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Tax planning for liquor-making enterprises – shanxi fenjiu group as an example

Shan Wang*
School of Business Administration South China University of Technology
Guangzhou 510640,(CHINA)
E-mail : 750385345@qq.com

ABSTRACT

In recent years, China has adjusted the taxation policy on liquors several times, in a bid to support the outstanding and large-scale enterprises and limit the bad and small ones. However, this move has increased the tax bearing of liquor making enterprises. Therefore, it is of obvious significance to reinforce the taxation planning for liquor making enterprises. This paper describes the taxation planning for production and operation of liquors in various aspects to help those enterprises to reduce the cost of tax payment and increased their income from tax saving.

KEYWORDS

Liquor; Taxation planning; Tax bearing.

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INTRODUCTION

Liquor industry is one of the oldest industries of China and also falls into the category with development under restriction. In recent years, Chinese government has adjusted the taxation policy on liquors several times, which has resulted in a rise in tax bearing pressure of liquor making enterprises. Furthermore, the listed liquor making enterprises are now under double pressure from supervision of tax authorities and investors. In such a competitive and highly taxed environment, it is of certain significance to discuss how to make proper taxation planning to reduce the cost of tax payment and improve the profit of liquor making enterprises.

NECESSITY OF MAKING TAXATION PLANNING OF FEBJU GROUP

Income from sales of liquid takes up more than 90% of the operating income of Fenjiu Group in terms of income structure and takes up more than 99% of the profit of Fenjiu Group in terms of profit structure. Furthermore, the tax on liquor sector takes up more than 99% of the total tax paid by Fenjiu Group. Therefore, the taxation planning research of Fenjiu Group should focus on its liquid sector.

At the beginning of 2001, the State Administration of Taxation issued the notice on Deducting Means before Tax of Enterprises Income Tax, which specifies that the expense on advertisement of liquid making enterprises should not exceed 2% of the total sales, and the part in excess should not exceed 5% of the sales; in the same year, Chinese government reinforced the recombination tax assessment method integrating price and quantity for the liquor and cancelled the policy that for enterprises that produce liquors by blending the outsourced liquors, the consumption tax that has paid for outsourcing of the liquor could be deducted. In 2006, after adjustment of consumption tax, the food derived liquor and yarn derived liquor are both subject to a uniform tax rate of 20% and management of transfer pricing of liquid making enterprises was strengthened. Those policies increased the burden on the liquor making enterprises considerably. When tax payers are under unbearable tax burden and the current tax law would not change in the near future, the tax payers have none but the following 3 choices: The first is to evade tax through illegal acts; but this is illegal and is a “dead-end street” for enterprises; the second is to face the situation negatively by contracting the production and operation scale so as to reduce tax; such enterprises will eventually be eliminated by the market; the third is to make taxation planning and avoid tax legally. This is the only way for the enterprise to confront the challenges and deal with the current policies and regulations.

TABLE 1: Tax Bearing of Fenjiu Group Unit: Yuan Currency: RMB

	Year of 2013	Year of 2012	Total
Amount of tax realized	560,374,609.87	534,767,813.33	1,095,142,423.2
Sales income	1,484,836,221.46	2,015,144,420.82	3,499,980,642.28
Tax bearing	37.74%	26.54%	31.29%

As shown above, the average tax bearing of Fenjiu Group in 2012 and 2013 reached 31.29%.

Taxation planning of Fenjiu Group

Liquor is the core sector of Fenjiu Group. According to the regulations of Tax Law, added value tax, consumption tax, enterprise income tax, individual income tax, urban construction tax, education surtax, stamp duty, business tax, housing property tax, land use tax and other taxes should be paid. See the following table for the structure of the tax types.

