

More Taxing Times

The stimulus plan that kept China out of a recession is forcing Chinese authorities to get more diligent about collecting its taxes. That means more scrutiny of tax evasion by local and foreign companies and individuals here, says Russell Brown, whose Lehman Brown financial advisory firm helps local firms keep their books in order.

Forbes magazine last year said China has the "harshest tax regime in the Asia-Pacific region while Hong Kong offers the friendliest." Why is that so?

China applies 25-percent corporate tax. What makes China's high is a 10-percent withholding tax on dividends, which makes the mainland China tax high even compared with EU taxes ... For Chinese companies 25 percent is already high relative to the benefits of avoidance.

What's China's logic for higher taxes?

Partly because of the perception that some companies will use transfer pricing and other methods to avoid paying. China has been studying closely OECD [Organisation for Economic Co-operation and Development] practice and a lot of tax officials have been

sent overseas to study models. Given the new tax law here is recent, China is only starting to get sophisticated about tax law and collection. Knowledge of transfer pricing remains fair.

Can you explain transfer pricing and why it's such a contentious issue for tax collectors?

It typically relates to large multinationals. For example a US firm buys a product from a Chinese subsidiary at well below the market rate and then sells at the market rate with the main profit on the sale of the product being captured in the US. Profits tax would be paid in the US instead of China. Transfer pricing though is not just about profit, it is about reviewing all elements and taxes in relation to a transaction.

What are those elements?

Let's say a Chinese subsidiary buys raw materials from its US parent at a lower price than normal market price, which will increase profit in China, but the US parent then charges cost in the name of other things – like R&D – so reducing the profit. Whilst from a profit perspective everything may look fine, in actual fact it could be argued that the company has manipulated the sale price to avoid Value Added Tax and import duties by using R&D as

EXECUTIVE OPINION

MARK GODFREY



a top up on cost. Avoidance of VAT and duties has possible criminal consequences.

China now has tax treaties with many countries – so that means firms that paid tax in China won't be taxed twice?

Even though China is a high tax country, the amount paid is not different from EU and US jurisdictions where taxes average 30 percent. Given that many firms consolidate their earnings and apply tax treaties, it could mean they pay taxes in China rather than in the US. The issue is withholding tax [on profits] paid in China. If you're making a loss at parent level [overall global operations] then you can't obtain a credit [since you made a loss you're not paying taxes in the US] for the withholding tax that you paid in China, thus the withholding tax becomes a tax cost. If you can obtain a credit then the Chinese withholding tax does not become an additional tax cost as your taxes at parent level would be on global operations less credits.

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