Tax evasion in China

Yin and yang

SHANGHAI

Film studios and financial firms flock to new Chinese tax havens

IT IS hard to go a day in China without seeing Fan Bingbing. The doe-eyed starlet gazes from film posters (she has averaged four films a year for the past decade), airbrushed ads for global brands and glossy magazine covers. But in the past week she has graced articles about tax evasion. Shares in a film-production firm that she partly owns fell by 10% on fears that it might be ensnared in a scandal in which actors have allegedly concealed their salaries. Ms Fan has denied wrongdoing. On June 3rd the government began a probe into tax compliance in the entertainment industry.

The controversy began when Cui Yongyuan, a TV presenter, described two anonymous contracts on Weibo, a microblog, one for 10m yuan ($1.6m) and another, linked to the first, for 50m yuan. He said it was a case of the "yin-and-yang" payments prevalent in the film business: reporting a low salary for taxation and pocketing a larger sum. Share prices of big film firms, such as Huayi Brothers, also plunged.

Fan Bingbing, on location in Khorgos

Yin-and-yang contracts are illegal but common, from the property sector to football clubs. For years the government has tried to crack down on them. In one high-profile case, Liu Xiaoqing, a popular actress, was imprisoned in 2002. But the emergence of tax havens inside China is now complicating matters. Film studios have been among the most aggressive in taking advantage of them.

Their destination of choice has been Khorgos, a desert outpost in China's far west, next to Kazakhstan. The central government hopes to build it into a key link in trading networks that traverse central Asia. Companies that register in Khorgos enjoy a five-year holiday from corporate taxes, followed by another five years in which they pay only about half.

In 2017, 14,472 firms registered themselves in Khorgos, up more than fourfold from 2016. Local tax revenues have soared. But many of the firms nominally based in the dusty border town do not actually do anything there. Roughly nine in ten are in asset-light industries, such as media and also financial services. Ms Fan is one of dozens of celebrities who have registered corporate entities in Khorgos. For private-equity firms, Tibet has become a popular locale for registering funds, also thanks to tax discounts.

Tax havens and yin-and-yang contracts highlight the holes in China's tax system. The International Monetary Fund estimates that government revenue from taxes on personal incomes is only 1.2% of GDP, compared with around 10% in many advanced economies.

China's film business is booming; box-office revenues were $8.6bn in 2017, up from less than $1bn a decade ago. But with the Klieg lights glaring on Khorgos, studios and stars will probably have to start sharing more of their riches with the government. For all the glitz and glamour of its film industry, China is still working out the basics of efficient taxation.

tended solely on the borrower's reputation. When Mr Sanea's empire collapsed in 2009 in the financial crisis, it had defrauded more than 100 banks. His firms took out more than 12,500 loans during a nine-year period; at times, 20 of them matured each day.

The Gosaibis claimed to know none of this. AHAB filed a $4bn lawsuit against Mr Sanea and his Saad Group, another conglomerate, in 2009. It accused him of forging signatures, using the family name to take out unauthorised loans, and siphoning profits to his own firms in the Cayman Islands and elsewhere (he denied the accusations). The case took eight years to wind through the courts. Anthony Smellie, the territory's chief justice, concluded that AHAB played an "active role" in the fraud. He sided with liquidators for six of Mr Sanea's companies, who should now be able to recoup some of their losses.

Follow the Maany

He also dismissed a $5.9bn counterclaim by Mr Sanea and left in place a prior $2.5bn ruling against him. Lawyers for AHAB are considering their options. The Gosaibis had hoped to use the Cayman judgment to pay creditors. There is an automatic right of appeal in the Cayman Islands. But the courts probably cannot hear an appeal until 2019, says Simon Charlton, the chief restructuring officer at AHAB.

Embarrassing as it is—international bankers have long memories, and Saudi businessmen say the AHAB case still comes up in conversations—the ruling could be useful for Saudi Arabia. It wants to see the whole affair go away, and to deepen foreign investors' trust in the country's regulatory and legal systems. Muhammad bin Salman, the ambitious crown prince, aims to attract tens of billions in foreign investment to reduce Saudi's dependence on oil revenues. One of his institutional reforms is a new bankruptcy law, which was approved in February, the kingdom's first.

Had it been passed earlier, AHAB's creditors might already have recouped some of their money. Though Mr Sanea lost much of his wealth after the default, he continued to lead a comfortable life in the kingdom's Eastern Province, ensconced in a palace with a private zoo. But in October the police were dispatched to arrest him for unpaid debts. His assets are being liquidated. Over the past few months, the Saudis have leaned on all parties to reach a deal. At least two Saudi-linked banks were coerced this year into accepting a settlement plan with AHAB, which now has the support of two-thirds of creditors. Under the new bankruptcy law, that will secure a restructuring. A fraud that is nearly as old as the crown prince may be the first proof of the success of one of his big reforms. ■