TABLE 2: Tax type structure of fenjiu group unit: yuan currency: RMB

	Value added tax	Consumption tax	Enterprise income tax	Urban maintenance and construction tax	Land use tax	Tax of other types
Tax	8,504,197.08	66,563,594.19	351,659,073.70	14,006,855.25	13,412,053.06	106,228,836.59
Structure	1.51%	11.88%	62.75%	2.50%	2.39%	18.97%

As shown in the above table, taxes of other types include individual income tax, stamp duty, housing property tax, and business tax. Though there are many types of taxes, but those taxes account for only a small proportion of the total. Consumption tax and enterprise income tax account for 74$ of the total taxation amount. Therefore, for Fenjiu Group, taxation planning should involve consumption tax and enterprise income tax.

Taxation planning for consumption tax

As liquor making enterprises are in a special industry, they should pay very high consumption tax. The computational formula of amount of consumption tax payable is: amount of tax payable = taxable sales ×proportional tax rate + taxable amount ×quota tax rate. For instance, if the proportional tax rate is 20%, and the quota tax rate is 0.5kg0.5yuan, then there could be no space for planning as the regulations in the Tax Law are specific. In such a case, the factors posing an impact on the amount of tax payable should be the taxable sales amount and the taxable value. Therefore, the taxation planning for consumption tax of liquor making enterprises should focus on the two factors. The main planning methods include:

1.Planning by reducing the taxable value

Lowering the taxable value is the primary method of taxation planning for consumption tax. With tax rate unchanged, amount of tax payable could be reduced by lowering the taxable value, so as to ultimately reduce the tax bearing and obtain the income from tax payment. To reduce taxable value, the first thing to do is to make planning in terms of setting up of organization. According to Tax Law, the consumption tax is regarded as the tax included in the calculated prices, which is only levied in one link. Taxes for liquor are paid in links including production, consigned processing and importation. In the subsequent links such as wholesales and retail sales, no further consumption tax is to be paid as the sales price already includes the consumption tax. To lower the taxable value, what we could do is to separate the original manufacturing enterprise into "two parts", with two independent accounting systems respectively for production and sales. "The producing enterprises sell products to the selling enterprises at a low price and then the latter sell the products at a high price." This way, the gross margin that is expected to be realized in the production link is transferred to the circulating link, thus lowering the consumption during the production link. There is a supply and marketing relationship between the two enterprises, which are related parties in terms of property right; the second thing to do is to determine the internal settlement price of the producing enterprise to the selling enterprise. Theoretically, the lower the taxable value is, the less the consumption taxable amount will be. Therefore, the lower the taxable value, the better. The producing enterprise and the selling enterprise are two independent tax payers. The transaction price between the two could be negotiated freely in accordance with the common commercial principles and no one else is allowed to interfere. But as they are related enterprises trying to avoid taxes, which will result in a reduction of China's revenue, Chinese government will sanction then through anti-tax avoidance measures. Hence, the internal settlement price should only be lowered to a certain extent rather than without a limit. The third thing to do is to lower the cost and expense of the producing enterprise. If such cost and expense are originally high, then the list price could only be even higher; otherwise, it will go against commercial practice and the enterprises will be sanctioned by the tax department through anti-tax avoidance measures. Thus, the taxation planning will fail. Cost and expense of producing enterprises could only be lowered a little through ordinary technical improvement and reinforced management. What's more effective are adjustment of internal business, and transfer of part of the cost and expenses.

There are two wholly-owned subsidiaries under Fenjiu Group: Shanxi Xinghuacun Fenjiu Sales Co., Ltd. and Shanxi Xinghuacun Bamboo Leaf Green Liquor Sales Co., Ltd., which are respectively responsible for sales of liquors of different types. The two subsidiaries and Fenjiu Group, as a producing enterprise, are three enterprises with independent accounting systems. Therefore, the three enterprises should determine the internal settlement price separately so as to reduce the taxable value and thee amount of tax payable.

