Application for Administrative Reconsideration

Applicant: Fake Design Culture Development Ltd.

Domicile: NO. 258, Cao Chang Di Village, Cui Ge Zhuang Town, Chaoyang District, Beijing

Postal Code: 100015

Legal Representative: Lu Qing

Respondent: The Second Investigation Branch of Beijing Local Taxation Bureau

Subject Matter of Application:

1. It is wrongful for the respondent to use Notice of the State Administration of Taxation on Some Issues Concerning the Punishments for Acts in Violation of the Regulations on Stamp Tax (Guo Shui Fa [2004] No. 15) as a basis. So, the applicant applies for a review of the regulation.

2. The applicant requests cancellation of the Written Decision on Administrative Punishment from the Second Investigation Branch of Beijing Local Taxation Bureau ([2011] No.56), made by the respondent, in accordance to the law.

Facts and Reasons:

The respondent made an inspection for tax from November 29, 2000 to December 31, 2010 with the applicant, and then made the Written Decision on Administrative Punishment from the Second Investigation Branch of Beijing Local Taxation Bureau ([2011] No.56) (hereinafter referred to as *the written decision on punishment*), which imposed a fine of RMB 6,766,822.37.

The applicant believes that this decision is wrong. Specific reasons are as follows:

I. The basis of this decision is unlawful.

In *the written decision on punishment* made by the respondent, part 2 (1) says, "Under Article 64 (2) of the Law of the People's Republic of China on the Administration of Tax Collection and Article 1 of the Notice of the State Administration of Taxation on Some Issues Concerning the Punishments for Acts in Violation of the Regulations on Stamp Tax (Guo Shui Fa [2004] No.15), your company is fined RMB 13,106.01 (three times the amount of stamp tax owed) because of the fact that your company does not affix tax stamps according to relevant provisions."

The Notice of the State Administration of Taxation on Some Issues Concerning the Punishments for Acts in Violation of the Regulations on Stamp Tax (Guo Shui Fa [2004] No.15) has clearly stated that, "After the Law of the People's Republic of China on the Administration of Tax Collection (hereinafter referred to as Law of Administration of Tax Collection) and the Detailed Rules for the Implementation of the Law of People's Republic of China to Administer the Levying and Collection of Taxes (hereinafter referred to as Detailed Rules for the Implementation of Law to Administer the Levying and Collection of Taxes) are revised, Article 13 of Provisional Regulations of the People's Republic of China on Stamp Duty (hereinafter referred to as Provisional Regulations on Stamp Duty), Article 39, Article 40 and Article 41 of Detailed Rules for Implementation of Provisional

Regulations of the People's Republic of China on Stamp Tax (hereinafter referred to as Detailed Rules for Implementation of Provisional Regulations on Stamp Tax) are no longer applicable. In order to strengthen management of levying the stamp duty and of handling related misconduct, according to relevant provisions from Tax Administration Law and the Detailed Rules for the Implementation of Law to Administer the Levying and Collection of Taxes, the punishment provisions applicable for violation of the stamp duty are hereby clarified as follows. If stamp tax payers are involved in any of the following acts, the tax authority shall punish them according to severity: (1) In cases with tax certificates not affixed or stamp tax tickets not fully affixed or stamp tax tickets in taxable vouchers not written-off, Article 64 of Law of Administration of Tax Collection will be applicable concerning punishment."

In fact, this text shows that the existing laws which are still valid, i.e. Provisional Regulations of the people's Republic of China on Stamp Duty (hereinafter referred to as Provisional Regulations on Stamp Duty) and Detailed Rules for Implementation of Provisional Regulations of the People's Republic of China on Stamp Tax (hereinafter referred to as Detailed Rules for Implementation of Provisional Regulations on Stamp Tax) have some provisions producing three abnormal situations (i.e. a lower level law contravenes a higher level law, administrative regulations are inconsistent, provisions are inappropriate), because of issuance of the new law and regulation.

1. The situation where a lower level law contravenes a higher-level law

In citation of Notice of the State Administration of Taxation on Some Issues Concerning the Punishments for Acts in Violation of the Regulations on Stamp Tax (Guo Shui Fa [2004] No. 15), there is a higher lower level law relation between Law of the Peoples Republic of China on the Administration of Tax Collection (hereinafter referred to as Law of Administration of Tax Collection) and Provisional Regulations on Stamp Duty or between Detailed Rules for the Implementation of the Law of People's Republic of China to Administer the Levying and Collection of Taxes (hereinafter referred to as Detailed Rules for the Implementation of Law to Administer the Levying and Collection of Taxes) and Detailed Rules for Implementation of Provisional Regulations on Stamp Tax. If the lower level law contravenes the higher level law, then Article 87 of The Legislation Law of the People's Republic of China (hereinafter referred to as Legislation Law) says, "In one of following circumstances, laws, administrative regulations, local regulations, autonomous regulations and separate regulations and rules will be changed or revoked by the relevant authorities according to rights given in Article 88 of this Law: (2) The lower level law contravenes the higher level law." Moreover, Article 88 of the Legislation Law of the People's Republic of China (hereinafter referred to as Legislation Law) says, "Concerning which has the right of changing or revoking laws, administrative regulations, local regulations, autonomous regulations and separate regulations and rules: (2) The Standing Committee of the National People's Congress has the right to revoke administrative regulations which conflict with the Constitution and the law, has the right to revoke local regulations which conflict with the Constitution, laws and administrative regulations, and has the right to revoke autonomous regulations and separate regulations which are approved by the standing committee of the people's congress in provinces, autonomous regions and municipalities but conflict with the Constitution and provisions of Article 66 (2) in this Law; (3) the State Council has the right to change or revoke inappropriate regulations in departments and local governments." The above texts indicate that Provisional Regulations on Stamp Duty can be changed by the Standing Committee of the National People's Congress rather than the State Administration of Taxation issuing Guo Shui Fa [2004] 15, and that Detailed Rules for Implementation of Provisional Regulations on Stamp Tax can be changed by the State Council rather than the State Administration of Taxation issuing Guo Shui Fa [2004] 15.

