales of wastes in 2009 has not been entered in an account for declaring the value-added tax of 334.19 Yuan and the urban maintenance and construction tax of 16.71 Yuan.

2. Educational surcharge and local educational surcharge

The income of 7604.00Yuan from the sales of wastes in 2006 has not been entered in an account for declaring the value-added tax of 1104.85 Yuan and the educational surcharge and local educational surcharge tax of 44.19Yuan;

The income of 9797.00 Yuan from the sales of wastes in 2007 has not been entered in an account for declaring the value-added tax of 1423.49 Yuan and the educational surcharge and local educational surcharge tax of 56.94 Yuan;

The income of 7275.00 Yuan from the sales of wastes in 2008 has not been entered in an account for declaring the value-added tax of 1057.05 Yuan and the educational surcharge and local educational surcharge tax of 42.28Yuan.

The income of 2300.00 Yuan from the sales of wastes in 2009 has not been entered in an account for declaring the value-added tax of 334.19 Yuan and the educational surcharge and local educational surcharge tax of 13.37Yuan;

3. Stamp Duty

2007 purchase and sales contract: $7363410.99 \times 3 / 10000 = 2209.00$ Yuan, the paid tax is 3856.40

Yuan and the overpaid tax is 1647.40, so it is proposed to settle the tax account with the concerned substation of the local taxation bureau.

4. Property tax

In 2007, the original property value is 2294540.04 Yuan, the land value is 2258242.20 Yuan, the property value including the land value is 504720.84 Yuan, the declarable tax amount is 23513.79 Yuan, the declared tax amount is 23440.76 Yuan and the evaded tax amount is 73.03.

In 2008, the original property value is 2294540.04 Yuan, the property value including the land value is 504720.84 Yuan, the declarable tax amount is 23513.79Yuan, the declared tax amount is 19287.01 Yuan and the evaded tax amount is 4226.78.

5. Individual income tax

In 2007, (1) The individual income tax of 2793.08 Yuan has been withheld under the item of “wages and salaries”. The tax inspection found that: the individual income tax that should be paid by individuals and the part of the social pension insurance and unemployment insurance that should be paid by individuals are listed and disbursed under the item of “payable warfare” and shall be incorporated in the wages and salaries. It is discovered upon the tax inspection that from February to December 2007, the salaries of the personnel whose salaries have come up to the deduction standard are the same each month, the number of the personnel paying the social pension insurance and the unemployment insurance during the period from January to November is three people, the number from December is 6 people, the part of the taxes that should be paid by individuals from January to June is 83.34Yuan per person, the part from July to December is 97.47 per person, the tax that should be withheld is 3589.55 Yuan, the tax that have been withheld is 2793.08 Yuan and the tax that should be, but not have been withheld is 796.47 Yuan.

(2) Other incomes: the listed gift expense is 2000.00 Yuan, and the individual income tax that should be, but has not been withheld is 720.00 Yuan.

In 2008, (1) The individual income tax of 1844.10 Yuan has been withheld under the item of “wages and salaries”. The tax inspection found that: the yearly lump-sum bonus has been paid under the item of payable warfare based on the accounting voucher as of January 22, but without withholding the individual income tax; the Individual income tax that should be paid by individuals and the part of the social pension insurance and unemployment insurance that should be paid by individuals are listed and disbursed under the item of “payable warfare” and shall be incorporated in the wages and salaries. It is discovered upon the tax inspection that the salaries of the personnel whose salaries have come up to the deduction standard except for Qin Meijuan are the same throughout the year, the pension premium and unemployment insurance premium that should be paid by individuals in July 2008 has been raised from 97.47 Year to 116.82 Year, the tax under the item of “wages and salaries” that should be withheld are 3069.24 Yuan, the tax that has been withheld are 1844.10 Yuan

and the tax that should be, but have not been withheld are 1225.14Yuan.

(2) Other incomes: the listed gift expense is 3900.00Yuan, and the Individual income tax that should be, but has not been withheld are 2287.80 Yuan.

6. Corporate income tax

In 2006, the annual taxable income of 184647.61 Yuan declared by the Company is 184647.61 and the income from the sales of wastes of 7604.00 Yuan has not been entered in an account, so the Company should make an additional payment of the corporation income tax of 2111.91 Yuan.

In 2007, the paper profit is 78172.62 Yuan, the declared annual taxable income is 92261.77 Yuan and the paid corporation income tax is 24910.68 Yuan. It is discovered through the tax inspection that in 2007, the income of 9797.00 Yuan from the sales of wastes has not been entered in an account, the income that should be increased is 8373.50 Yuan, the urban maintenance and construction tax that should be decreased is 71.17 Yuan, the educational surcharge and local educational surcharge that should be decreased is 56.94 Yuan, the taxable income is 100507.16 Yuan, the tax that should be declared and paid is 33167.36 Yuan, the tax that has been declared and paid is 24910.68 Yuan and the tax that should be, but has not been declared and paid is 8256.68 Yuan.

