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Insight: Legal Theoretical Application and Penalty Analysis of Tax Evasion via Fake VAT Invoices and Tax Deduction

By Ben Lu

In relation to the act of tax evasion through the use of fraudulent VAT invoices to claim tax deductions, there are five different theoretical viewpoints in legal academia regarding the applicable legal theory and corresponding penalties:

1. Concurrent Punishment for the Crime of Issuing Fake VAT Invoices and Tax Evasion
2. Punishment According to the Principle of Consecutive Offenses
3. Application of the Principle of Special Law Prevailing Over General Law in Cases of Conflict of Legal Provisions
4. Aggravated Offense Based on Consequences
5. Absorption Offense Theory: Heavier Crime Absorbs the Lighter Crime

The author supports the fifth viewpoint.

1. Analysis of the First Viewpoint

The first viewpoint fails to recognize the inevitable connection between the crime of issuing fake VAT invoices and tax evasion, merely classifying them as two separate offenses based on their appearance and imposing concurrent penalties. This approach is excessively harsh on the offender and contradicts criminal law theory, making it unadvisable.

2. Analysis of the Second Viewpoint

According to criminal law theory, a "consecutive offense" occurs when an offender, while intending to commit one crime, inadvertently commits other distinct offenses. The crimes must be related in a way that one act leads to another—either methodically or causally.

In this case, the principle of consecutive offenses seems to be applicable to the act of issuing fake VAT invoices and subsequently using those invoices to claim tax deductions. These two acts are carried out with the same intent of evading taxes, constituting two separate crimes under criminal law: the crime of issuing fake VAT invoices and the crime of tax evasion. Besides, issuing fake VAT invoices leads to the evading of tax methodically.

But punishing according to the principle of consecutive offenses, with the more severe offense being applied, is not applicable here. Article 2 of the Criminal Law clearly stipulates: "The act of issuing fraudulent invoices to deceive the state out of tax payments... shall be punished under the crime of issuing fake VAT invoices."

3. Analysis of the Third Viewpoint

The conflict of provisions refers to situations where a criminal act might be covered by multiple legal provisions, and in such cases, only one provision is applicable, thereby excluding others. The prerequisites for a conflict of provisions include: (1) an act violating multiple legal provisions; and (2) a relationship of overlap between those provisions. The essential feature is that a single act fulfills the criteria for a single crime, and the appropriate legal provision should be chosen without implicating multiple offenses. Given that the crimes of issuing fake VAT invoices and tax evasion are defined separately under criminal law, they do not overlap in a way that would constitute a conflict of provisions. Therefore, the author disagrees with interpreting this case as one of legal conflict.

4. Analysis of the Fourth Viewpoint

The theory of aggravated offenses applies only in cases where the amount of tax evaded is extraordinarily large, the circumstances are particularly severe, or the loss to the state is especially significant. This is not applicable to the general act of tax evasion via fraudulent invoices.

5. Analysis of the Fifth Viewpoint

The theory of absorption offenses applies when multiple different crimes are committed, but one offense is absorbed by another due to the nature of the crimes. One crime is considered an inevitable method or result of another, thus only the more severe crime is punished. In the context of this discussion, the offender's intent in issuing fake VAT invoices is to use the invoices for tax deduction and therefore evade tax. As a result, the tax evasion offense is a natural consequence of the crime of issuing fraudulent VAT invoices, which perfectly aligns with the requirements for an absorption offense. As such, the crime of issuing fake VAT invoices, as the more severe crime, should be punished as the primary offense, absorbing the tax evasion offense.

Insight: Discussion on Disputes Arising from Investors' Claims for Breach of Contract When Target Companies Fail to Fulfill Repurchase Obligations

By Mengting Chen

The buyback clause serves as a crucial exit mechanism in equity investments, enabling investors to require the target company to repurchase their shares under specific conditions, thereby safeguarding investors' interests. When the target company fails to fulfill its repurchase obligations in a timely manner, investors typically seek to protect their rights by holding the company liable for breach of contract. In judicial practice, courts may limit or deny the target company's liability for breach of contract based on considerations such as creditor protection and market order maintenance. This article provides an overview of the legal validity of buyback clauses, outlines three judicial approaches to investors' claims for breach of contract by target companies, and offers risk mitigation strategies for investors.

1. Legal Validity of Buyback Clauses

The legal validity of buyback clauses has evolved from being contentious to becoming increasingly clarified. Initially, certain opinions regarded buyback clauses as violating mandatory provisions of corporate law, such as prohibitions against capital withdrawal or actions detrimental to creditors' interests, thus deemed them invalid. However, recent judicial practice has predominantly recognized the validity of buyback clauses, provided they adhere to the principles of fairness and do not infringe upon the legitimate rights of the company or external creditors.