2. The situation where the administrative rules and regulations are inconsistent

For Detailed Rules for the Implementation of Law to Administer the Levying and Collection of Taxes and

Provisional Regulations on Stamp Duty, both of them are on the same level as administrative regulations. The Legislation Law's Article 85 (2) provisions say, "The State Council will decide whether new general provisions or old special provisions in administrative regulations are applicable, when inconsistency on a matter occurs." So, in case of inconsistency, the decision will be the State Council rather than the State Administration of Taxation issuing Guo Shui Fa [2004] 15.

3. The situation where rules and regulation are inappropriate

Detailed Rules for Implementation of Provisional Regulations on Stamp Tax are a kind of departmental rules. If its Article 39, 40 and 41 are considered inappropriate, they must be changed by the State Council rather than the State Administration of Taxation issuing Guo Shui Fa [2004]15. The reasons are as follows: Article 87 of The Legislation Law of the People's Republic of China (hereinafter referred to as Legislation Law) says, "In one of following circumstances, laws, administrative regulations, local regulations, autonomous regulations and separate regulations and rules will be changed or revoked by the relevant authorities according to rights given in Article 88 of this Law: (4) Provisions considered inappropriate shall be changed or revoked." Moreover, Article 88 of the Legislation Law of the People's Republic of China (hereinafter referred to as Legislation Law) says, "Concerning which has the right of changing or revoking laws, administrative regulations, local regulations, autonomous regulations and separate regulations and rules: (3) the State Council has the right to change or revoke inappropriate regulations in departments and local governments."

II. Law for administrative punishment is wrongfully applied, statute of limitations and punishment are inappropriate

In addition to the wrong basis of administration, the respondent made mistakes in citing applicable law. Regardless of "whether the fact of violation of the law is true", on the applicability of *the written decision on punishment* as legal basis, the applicant considers that there are several problems, as explained as follows:

1. The wrong law was cited and applied

The currently valid Tax Administration Law was issued on April 28, 2001 by the National Presidential Decree No.49 and was implemented since May 1, 2001. Article 84 of Legislation Law for the People's Republic of China says the non-retroactivity principle is adopted in laws, administrative regulations, local regulations, autonomous regulations and separate regulations and rules except for those with special provisions for a purpose of better protecting the right and interest with the citizens, legal persons and other organizations. According to the non-retroactivity principle, the above Law of Administration of Tax Collection only applies to tax collection after May 1, 2001.

In part 1(2) of *the written decision on punishment* made by the respondent, the duration is from November 29, 2000 to December 31, 2010; yet the legal basis cited is the Tax Administration Law that was implemented since May 1, 2001. As a result, the Tax Administration Law, which was implemented from May 1, 2001, was also directly applied to part 2(2) of *the written decision on punishment*.

The Tax Administration Law was implemented as early as January 1, 1993, and was revised respectively on February 28, 1995, and April 28, 2001. Why does the respondent apply the Tax Administration Law that was implemented since May 1, 2001 to the period from November 29, 2000 to April 30, 2001?

2. Punishment is beyond the statute of limitations

The Law of the People's Republic of China on Administrative Punishments (hereinafter referred to as *Administrative Punishment Law*) is a general law, and Tax Administration Law is a special law. Article 29 of

Administrative Punishment Law states that “an illegal act that has not been discovered in 2 years will no longer be subjected to administrative punishment, except provided otherwise by law." In Tax Administration Law, Article 86 says, "Any act which contravenes tax laws and administrative regulations, deserving administrative punishment, will no longer be subjected to administrative punishment in the event that it is not detected in 5 years.” According to the principle that a general law is superior to a special law, the punishment for a taxpayer in the act of contravening tax and administrative laws should apply to the provision of statute of limitations of 5 years in Article 86 of Tax Administration Law, and punishment for other illegal acts except for the above said act should apply to the provision of statute of limitations of 2 years unless specified in the other special law.

The applicant believes that if the provision of statute of limitation of 5 years is applicable, then the first thing is to determine whether *Invoice Management Regulations* of the People's Republic of China (hereinafter referred as *Invoice Management Regulations*) - Decree No. 006 of the Ministry of Finance is a tax or administrative law.

The currently valid *Invoice Management Regulations* was approved by the State Council on December 12, 1993, issued on December 23, 1993 via decree No.006 from the Ministry of Finance, and revised on December 20, 2010 according to ***Decision of the State Council on Amending the Invoice Management Measures of the People's Republic of China***. According to provisions of Legislation Law of the People’s Republic of China, *Invoice Management Regulations* before revision on December 20, 2010 was a departmental law, and then it becomes an administrative law after revision on December 20, 2010. Therefore, regardless of whether *Invoice Management Regulations* is involved in taxation, Decree [1993] No. 006 (i.e. *Invoice Management Regulations* before revision on December 20, 2010) of the Ministry of Finance cited by the respondent is not an administrative law, thus is neither a tax administrative law. As a result, the statute of limitations of 2 years in *Administrative Punishment Law* applies to illegal acts specified in the Invoice Management Regulation before its revision on December 20, 2010, when it was a general law.