2.Planning for reducing or postponing the taxable sales

As specified in the Rules for Implementation of Interim Regulations on Consumption Tax, the time when the tax liability is established depends on the settlement method of payment. (1) When the tax payer is selling the taxable consumer goods, if the charge sales or installment method is used, then the collection date agreed in the contract should be the time when the tax liability is established; (2) If the advance payment method is used, the delivery date should be the time when the tax liability is established; (3) If collection with acceptance method is used or collections are entrusted to the bank, then the data on which the goods are delivered and collection procedures are completed should be the time when the tax liability is established; (4) If other settlement method is used, then the date on which the sales payment is fully made or the receipt is obtained should be the time when the tax liability is established. The time when the tax liability is established should, which is the time of sales confirmation, should differ with change of the settlement method. Therefore, planning could be made with regard to the time of sales realization. When selling the goods, the enterprise should pay attention to the settlement method: (1) Try not to use the collection with acceptance method or entrust the collections to the bank; do not pay any fund in advance; (2) During product sales of the enterprises, especially for wholesales, if the trade receivable can not be collected in the near future, or can not be collected in full, then an installment contract should be signed; then the taxable amount should be determined according to the date of collection agreed in the contract to avoid paying large amount of tax due to confirmation of income in one time; (3) If the direct collection method is used for settlement, then the time for delivery of bill of lading should be postponed to obtain the time value.

3.Export rebate strategy

Sales of liquors of listed liquor making enterprises involve export rebates of value added tax and consumption tax. According to the Tax Law: "For direct export of taxable consumer goods imported by a foreign trade enterprise with export authorization and export of taxable consumer goods by one foreign trade enterprise under entrustment of other foreign trade enterprises, the export tax exemption and export tax rebates policy shall apply; for export of self-produced taxable consumer goods of a production enterprise with export authorization or export of such consumer goods entrusted to the foreign trade enterprise as an agent, the tax exemption policy, rather than the tax rebates policy, shall apply; for export of goods by an ordinary commerce and trade enterprise, i.e., an enterprises other than the production enterprise and foreign trade enterprise, no such policy shall apply.” As such, the listed liquor making enterprises intending to export their products should note that: the export should be made directly by the listed company or entrusted by the listed enterprise to a foreign trade enterprise by utilizing the channel advantage of the foreign trade enterprise. Such direct exporter and the entrusting party should both be listed companies, and only in such a case shall the export tax rebate policy apply. Fenjiu Group enjoys a long history and is quite reputable in the world, especially among Chinese people. In such a domestic environment with fierce competition, it is a strategic decision for a listed liquor making enterprise to explore the foreign market with its brand influence. Fenjiu Group already has some export proportion, and it should increase the export proportion to be more benefited by the export tax rebate policy.

TAXATION PLANNING OF ENTERPRISE INCOME TAX

Enterprise income tax is one of the important tax types related to Fenjiu Group. The computational formula of enterprise income tax: Amount of tax payable = amount of taxable income × tax rate; amount of taxable income = total amount of taxable income – amount of permitted deduction items. In practice of administration of tax collection, the taxation department mainly levy enterprise income tax based on the accounting data of the enterprise. So, the computational formula of amount of taxable income should be altered as: Amount of taxable income = total profit amount + (-) amount of adjustment items. As indicated by the formula, the factors that pose an impact on the amount of tax include: tax rate, income, cost, expense and other expenditures. Therefore, the taxation planning strategies for enterprise income tax generally include: use of the lowest possible tax rate; delay or reduction of confirmed income; increase or bring forward confirmation of cost, expense and other expenditures. Considering the real situation of Fenjiu Group, the taxation planning strategies for enterprise income tax are as follows: (1) Transfer of profits via the related organizations; (2) Shifting of taxation.