Article 5 of the *National Court's Civil and Commercial Trial Work Conference Memorandum* (hereinafter referred to as the "Nineth Civil Memorandum") stipulates that investors’ requests for target companies to repurchase shares must comply with the corporate law requirements regarding prohibitions on capital withdrawal and mandatory provisions on share repurchase. If the target company fails to complete the statutory procedures for capital reduction, the people's court shall dismiss such claims.

2. Judicial Determination of Breach of Contract by Target Companies for Failure to Fulfill Repurchase Obligations

When a court dismisses an investor’s claim for equity repurchase due to the target company’s failure to complete the statutory procedures for capital reduction, the investor may pursue damages for breach of contract under the terms of the investment agreement. Judicial practice in these cases often involves balancing the complexities of competing interests, including the protection of contractual freedom, the assurance of reasonable returns for investors, the preservation of corporate capital adequacy, and protection of creditors’ interests. Courts have adopted three distinct approaches in handling such disputes:

(I) **Requiring the Target Company to Pay Liquidated Damages as Specified in the Agreement**
In Case No. (2024) Zhe 0108 Minchu 1744, the Intermediate People’s Court of Shaoxing, Zhejiang Province, held that the agreements reflected the true intent of the parties, did not violate mandatory legal provisions, and were therefore valid. Since the target company failed to complete the statutory procedures for capital reduction as required, it was found in breach of its contractual obligations and ordered to pay overdue payment penalties at four times the Loan Prime Rate (LPR) stipulated in the contract.

(II) **Requiring the Target Company to Pay Adjusted Liquidated Damages**
In Case No. (2021) Jing Min Zhong 495, the Beijing High People’s Court upheld the validity of the investment and supplementary agreements, recognizing their fairness and compliance with the Contract Law of the People’s Republic of China. While affirming the company’s liability for breach, the court adjusted the liquidated damages amount, considering the high daily penalty rate of 0.05% excessive. Instead, the court lowered the rate to 0.03%, based on the actual damage, the contract's performance, the parties’ fault, and expected benefits.

Firstly, the court of first instance affirmed the validity of the "Investment Agreement" and the "Supplementary Agreement" for the following reasons: "For investment contracts containing 'betting' clauses, the law has not issued any negative evaluation. When the 'Supplementary Agreement' does not fall under the invalidity provisions in Article 52 of the Contract Law of the People's Republic of China, the validity of the 'Supplementary Agreement' should be affirmed according to the law." Furthermore, "Although the target company's repurchase of the investor's shares as stipulated in the agreement may, in objective terms, harm the target company's capital maintenance and external solvency as a legal entity, the target company's signing of the 'Supplementary Agreement' and obtaining investment funds from the investor helps the company with financing and its operational activities, which in turn supports its capital maintenance and external solvency."

Secondly, with regard to breach of contract liability, both the courts of first and second instance supported the investor's claims. The first-instance court held that the target company's failure to complete the capital reduction procedure caused the investor not to receive the redemption price in a timely manner, and therefore, the investor's demand for overdue payment penalties was supported by the contract. The second-instance court stated that when entering into the "Investment Agreement" and the "Supplementary Agreement" and during its performance, all parties should have a reasonable expectation of its ability to fulfill their corresponding obligations and perform them honestly. The target company's failure to timely perform the capital reduction procedure violated its ancillary obligations under the contract, resulting in its failure to pay the redemption price to the investor within the agreed time frame, and thus, the target company should bear the delay in performance liability for failing to fulfill its contractual obligations in a timely manner. The court further noted that the payment of liquidated damages by the target company would not lead to a reduction in its registered capital nor would it necessarily harm the interests of creditors.

Lastly, with regard to the calculation of the penalty for expected performance delay, the investor requested the target company to pay overdue payment penalties based on the equity repurchase price, calculated at a rate of 0.05% per day, as well as a penalty of 1% of the actual investment amount (300,000 RMB) according to the breach of the "Supplementary Agreement." The first-instance court held that the investor's request for both liquidated damages and overdue payment penalties was excessive, and the 0.05% daily calculation rate was too high. Therefore, the overdue payment calculation rate was adjusted to 0.03% per day. The second-instance court, based on the losses caused by the breach, considered factors such as the contract's performance, the degree of fault of the parties, and expected benefits, and upheld the first-instance court's ruling.