For the time from November 29, 2000 to December 31, 2010 in Part 1(3) of *the written decision on punishment*, the respondent takes the Decree [1993] No. 006 of the Ministry of Finance as its basis; correspondingly, this basis is applied by the respondent to Part 2 (3) of *the written decision on punishment*. “The act of issuing and obtaining invoices against provisions” that the respondent cited took place before 2010. According to the aforementioned principle of non-retroactivity, this case should be applicable to the Invoice Management Regulations before revision on December 20, 2010, that is, Decree [1993] No. 006 of the Ministry of Finance. Therefore, for “the act of issuing and obtaining invoices against provisions” according to the respondent, the statute of limitations for punishment should be 2 years; but not from November 29, 2000 to December 31, 2010, a period of over 10 years.

3. Punishment amplitude is inappropriate

In Part 2(1), 2(2), and 2(3) of *the written decision on punishment*, the fines are 3 times, 1.5 times, RMB 10,000 and RMB 10,000, respectively.

According to the *Circular of Beijing Local Taxation Bureau on Forwarding the Notice of Beijing Municipal People's Government on Release of Administrative Law Enforcement Responsibility Supporting System* (Jing Di Shui Fa [2007] No.349) and the *Several Provisions of Regulating the Free Judging Right of Administrative Penalties in Beijing* (Jing Zheng Fa [2007] 17), Article 5 of the latter says, “The free judging right should be based on legal purposes to have a comprehensive consideration for relevant factors such as illegal facts, nature, circumstances and extent of social harm excluding the interference of irrelevant factors; the same kind of administrative violations, that is, illegal facts, nature, circumstances and extent of social harm being basically same should be applicable for basically same legal basis, same punishment type and same punishment magnitude.", the respondent shall exclude irrelevant factors and apply the same magnitude of punishment for similar acts or a

magnitude which will not higher than that for more serious acts. In a major tax-related case which was announced by the State Administration of Taxation (see http://www.chinatax.gov.cn/n8136506/n8136548/n8136623/8279062.html), the Local Taxation Bureau in Beijing conducted a comprehensive inspection of tax in Beijing Taiyue Real Estate Development Co., Ltd. in June 2007, and concluded that this real estate company made a false tax declaration to cover a total of taxable income of 13.53 billion RMB, which was involved in the sales tax of 6,762.87 million RMB. The tax authority ordered this real estate company to pay the arrears of 6,762.87 million RMB as the sales tax, 473.4 million RMB as the urban maintenance and construction tax, and 202.89 million RMB as the education surtax, 3,246.8 million RMB as the overdue fine, and 3,618.14 million RMB as a fine. The case is from the real estate industry which is highly policy-sensitive, and is identified as a major tax case by State Administration of Taxation, whose amount and influence is far greater than our case; however, the punishment magnitude of this real estate company is only 0.5 times. In contrast, in our case, why is the applicant subject to the fine of 1.5 times, 3 times or even the maximum of 10,000 RMB?

On the other hand, Article 7 of the Several Provisions of Regulating the *Free Judging Right of Administrative Penalties in Beijing* (Jing Zheng Fa [2007] 17) says, "When there is a heavier administrative punishment, the consideration shall be into the following circumstances: (1) acts to cover and destroy illegal evidence or impede law enforcement and etc.; (2) ignore the advice and continue implementation of violations; (3) Offenses resulting in serious consequences; (4) Force, trick, and abet others to commit illegal acts; (5) a major role in joint implementation of the offense; (6) incorrigible, and repeated violations; (7) implementation of the violations in the event of public emergencies; (8) other circumstances which are subject to a heavier punishment." How can the applicant be subject to the heavier administrative punishment in event of above situations in Article 7 being ruled out?

4. Additional fine is improper

In *the written decision on punishment* made by the respondent, the second paragraph of page 3 states, “your company must have the payment in the deputy treasure of Chaoyang District in Beijing within 15 days after delivery of this written decision. In case of overdue payment of the fine, our bureau will impose an additional fine at rate of 3% daily in accordance with the Article 51 (1) of *the Administrative Punishment Law*.”

In *the Reply of Supreme People’s Court on Whether Additional Fine of Administrative Punishment Should Be Calculated during Proceedings* (Supreme People's Court [2005] No.29), a provision says, “Under *the Administrative Procedure Law*, the additional fine which is a kind of aggravated punishment imposed for non-compliance with the decision on administrative punishment should not be counted during the proceedings."

First, the judicial interpretation is applicable to all decisions on administrative punishment made by all the administrative organs, regardless of whether these organs are tax authorities.

Second, since the additional fine is not counted during the proceedings, it is also a kind of aggregated punishment and shall not be counted in the review period. Supreme Court administrative tribunal chief judge Cai Xiaoxue published an article titled The Additional Fine Should not be Counted During the Proceedings in November 2008 Issue of the People's Justice Journal. This article clearly points out that if the additional fine is still counted during the proceedings, then it will likely make the administrative counterpart to pay the additional fine which is several times the principal amount of the fine, which might lead to a situation where administrative proceedings are prohibitive for the administrative counterpart whose appeal right will not adequately protected. This approach is clearly inconsistent with the goal of Administrative Procedure Law to protect citizens, legal persons and other

organizations bringing an administrative lawsuit.