In 2008, the book profit is 199215.66 Yuan and the declared annual taxable income is 157374.88 Yuan. It is discovered through the tax inspection that:

- 1) Change in the use of the payable welfares: listing the subsidy of 15000.00 Yuan to resolve the difficulties not belonging to the staff and workers of the Company;
- 2) Change in the use of the payable welfares: listing the gift expenditure of 6000.00 Yuan under the item of “payable welfares”, and thus increasing the taxable income.
- 3) Change in the use of the payable welfares: listing the gift expenditure of 3900.00 Yuan under the item of “payable welfares”, and thus increasing the taxable income
- 4) In 2008, the income of 7275.00 Yuan from the sales of wastes has not been entered in an account, the income that should be increased is 6217.95Yuan, the urban maintenance and construction tax that should be decreased is 52.85Yuan, the educational surcharge and local educational surcharge that should be decreased is 42.28Yuan, so the amount that should be increased is $6217.95-52.85-42.28=6122.82$ Yuan.

Under the above (1)-(4) Items, the amount of 31022.82 Yuan shall be increased, and the taxable income in 2008 is 126352.06 Yuan.

In 2009, the income from the sales of wastes is 2300.00 Yuan, so the Company is ordered to enter

the income in an account.

The case is determined as tax evasion. Our bureau hereby made the following decisions.

1. In accordance with Article 25.1, Article 32 and Article 63.1 of the Tax Administration and Collection Law of the People's Republic of China, Articles 2, 3, 4 and 5 of the Provisional Regulations of the People's Republic of China on Urban Maintenance and Construction Tax and Article 12.2 of the Measures of Jiangsu Provincial Tax Bureau for Implementing the Tax Administrative Penalties, the Company evaded the urban maintenance and construction tax of 195.97 Yuan by reducing the listed income, so the company shall be ordered to pay the urban maintenance and construction tax of 195.97 Yuan, fined 195.97 Yuan and surcharged 66.04 Yuan for the overdue tax payment.
2. In accordance with Article 25.1 of the Tax Administration and Collection Law of the People's Republic of China, Articles 2 and 6 of the Interim Provisions on the Collection of Educational Surcharges (No. 50 [1986] of the State Council), and Articles 1.1, 1.2 and 1.4 of the Notice on Adjusting the Method of Collecting Educational Surcharges and other Governmental funds, the educational surcharge and local educational surcharge of 156.78 Yuan shall be recovered.
3. In accordance with Articles 25.1, 32 and 64.2 of the Tax Administration and Collection Law of the People's Republic of China, and Articles 1, 2, 3, 4, 7, and 8 of Provisional Regulations of the People's Republic of China on Real Estate Tax, the Company did not file the tax declaration and evaded the payable tax, so the company shall be demanded to pay the evaded property tax of 4299.81 Yuan, fined 2149.91, which is 50% of the evaded tax of 4299.81 Yuan, and surcharged 389.81 Yuan for the overdue tax payment.
4. In accordance with Articles 25.2 and 69 of the Tax Administration and Collection Law of the People's Republic of China, Articles 1, 2, 3, 6, 8, 9 and 13 of Individual Income Tax Law of the People's Republic of China, Article 2 of the Notice of the State Administration of Taxation on Implementing the Tax Administration and Collection Law of the People's Republic of China and the Rules for the Implementation thereof [No. 47 [2003] issued by the State Administration of Taxation], and Article 16.1 of the Measures of Jiangsu Provincial Tax Bureau for Implementing the Tax Administrative Penalties, the Company should, but has not withheld the individual income tax of 5029.41 Yuan, so the Company shall be demanded to withhold the individual income tax of 5029.41 Yuan and fined 2514.71, which is 50% of the individual income tax that should be withheld.
5. In accordance with Articles 25.1, 32 and 63.1 of the Tax Administration and Collection Law of the People's Republic of China, Articles 1, 2, 3 and 4 of the Provisional Regulations of the People's Republic of China on Enterprises Income Tax, Article 12.2 of the Measures of Jiangsu Provincial Tax Bureau for Implementing the Tax Administrative Penalties, and Article 13 of the Administrative Penalties Standard for Tax related Illegal Activities issued by Nantong Local Tax Bureau (trial

implementation), the Company evaded the enterprise income tax of 10368.59 Yuan during the period from 2006 to 2007 by reducing the listed income, so the company shall be demanded to pay the enterprise income tax of 10368.59 Yuan, fined 10368.59 Yuan and surcharged 2667.57 Yuan for the overdue tax payment.

6. In accordance with Article 64.1 of the Tax Administration and Collection Law of the People's Republic of China, Articles 1,3, 4, 5, 22, 49 and 53 of the Enterprise Income Tax Law of the People's Republic of China, and Article 13 of the Administrative Penalties Standard for Tax related Illegal Activities issued by Nantong Local Tax Bureau (trial implementation), the Company falsely filed the tax declaration, but not causing the result of not paying or less paying the tax, so the Company shall be demanded to make corrections and fined 5000.00 Yuan for its activity of making the false taxable bases.