(III) Rejecting Investors' Claims for Liquidated Damages

In Case No. (2020) Jing Min Zhong 549, the Beijing High People's Court dismissed the investor's claim, reasoning that the target company had not completed capital reduction procedures necessary for repurchasing shares. Supporting the investor's claim for damages would effectively allow the company's shareholders to indirectly withdraw capital, violating mandatory legal provisions. As a result, rejected the investor's claim for liquidated damages.

3. Risk Mitigation Strategies for Investors

(I) Enhancing Due Diligence
Before signing investment agreements, investors should comprehensively assess the target company's financial status, including analyzing balance sheets, monitoring cash flows, examining governance structures, and evaluating business performance. Legal risks should also be scrutinized, with a particular focus on potential litigation, compliance issues, and historical capital reduction records to gauge future risks.

(II) Optimizing Buyback Clauses
Investors should draft buyback clauses with clear conditions, specific triggers (e.g., performance shortfalls, delays in public listing), and detailed procedures covering notifications, timelines, and payment methods. Liquidated damages should be structured to provide effective deterrence while setting reasonable limits. Additionally, collateral measures such as guarantees from controlling shareholders or asset pledges should be incorporated to enhance enforceability. Importantly, buyback clauses must comply with legal and regulatory requirements to ensure validity and enforceability.

Regulatory Updates

Announcement by the Ministry of Finance, the State Taxation Administration, and the Publicity Department of the CPC Central Committee on Tax Policies for the Conversion of Commercial Cultural Institutions into Enterprises under the Framework of Cultural System Reform

December 6, 2024 — The Ministry of Finance, the State Taxation Administration, and the Publicity Department of the CPC Central Committee jointly issued Announcement No. 20 of 2024, providing tax policy support to promote the conversion of commercial cultural institutions into enterprises, thereby advancing the cultural system reform.

I. Key Tax Incentive Policies

(1) Corporate Income Tax Incentives
Institutions converted into enterprises, having completed registration as corporate legal entities and the lawful and regulated cancellation of their institutional registration or staffing quota by December 31, 2022, shall be exempt from corporate income tax from the date of registration until December 31, 2027. This policy applies to conversions of entire entities or spin-offs in fields such as news publishing, broadcasting, film, and the arts. The date of conversion shall be determined based on the registration of the corporate entity or specific legal entity, as applicable.

(2) Real Estate Tax Incentives
Cultural institutions converted within the specified period and funded by fiscal allocations, using self-occupied properties, shall be exempt from real estate tax from the date of registration until December 31, 2027. This policy reduces operational costs and enables enterprises to focus resources on their core business development.

II. Conditions for Tax Incentive Eligibility

(1) Basis for Conversion and Registration

The conversion process must comply with approvals from relevant authorities, with completion of corporate entity registration to ensure legal compliance, clear ownership, and alignment with market operation requirements.

(2) Staffing and Legal Entity Disposal

For institutions with prior legal entity registration, staffing quotas must be canceled, and institutional legal entities deregistered after conversion. For institutions without legal entity registration, only staffing quotas need to be canceled. This ensures a thorough market-oriented transition and optimizes resource allocation and operational efficiency.

(3) Protection of Employee Rights

Enterprises must enter into labor contracts with existing employees and enroll them in social insurance programs as per corporate requirements. This measure stabilizes labor relations and strengthens enterprises' human resource foundations and social responsibility.

(4) Regulation of Capital Operations

When introducing non-public or foreign capital, enterprises must strictly comply with laws and regulations. Any changes in capital structure must be lawfully approved to ensure orderly capital flows within the industry and maintain market stability.

III. Enterprise Recognition and Management

(1) Recognition Entities and Processes

Enterprises under central jurisdiction shall be recognized and listed by the Publicity Department of the CPC Central Committee in coordination with the Ministry of Finance and the State Taxation Administration. Local enterprises shall be recognized and listed by local publicity departments in collaboration with financial and taxation authorities, with the results reported to higher authorities. This hierarchical recognition system ensures precise implementation of the policy.

(2) Detailed Rules on Changes

For enterprises undergoing name changes without altering their primary business, tax registration changes may proceed with consent from publicity authorities. If primary business changes, the enterprise must be re-recognized in accordance with the conditions stipulated in the announcement, balancing enterprise flexibility with policy integrity.

(3) Procedures and Supervision Mechanisms

Recognized enterprises must follow regulations for tax incentive applications and retain key documents for potential inspections. Tax authorities shall strengthen subsequent supervision. Enterprises not recognized or failing to meet stipulated conditions shall not enjoy the incentives. For enterprises that improperly received incentives, tax authorities shall recover the taxes, while overpaid taxes eligible for reductions or exemptions may be offset or refunded according to regulations. These measures ensure the fairness and authority of the policy and its precise enforcement.