According to Article 88(2), “If not agreeing with the punishment decision, enforcement measures or measures of saving from damage from the tax authority, the parties concerned may apply for administrative reconsideration according to law or bring a lawsuit to the people's court according to law.” If the parties concerned directly bring a lawsuit to the people's court, then there is no additional fine under the Reply of Supreme People’s Court on Whether Additional Fine of Administrative Punishment Should Be Calculated during the Proceedings (Supreme People's Court [2005] No.29). If the parties concerned apply for administrative reconsideration to the tax authority yet an additional fine is still imposed, the application for administrative reconsideration will become prohibitive for administrative counterparts, thus impeding the equal exercise of judicial choice for parties concerned. This renders the choice right specified in Article 88 (2) of Law to Administer the Levying and Collection of Taxes meaningless. Therefore, if the respondent mechanically cites the provision of Article 51(1) in the *Administrative Punishment Law* instead of distinguishing the application for the administrative reconsideration from the initiation of an administrative litigation, then it will inevitably abandon the goals established in the Administrative Reconsideration Law to “prevent and correct illegal or improper administrative acts, protect the legitimate rights and interests of citizens, legal persons and other organizations and protect and monitor the exercising of powers with the administrative organ”.

III. Unclear factual findings and wrong collection methods, resulting in punishment mistakes

1. Unclear factual findings and wrong collection methods

In the Administrative Punishment Decision of No. 2 Tax Inspection Department of Beijing Local Taxation Bureau (Er Ji Shui Ji Chu [2011] No. 63) issued by the respondent, it uses an “audit collection” instead of “verification collection.” This approach indicates self-contradictions and mistakes on the respondent’s part.

According to Article 3 of the Criminal Law Amendment of the People’s Republic of China（VII） dated February 28, 2009, before the tax authorities issue a recovery notice and settle taxes, the public security department cannot intervene any case of “evasion of tax payment” (i.e. “Tax Evasion” in Article 63 of the Tax Administration Law) in advance, and the reason for early intervention by the public security department in this case is limited to “hiding and intentionally destroying accounting vouchers, account books and financial and accounting reports.” The respondent also claimed that its materials come from the public security department, this indicating that the account books obtained by the respondent are incomplete materials, and the so-called “illegal facts” identified by the respondent are sure to feature unclear facts and inadequate basis.

According to Article 35 of the Tax Administration Law, “If a taxpayer is under one of the following circumstances, tax authorities shall have the power to assess the amount of tax payable by him：(4) where account books are established, but the accounts are not in order or information on costs, receipt vouchers and expense vouchers is incomplete, making it difficult to check the books;” and Article 3 of Measures for Verification Collection of Enterprise Income Tax (for Trial Implementation) (Guo Shui Fa [2008] 30) “If a taxpayer is under one of the following circumstances, tax authorities shall have the power to verify the enterprise income tax：(4) where account books are established, but the accounts are not in order or information on costs, receipt vouchers and expense vouchers are incomplete, making it difficult to check the books”, the respondent should use the method of “verification collection” instead of using “audit collection” mistakenly.

2. Wrong punishment

In the “verification collection” mode, the respondent should not punish the applicant.

(1) “Verification collection” is a collection mode applicable to unclear facts and insufficient evidence

According to the formerly cited Article 35 of the Tax Administration Law and Article 3 of the Measures for Verification Collection of Enterprise Income Tax (Tentative) (Guo Shui Fa [2008] No. 30), “verification collection” means a collection mode used by the tax authorities to verify the taxable amount of the taxpayer when the taxpayer's account books are not perfect, incomplete information is difficult to audit, or for other reasons is difficult to accurately determine the tax liability. That is, “verification collection” is a collection mode that has to be used by the tax authorities if accurate tax payment information cannot be obtained.

According to Article 47 of the Rules for the Implementation of the Law of the People’s Republic of China on the Administration of Tax Collection, “In the case of a taxpayer in one of the instances stated in Article 35 or Article 37 of the Tax Administration Law, a taxation authority shall have the right to use one of the following methods to assess the amount of tax payable: (1) assess the amount of tax payable with reference to the income and profit rate of other local taxpayers involved in the same or a similar line of business on a similar scale and at a similar level of income; (2) assess the amount of tax payable according to the cost, plus reasonable amounts of expenses and profit; (3) assess the amount of tax payable according to a calculation or assessment of the amount of raw materials, fuel, power, etc. , consumed; (4) assess the amount of tax payable according to other reasonable methods. If use of one of the aforesaid methods is insufficient to accurately assess the amount of tax payable, two or more methods may be used concurrently. Accordingly, the “verification collection” is a collection mode adopted by the tax authorities, which is closest to the actual operating conditions of the taxpayer, but the verified tax liability is a result calculated by the tax authorities according to a legal procedure in case of unclear facts and insufficient evidence.

(2) In case of verification collection, fact of violation of law is difficult to identify with accuracy

Under the Article 4 of the Administrative Punishments Law, “Administrative punishments shall be set and implemented according to facts”; according to Article 30 of the Law of Administrative Punishments, “Where citizens, legal persons or other organizations shall according to law be given administrative punishments for acts violating administrative order, the administrative organ must ascertain the facts; no administrative punishments shall be imposed if facts about the illegal acts remain unclear”.