The tax inspection department of Nantong Tongzhou Local Taxation Bureau

September 4, 2009

Tax News

'Boring' tax forms are overlooked by majority

Paste the detail content here China Daily

Most Beijingers are ignoring rules that call for those who earn more than 120,000 yuan (\$17,578) a year to complete a self-declaration tax form.

Observers say taxpayers think the forms are complicated and believe the tax authorities are unlikely to trace all of their personal income, especially that from property and stock market transactions.

According to the Beijing local taxation bureau, people must report their individual earnings between January and March or they could be fined up to 10,000 yuan.

Experts pointed out that more than half of qualified taxpayers in the capital did not report earnings to the tax authorities. Compliance in major cities in the United States, by comparison, stands at 90 percent.

"I would say hardly any people who make money from selling or buying property ever report their

earnings," said Liu Huan, deputy dean of the taxation school at the Central University of Finance and Economics.

"So far, the monitoring system in tax bureaus is capable of tracing personal wages or salaries, but for income made from property or stock deals, which is quite private and hidden, it's really hard to find out," Liu said.

Another reason why people shy away from tax reporting is that they see it as a painstaking task - taxpayers must carefully remember and record income from various sources, assigning them into 11 fields on the declaration form.

"After a year's hard work, I still have to deal with these trivial figures and report them to the tax bureau one by one?" said Beijing resident Liu Xiaoxue, who works in the Central Business District and earns more than 120,000 yuan a year. "Isn't that boring and a waste of time?"

But Liu pointed out that avoiding the "boring" task was morally wrong.

"Tax evasion is an immoral thing, but who will say not reporting personal earnings is immoral?" Liu said.

"Though rules explain how to punish people, I have not heard of anyone being fined because of a lack of tax reporting."

The tax self-declaration policy was introduced in 2006. Whether people have already paid personal income tax or not, they still need to make a tax self-declaration at a local tax bureau at each taxation year-end.

In 2007, around 260,000 Beijing residents completed personal tax reports. The number has increased by an average of 14 percent each year, reaching 340,000 in 2009.

The total number of tax self-declarations made in China in 2009 was 2.4 million.

Haidian district houses Beijing's largest number of tax report submitters, with Chaoyang, Xicheng, Dongcheng and Xuanwu close behind.

"Beijing is listed second in terms of the number of tax report submitters among various provinces in 2009, behind only Guangdong," Liu said.

"But Guangdong has a larger population."

However, experts point out that the number of declarations submitted in Beijing still lags far behind

expectations because the capital boasts the largest number of rich people in China.

In research issued in April conducted by Hurun, a research company that has tracked China's rich and famous for 11 years, revealed there were 143,000 multimillionaires and 8,800 billionaires in the city.

Commercial property tax expected

China Daily

Property tax, an issue debated for almost seven years, suddenly became a reality on Tuesday when authorities revealed it could be imposed as early as the end of next year.

An insider from the Beijing municipal taxation bureau revealed that a department chief from the State Administration of Taxation had mentioned property tax at a conference last year. Tax experts estimated the tax ratio would range from 0.5 to one percent, according to the Beijing Times.

He predicted the quickest length of approval would be 15 months, because the State Administration of Taxation would need more than half a year to resolve the scheme with the Ministry of Finance.

Following that, the scheme would be reported to the State Council. Finally, it needed approval from the National People's Congress, which could take at least eight to nine months.

These factors combined mean that collection of property tax on commercial properties could not start until the end of next year, according to the insider.

Property tax, regarded as a key "weapon" to burst the bubbling housing prices, has failed to form a clear definition since it was first put forward at the 16th Plenary Session of the Central Committee of the Communist Party of China in 2003.

According to its equivalent system in western countries, property tax is imposed annually and adjusts its ratio depending on the housing market.

Second-hand property prices in the capital's 320 residential complexes increased an average of 120 percent from 2007 to 2009.

However, the biggest drop was 15 percent during the largest housing market depression at the end of 2008, according to Lianjia, a second-hand property agent tycoon.

Liu Huan, assistant dean with the taxation college of the Central University of Finance and Economics, told METRO that now was the time for Beijing to put property tax into practice.

"The procedure first needs to impose tax on commercial properties, and should then be extended to

luxury residential real estate," he said.

He added property tax would combine current tenure tax and construction tax.

"Estimates for property tax in the city's most expensive land, such as that in the Wangfujing area, won't surpass one percent," Liu said.

He added that property tax would largely lower speculation and finally let most people afford housing.

Hong Yamin, vice chairman with the China Real Estate Values Association, said the introduction of property tax might result in a 50 to 70 percent discount in the housing market price, according to the Beijing Times.

Pan Shiyi, a commercial property developer tycoon, said the tax would directly increase speculators' holding costs of housing, and suggested the first property for a family should be tax exempt, according to qianlong.com.

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