Ministry of Finance, State Taxation Administration, and Ministry of Housing and Urban-Rural Development Issue the "Announcement on Tax Policies to Promote Stable and Healthy Development of the Real Estate Market"

On November 13, the Ministry of Finance, the State Taxation Administration, and the Ministry of Housing and Urban-Rural Development jointly issued the **"Announcement on Tax Policies to Promote Stable and Healthy Development of the Real Estate Market"**, which clarifies several tax incentives aimed at supporting the real estate market.

Key Tax Policies Outlined in the Announcement

1. **Deed Tax Incentives**
   The announcement strengthens deed tax relief measures for housing transactions to actively support residents' demand for first homes and improved housing. The eligibility threshold for the 1% preferential deed tax rate has been increased from 90 square meters to 140 square meters. Furthermore, Beijing, Shanghai, Guangzhou, and Shenzhen are now allowed to apply the same preferential deed tax policies for second homes as other regions.

Under the revised policy, for personal purchases of the sole home for a household or a second home, if the area does not exceed 140 square meters, the deed tax will be uniformly levied at a 1% rate nationwide.

2. **Land Value-Added Tax (LVAT) Reductions**
   The lower limit for the pre-levy rate of land value-added tax has been reduced by 0.5 percentage points across all regions. Local authorities may further adjust the actual pre-levy rates based on local conditions, thereby alleviating financial difficulties faced by real estate enterprises.

3. **VAT and LVAT Policies Linked to the Removal of Residential Standards**

   - **Value-Added Tax (VAT):** In cities that have removed the "ordinary residential" classification, individuals selling residential properties purchased at least two years ago (including two years) will be exempt from VAT. The prior regulation, which imposed VAT on sales of non-ordinary residential properties purchased for at least two years in Beijing, Shanghai, Guangzhou, and Shenzhen, will cease to apply.

   - **Land Value-Added Tax:** For cities where the "ordinary" and "non-ordinary" residential classifications have been removed, taxpayers constructing and selling standard residential properties with added value not exceeding 20% of the deductible costs will continue to enjoy the exemption from land value-added tax.

4. **Implementation and Transition Arrangements**

To ensure broader access to the policy benefits, the relevant authorities clarified the following:

- For individuals who purchase residential properties and file deed tax declarations on or after December 1, 2024, or who purchased properties before December 1, 2024, but file deed tax declarations thereafter, the provisions of the newly issued announcement will apply.
- Similarly, for individuals selling residential properties involving VAT payments that have not been declared before December 1, 2024, the new policies may also apply if they meet the criteria outlined in the announcement.

Officials from the Tax Policy Department of the Ministry of Finance, the Property and Behavior Tax Department and the Goods and Services Tax Department of the State Taxation Administration, and the Real Estate Market Regulation Department of the Ministry of Housing and Urban-Rural Development emphasized in a press conference that these measures aim to allow a broader range of taxpayers to benefit from the tax reforms, reduce housing transaction costs, and stabilize the tax burdens of real estate enterprises.

Fortran News

1. **Fudan Tax Forum and 10th Anniversary Celebration of Fudan Taxation Master's Program Successfully Held**

   On December 7, 2024, the inaugural Fudan Tax Forum and the 10th Anniversary Celebration of the Fudan Taxation Master's Program were successfully held at the School of Economics, Fudan University. The event was co-hosted by the School of Economics and the Public Economics Research Center of Fudan University, with Shanghai Fortran Law Firm as a supporting partner.

   The forum brought together over 160 participants, including members of the National Steering Committee for Professional Tax Degree Education, experts from the State Taxation Administration, industry professionals, experts from the State Taxation Administration, scholars from peer institutions, and experts from other schools within Fudan University, such as the School of Law and the School of Computer Science. Also in attendance were faculty, students, alumni of the Fudan Taxation Master's Program, representatives from practice bases, and mentors from various industries.

   In the lead-up to the event, more than ten members of the National Steering Committee for Professional Tax Degree Education extended their congratulations to the Fudan Taxation Master's Program through congratulatory letters, messages, and videos.

   Fortran Law Firm's partners, Ryan Yan and Ben Lu, attended the event and delivered speeches, showcasing the firm's commitment to the development of the taxation profession and its active engagement with academic and professional communities.

2. On December 14, 2024, lawyer Ryan Yan and Ben Lu were invited to attend the 2024 Annual Conference on the Development of the Taxation Master's Degree Authorization Program at Shanghai University of Finance and Economics.