Therefore, the premise of administrative punishment is that illegal facts are clear and evidence authentic. According to the Tax Administration Law, verification collection means a collection mode used by the tax authorities to verify the tax liability of the taxpayer according to the legal method when the taxpayer's account books are not perfect, incomplete information is difficult to audit, or for other reasons is difficult to accurately determine the tax liability. That is, “verification collection” is a collection mode used in case of insufficient facts and evidence.

Thus, in the case of unclear illegal facts, simple use of the verified tax amount as a calculation basis for penalty obviously fails to meet the requirements of the Law of Administrative Punishments.

(3) Insufficient basis for punishment

According to Article 63 of the Tax Administration Law, "A taxpayer forges, alters, conceals or, without authorization, destroys account books or vouchers for the accounts, or overstates expenses or omits or understates incomes in the account books, or, after being notified by the tax authorities to make tax declaration, refuses to do so or makes false tax declaration, or fails to pay or underpays the amount of tax payable. Where a taxpayer evades tax, the tax authorities shall pursue the payment of the amount of tax he fails to pay or underpays and the surcharge thereon, and he shall also be fined not less than 50 percent but not more than five times the amount of tax he fails to pay or underpays".

When identifying the amount of tax evasion by the taxpayer, the respondent shall provide sufficient evidence that the taxpayer has implemented the tax evasion means specified in Article 63 of the Tax Administration Law; the respondent should also identify whether the applicant has hidden his income, and the amount of income concealed; whether the taxpayer has inflated costs, and inflated amount of costs and expenses. The evidence of concealing of income or demonstration of inflated costs and expenses shall be verified accurately by direct evidence. If the evidence is missing, or an evidence chain is difficult to form between the evidences, and thus it is impossible to accurately prove the concealed income or inflated costs and expenses, the so-called amount of amount will be difficult to be identified by the judiciary. The tax determined in the verification collection mode may be less than any tax amount that the taxpayer actually fails to pay or underpays; it may actually be higher than the amount to be paid by the taxpayer actually. However, such tax is obviously not equal to any tax amount that the taxpayer actually fails to pay or underpays. Where the respondent fails or is difficult to provide sufficient evidence to prove the real and accurate account of tax that the applicant fails to pay or underpays, Article 63 of the Tax Administration Law is clearly difficult to apply, and punishment of the applicant also lacks legal basis.

(4) The provisions of relevant laws and regulations that punishment is not imposed on verification collection indicate that they does not apply to tax evasion identification and punishment in the mode of verification collection

According to Article 37 of the Tax Administration Law, "Where a taxpayer engaged in production or business operations or a taxpayer temporarily engaged in business operations fails to complete the formalities for tax registration in accordance with regulations, the tax authorities shall assess the amount of tax payable by him and order him to make the payment; if he fails to do so, the tax authorities may detain the commodities or goods of a value equivalent to the amount of tax payable". For an unlicensed taxpayer, his earnings from production and operation are surely subjected to the lack of income tax returns and tax payments, but the Tax Administration Law only verifies the tax liability with regard to such failure to pay tax or underpayment of tax, and does not specify whether to impose late fees or punishment. When compulsory measures are taken lawfully against the failure of the taxpayer to pay the verified tax, such compulsory measures are only for commodities and goods with the price equal to the tax liability, without any late fees. Thus, the Tax Administration Law had a very clear legislative intent, i.e. neither late fees nor fines shall be imposed on the verified tax liability.

Even in the case of tax audit, there is still the situation of ex-post verification collection. For example, Article 3 of the Guide to Ex-post Verification Collection of Penalties and Late Fees Imposed on Enterprise Income Tax and Enterprise Income Tax Supplemented in Tax Assessment (Shui Di Shui Fa [2006] No. 192) issued by Guangzhou Local Taxation Bureau provides that, "Comply with the situations of Article 5 of the Interim Measures