1.Transfer of profit via related organizations

This means to sell of products to the related selling enterprise at a lowered factory-gate sales price so as to transfer the profit to the related selling enterprise, which is generally a subsidiary of the listed enterprise. If the income tax rates of the two are the same, then the tax saving effect of this method is not obvious. When part of the profit of the listed enterprise flows into the related selling enterprise, as the income tax rates are the same, the total amount of enterprise income tax of the group company as a whole will remain the same. Hence, in such a case, the prerequisite to use the transfer pricing method to transfer the profit to reduce the income tax bearing is that the income tax rate of the related selling enterprise and the related raw material supplier is lower than that of the listed enterprise. The operation thought is that: The first way is to establish a related selling enterprise and the related raw material supplier in an area where the income tax rate is lower than that of the listed enterprise; the second day is to sell the products of the listed enterprise to the related selling enterprise with a low tax rate at a properly low price; the third way is to purchase the raw materials and packages from the related company with a low tax rate at a properly high price. The income tax rates for Fenjiu Group and its two subsidiaries are all 33%. Fenjiu Group could consider establishment of a subsidiary A in special zones such as Shenzhen, or in western China, where subsidiary A will be offered a tax rate discount of 15%. This way, the income or profit with high tax rate could be transferred to Company A through related party transaction, so as to reduce the amount of tax payable of the group company as a whole and increase the after-tax income.

2.shifting taxation

According to the policy on enterprise income tax: (1) For charitable donation and benevolent donations with an amount lower than 3% of the amount of annual taxable income could be exempted from income tax; (2) for business entertainment fees, 5‰ could be deducted when the annual sales income is 15 million yuan or less, and 3‰ could be deducted when the annual sales income is more than 15 million yuan. (3) The advertisement fee of grain derived liquor should not be disbursed before tax. (4) The business publicity expense should be deducted within 5‰ of the annual sales income of the enterprise. For the part of the above expenses or expenditures in excess of the limit, when the amount of taxable income of the enterprise is higher than 0 in the current period, then the enterprise income tax should be paid based on the applicable tax rate. If Fenjiu Group transfers the above expense in excess of the limit to the related Company A with a low tax rate, then the amount of income tax payable of the group company as a whole could be reduced.

TABLE 3 : List of Advertisement Expenditures of Fenjiu Group
Unit: yuan Currency: RMB

	Year of 2013	Year of 2012	Total
Advertising and publicity	957,911,729.45	763,406,010.73	1,721,317,740.18

expense			
Selling expenses	1,666,894,751.12	1,378,306,935.97	3,045,201,687.09
Proportion	57.47%	55.39%	56.53%

The expenditures of Fenjiu Group on advertisement during 2012 and 2013 are given in the above table, which account for more than 55% of the total selling expenses in both of the 2 years and are the largest expenditure item. According to related regulations, the advertisement expense of grain derived liquor shall not be disbursed before tax. However, in such a competitive environment, the brand popularity will surely decrease without advertisement, thus reducing the market consumption. Therefore, it is actually not realistic to cut down the advertisement expense. However, the advertisement expense could not be disbursed before tax, and this could drive up the enterprise income tax remarkably. Therefore, proper planning should be made. The most ideal method is to transfer the expense to related parties with business relation. (1) The exclusive purchaser of the enterprise or the bug customer is to pay all the advertisement expense; (2) The enterprise grant such expense to the exclusive purchaser or big customer of the enterprise as subsidy by offering a concessional rate; (3) This way, the advertisement expense will not be included in the selling expense of Fenjiu Group and the enterprise income tax could thus be avoided. This is actually shifting-based planning.

CONCLUSION

Fenjiu Group is in the liquor industry, which falls into the category with development under restriction and very heavy tax burden is imposed by the state government. The market competition is also fierce. Therefore, many liquor making enterprises start to sell their products at a very low price to gain competitive advantage over other enterprises and try every possible measure to reduce the tax bearing. However, as the tax law of China becomes increasingly comprehensive, it leaves an increasingly small space for reduction of tax bearing, which may even be predicated as delinquency. Therefore, it is the inevitable choice of Fenjiu Group to make taxation planning without violating the law. Before implementation of the taxation planning, measures such as tax saving planning, tax avoidance planning and tax shifting could be used separately or jointly, depending on the specific situation. Meanwhile, care should be exerted to avoid planning related risks to realize the ultimate goal of enterprise value maximization.

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