of Guangzhou Local Taxation Bureau on Verification Collection of Enterprise Income Tax (Shui Di Shui Fa [2005] 297, hereinafter referred to as Interim Measures) and treatment measures for verification collection of enterprise income tax: (1). Where the situation in Article 5 (1) of the Interim Measures is met, i.e. 'where account books should be established according to the laws and administrative regulations but were not established', punishment will be given and late fees imposed in accordance with Article 60 of the Law of the People's Republic of China on the Administration of Tax Collection (hereinafter referred to as the Tax Administration Law). (2). Where the situation in Article 5 (2) of the Interim Measures is met, i.e. 'where account books are destroyed without permission or tax payment materials are not provided', punishment will be given and late fees imposed in accordance with the Article 62 of the Tax Administration Law. (3). Where the situation in Article 5 (3) of the Interim Measures is met, i.e. 'where account books are established, but the accounts are not in order or information on costs, receipt vouchers and expense vouchers is incomplete, making it difficult to check the books, including: 1. Where total income can be only checked accurately or verified, but its expenses and expenditures can not be checked accurately; 2. Where costs, expenses and expenditures can be only checked accurately or verified, but its total income cannot be checked accurately; 3. Total income and costs and expenses cannot be checked properly, and true, accurate and complete tax information cannot be submitted to the competent tax authorities, causing it difficult to be verified', punishment will be given and late fees imposed in accordance with Article 60 of the Tax Administration Law if the vouchers and related materials are incomplete; punishment will not be given and only late fees imposed if accounts are in disorder. (4). Where the situation in Article 5 (3) 4) of the Interim Measures is met, i.e. 'where account books are established and checked in accordance with the regulations but account books, vouchers and tax-related materials are not maintained according to the regulations', punishment will be given and late fees imposed in accordance with the Article 60 of the Tax Administration Law. (5) Where the situation in Article 5（4）of the Interim Measures is met, i.e. 'Where institutions, social organizations, and private non-enterprise units fail to check taxable income-related costs, expenses, losses and tax-exempt related costs, expenses and losses respectively and can not calculate the taxable income as per the reasonable measures such as absorption proportion method, punishment will not be given and only late fees imposed. (6) Where the situation in Article 5（5）of the Interim Measures is met, i.e. "Where the taxpayer of enterprise income tax fails to handle the tax registration in accordance with regulations in production and operation', punishment will be given and late fees imposed in accordance with the Article 60 of the Tax Administration Law. (7) Where the situation in Article 5（6）of the Interim Measures is met, i.e. "Where, in case of tax liability, the taxpayer fails to handle the tax return within the specified period and still fails to do so overdue after being ordered by the tax authorities to handle tax return within the specified term', punishment will be given and late fees imposed in accordance with the Article 62 of the Tax Administration Law. (8). Where the situation in Article 5 （7）of the Interim Measures is met, i.e. 'Where the taxbase of tax return is obviously low, without proper reasons', and there is no situation in each item of Article 5 of the Interim Measures, punishment will not be given and no late fees imposed when first ex-post verification collection is made, being ordered to correct such cases. If presence of such situation is discovered, it shall be brought to the audit department for treatment".

Firstly, the document clearly points out that verification collection allows advance verification, i.e. after application by the taxpayer as per year, the collection mode for his income tax shall be identified, and income tax shall be verified and levied in accordance with the taxable rate; furthermore, the document has also defined regulations, based on the Interim Measures of Guangzhou Local Taxation Bureau on Verification Collection of Enterprise Income Tax (Shui Di Shui Fa [2005] No. 297), Article 1, "In order to further standardize verification collection of enterprise income tax, to strengthen the management of collection of enterprise income tax, according to the Law of the People's Republic of China on the Administration of Tax Collection (hereinafter referred to as

the Tax Administration Law) and its implementing rules (hereinafter referred to as the Implementation Rules of Tax Administration Law), Provisional Regulations of the People's Republic of China on Enterprise Income Tax (hereinafter referred to as Regulations) and its implementing rules (hereinafter referred to as Rules of Regulations) and the Interim Measures for Verification Collection of Enterprise Income Tax (Guo Shui Fa [2000] No. 38 by the State Administration of Taxation (hereinafter referred to as Measures for Collection), in combination with specific situation of our city, these measures are hereby formulated', Article 3, "Verification collection of enterprise income tax, according to the verification behavior and respective tax period, is divided into ex ante verification, in-progress verification and ex-post verification', and Article 4, "Ex ante verification refers to verification collection of the tax for the future month (quarter) of the year by the tax authorities before end of the year of enterprise income tax according to the situation of the taxpayer for the previous month or year; in-progress verification refers to verification collection of the tax by the tax authorities on the income because of incomplete vouchers of relevant income and expenditures when a taxpayer obtains temporary income and applies to the tax authorities for invoices; Ex-post verification refers the verification collection by the tax authorities when finding the taxpayer to have the situation in Article 5 during in section (audit) after end of the tax period, verification collection may also be ex-post verification, i.e. after end of the tax period, the tax authorities may pursue ex-post verification when the taxpayer is found to have the situation for verification collection during the audit process.

Secondly, the document clearly states that, if tax collection is made according to the ex-post verification mode, punishment shall be given in accordance with Article 60 of the Tax Administration Law, "Where a taxpayer commits one of the following acts, he shall be ordered by the tax authorities to rectify within a time limit and may be fined not more than RMB 2,000 yuan; if the circumstances are serious, he may be fined not less than 2,000 yuan but not more than 10,000 yuan", i.e. a fine not more than 10,000 yuan will be imposed. That is, in the mode of ex-post verification collection, the regulations of Article 63 of the Tax Administration Law are not applicable, and of course, corresponding penalty shall not be imposed.

In the opinion of the applicant, firstly, verification collection of tax may occur in advance or afterwards; secondly, no matter the ex ante verification collection or the ex-post verification collection, its bases for enforcement are the Provisional Regulations of the People's Republic of China on Enterprise Income Tax, the Law of the People's Republic of China on Enterprise Income Tax, normative documents of the State Administration of Taxation on verification collection of enterprise income tax as well as implementing rules of local tax authorities at all levels on verification collection of enterprise income tax, different legal bases are not applicable to ex ante verification collection and ex-post verification collection respectively; finally, with regard to ex-post verification collection, now that the higher-level laws cited in all places are the same, the bases for enforcement in all places shall also be consistent, and for the same action, the following situation shall not be allowed: a fine of less than RMB 10,000 is given in the south but so-called 1.5 times fine as high as RMB 6,733,716.36 is given in the north.

IV. Wrong procedures

Subject to Paragraph 1 (c) of Article 28 of the Administrative Reconsideration Law of the People's Republic of China (hereinafter referred to as Administrative Reconsideration Law), "If a specific administrative act has been undertaken in one of the following circumstances, the act shall be annulled, altered, or confirmed as illegal by decision; if the specific administrative act is annulled or confirmed as illegal by decision, the applied may be ordered to undertake a specific administrative act anew within a fixed time: 3. violation of legal procedures; 4. excess of authority or abuse of powers", Article 45 of the Regulation on the Implementation of the Administrative

Reconsideration Law of the People's Republic of China, "Where a specific administrative action is under any of the circumstances set forth in Paragraph 1 (c) of Article 28 of the Administrative Reconsideration Law, an administrative reconsideration organ shall decide to revoke or modify the specific administrative action or confirm the specific administrative action as a violation of law", and Article 55 of the Rules for Taxation Administrative Reconsideration (No. 21 Decree of the State Administration of Taxation), "The administrative reconsideration agency shall examine the legitimacy of the evidences in the following respects according to the specific situations of a case:

(1) Whether the evidences conform to the legal form; (2) Whether the obtaining of evidences conforms to the provisions of laws, regulations and judicial interpretations; and (3) Whether there are other circumstances in violation of laws which may affect the force of evidences", and Article 58 "The following evidentiary materials shall not be used as the basis for determination of a case:

(1) Any evidentiary material collected by any means in violation of legal procedures", the punishment decision made by the respondent to the applicant should have sufficient evidence; and such evidence should have legitimacy, including those obtained through legal procedures; furthermore, if the respondent collects evidence in violation of legal procedures, such evidence shall not be used as the factual basis for specific administrative act; moreover, if the respondent commits an action in violation of legal procedures when implementing the specific administrative act, its specific administrative act shall be revoked according to law. In terms of the respondent in the present case, its law enforcement has committed serious violation of legal procedures and excess of authority or abuse of powers, and thus its penalty decision should of course be revoked according to law.

1. Before tax inspection, the respondent has not fulfilled obligations of disclosure according to law

According to Article 22 (1) of the Tax Audit Regulations (Guo Shui Fa [2009] No. 157), "Before inspection, the inspected party shall be informed of the inspection time and materials to be prepared, unless prior notice impedes the inspection".

However, late at night on April 6, 2011, the respondent failed to inform the applicant according to legal procedures and retrieved accounting materials of the applicant from the founding time of the company, the year 2000, to February 2011, from Beijing Huxin Financial Accounting Services Co., Ltd. (hereinafter referred to as Huxin Company), to which the applicant entrusts for bookkeeping.

2. The respondent failed to issue a tax inspection certificate and the Tax Inspection Notice according to law

According to Article 59 of the Tax Administration Law, "When conducting tax inspection, the officials sent by the tax authorities shall produce tax inspection certificate and tax inspection notice, and shall have the duty to keep confidentiality for the persons under inspection; where no such certificate and notice are produced, the persons subject to inspection shall have the right to refuse to accept the inspection" and Article 22 (2) of the Tax Audit Regulations (Guo Shui Fa [2009] No. 157), "The inspection shall be executed by two or more inspectors, who should show the inspected party the tax inspection certificate and the Tax Inspection Notice", it is a necessary legal procedure for the tax inspectors to show the inspected party the certificates and tax legal documents.

However, late at night of April 6, 2011, when retrieving accounting materials from Huxin Company, the respondent failed to present the tax inspection certificate and the Tax Inspection Notice, in violation of the legal procedure.

3. The respondent gravely violated the legal procedure when retrieving accounting materials of the applicant

According to Article 25 of the Tax Audit Regulations (Guo Shui Fa [2009] No. 157), "When retrieving account books, accounting vouchers, statements and other relevant information, present to the inspected party the Notice for Retrieving Account Book Materials and fill out the List of Retrieved Account Book Materials, which shall be signed for confirmation after being checked with the inspected party.

However, when retrieving accounting materials from Huxin Company and the applicant, the respondent failed to issue the Notice for Retrieving Account Book Materials and fill out the List of Retrieved Account Book Materials for verification with the applicant.

4. The accounting materials of the applicant retrieved by the respondent had not been returned within the statutory time limit

According to Article 86 of Rules for the Implementation of the Law of the People's Republic of China on the Administration of Tax Collection, "A taxation authority exercising its powers of office provided under the provisions of item (1) of Article 54 of the Tax Administration Law may do so at the business premises of a taxpayer or tax-withholding agent. If deemed necessary and subject to approval by the head of a taxation authority at county level or above, the taxation authority may also demand that the taxpayer's or tax withholding agent's account books, accounting documentation, statements and other relevant materials of the previous accounting year be submitted for examination. When doing so, however, the taxation authority must provide the taxpayer or tax withholding agent with a detailed list of the items taken and shall return them **within three months in entirety**; in special cases, and subject to approval by the head of a taxation authority at city and autonomous prefecture level or above, the taxation authority may take back the taxpayer's or tax withholding agent's account books, accounting documentation, statements and other relevant materials of the current accounting year for examination, which must be returned by the taxation authority **within 30 days**", and Article 25 (2) of the Tax Audit Regulations (Guo Shui Fa [2009] No. 157), "Retrieving of the taxpayer's or tax withholding agent's account books, accounting documentation, statements and other relevant materials of the previous accounting year shall be approved the head of a taxation authority and they shall be returned within three months; retrieving of the taxpayer's or tax withholding agent's account books, accounting documentation, statements and other relevant materials of the current accounting year shall be subject to approval by the head of a taxation authority at city and autonomous prefecture level or above and they must be returned within 30 days", any accounting materials of the previous accounting year retrieved by the respondent from the applicant shall be returned completely within three months; any accounting materials of the current accounting year retrieved by the respondent from the applicant shall be returned within 30 days.

When, however, the above statutory time limit expired, the respondent did not return all the retrieved accounting materials according to the law, and until now, has not yet returned them, which not only seriously affects the applicant's production and business activities, and substantially impedes the applicant's rights to hearing and reconsideration.

5. Illegal tax penalty hearing procedure

Under Article 42 of the *Administrative Punishment Law*, "The administrative organ before making a decision on the administrative punishment such as ordering to stop production and business, withdrawing the permit or license，or large sum of fine，shall advise the party of the right to hearing. And the administrative organ at the request of the party shall organize hearing;（3） Hearing shall be held in public，with the exception that state or commercial secret or personal privacy is involved", and Section 3, "Hearing Procedure" of Chapter 2 in "Punishment Procedure" of the Interim Measures for Administrative Punishment printed and issued by Beijing Local Taxation Bureau (Jing Di Shui Fa [2001] No. 488), the hearing procedure is a necessary procedure for implementation of tax administrative punishment. The respondent at the request of the party shall organize hearing in accordance with the specified procedures and requirements. If the hearing itself violates the regulations and the procedures, it will inevitably lead to "violation of legal procedures" by the tax administrative punishment itself, and thus, the corresponding tax administrative punishment shall be revoked according to law. In present case, although the respondent has organized a hearing, its hearing procedure has violated the law seriously.

(1) The hearing was not conducted in public

According to Article 53 of the Tax Audit Regulations (Guo Shui Fa [2009] No. 157), "Where the inspected party or other tax-related party requests a hearing, the hearing shall be organized according to law. A hearing officer should preside over the hearing. A hearing shall be conducted in accordance with the relevant regulations of the State Administration of Taxation", and Article 2 of Implementing Measures for Hearing Procedures of Tax Administrative Punishment (tentative) (Guo Shui Fa [1996] No. 190) states that "The hearing of tax administrative punishment shall follow a principle of being lawful, fair, open, timely and convenient for citizens" and Article 11, "The hearing of tax administrative punishment shall be conducted in public, with the exception that the state's or commercial secret or personal privacy is involved. For a case of public hearings, the name of the parties and investigators in the case, cause of action, hearing time and place shall be announced in advance. People shall be allowed to attend public hearings. For a case of closed hearings, the reason for closed hearings shall be announced", tax administrative punishment hearings shall be conducted in public, with the exception that state or commercial secret or personal privacy is involved.

On June 29, 2011, the applicant submitted a written application to request a hearing. In light of the decision of the respondent that "trade secrets" of a third party is involved and a "closed hearing" will be carried out", the applicant submitted a written objection to the respondent twice, but the respondent refused to state the reasons. The hearing dated July 14, 2011 shows that the respondent cannot produce any application of a third party for cofidentiality to the applicant.

Public hearing is the procedural requirements of tax administrative punishment. If the contents of the hearing in the case involve commercial secrets, the respondent should also explain to the applicant any written application of a third party for keeping confidential. According to the Criminal Law of the People's Republic of China and the Anti Unfair Competition Law of the People's Republic of China, commercial secrets refer to "the technical information and operational information which is not known to the public, which is capable of bringing economic benefits to the owners of the rights, which has practical applicability and which the owners of the rights have taken measures to keep secret". The respondent does not have any evidence that the information of a third party has such features that the information is not known to the public, is capable of bringing economic benefits to the owners of the rights, has practical applicability and the owners of the rights have taken measures to keep secret, and so-called

“commercial secrets” are unwarranted.

(2) The applicant was illegally deprived of rights to statement and defence

According to Article 14 of Implementing Measures for Hearing Procedures of Tax Administrative Punishment (tentative) (Guo Shui Fa [1996] No. 190), “During the hearing, the case investigation officer shall accuse the parties of illegal acts, and produce evidence of facts”, during the hearing, the respondent shall present to the applicant the evidence materials for administrative punishment, and provide the originals to verify the authenticity of the evidence. However, the respondent, only at the beginning, provided the applicant with copies of relevant evidence materials, and such copies did not bear a signature of the applicant for confirmation. Because the respondent did not produce the originals to be checked with the applicant, the applicant is unable to confirm the evidence for authenticity, legitimacy and effectiveness, and moreover, the applicant was substantially deprived of its rights to statement and defence.

To safeguard the legitimate rights and interests of the applicant, to keep the tax payment relation between tax authorities and enterprises, and to maintain authority, equality and fairness of national tax laws and tax law enforcement, your bureau is kindly asked to forward the Notice of the State Administration of Taxation on Some Issues Concerning the Punishments for Acts in Violation of the Regulations on Stamp Tax (Guo Shui Fa [2004] No. 15) on which the respondent is based to the competent authorities for review, verify the facts and according to law, withdraw the Administrative Punishment Decision of No. 2 Tax Inspection Department of Beijing Local Taxation Bureau (Er Ji Shui Ji Fa [2011] No. 56).

Hereby undersigned, for the

Beijing Local Taxation Bureau

Applicant: Fake Design Culture Development Ltd.

Legal representative: Lu Qing

December 28, 2011