The Phenomenon and Regulation of Internet Anchor’s Tax Evasion by Setting Up Sole Proprietorship

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Abstract: The issue of tax evasion by internet anchors has recently become a hot topic of concern. As an emerging economic field spawned by the development of the internet, although live streaming has enhanced the vitality of the Internet economy, it has also led to a new situation of tax evasion by converting the nature of income through the establishment of individual sole proprietorship enterprises. When dealing with such new problems, the existing tax system has shown many shortcomings, including vague criteria for distinguishing personal service remuneration and business revenues, unclear concepts of fictitious business deals, and abuse of tax incentives. Therefore, it is necessary to carry out a theoretical analysis of this behavior from the perspective of economic substance and put forward reform suggestions for the shortcomings of the existing tax collection and management model.

Keywords: Online streaming, Individual tax collection and management, Tax evasion.

1. Introduction

Since 2016, China’s online streaming industry has developed rapidly, generating many new business forms. The “2020 China Online Performance (Live) Industry Development Report” released in May 2021 pointed out that in 2020, the development of online streaming has entered a new stage and has become an important economic growth point for the national economic recovery. According to the data in the report, the number of Internet users nationwide has exceeded 617 million, and the market size has reached 193.03 billion yuan. However, the phenomenon of tax evasion in the online live streaming industry has occurred from time to time. Since 2021, the tax-related illegal cases of anchors have been intensively exposed. For example, well-known network anchors Zhu Chenhui and Lin Shanshan will be subject to tax collection, late payment fines, and financial penalties of 65.5531 million yuan and 27.6725 million yuan respectively; Anchor Huang Wei, from 2019 to 2020, evaded tax of 643 million yuan through concealment of income, using fictitious business deals to convert the nature of income, false declaration of income, etc., and will be subject to tax collection, late payment fines and financial penalties of a total of 1.341 billion yuan.

The phenomenon of tax evasion in the emerging economy has put forward new requirements for the theory and practice of tax collection and management.

2. Explanation of the Connotation of Tax Evasion by Internet Anchors

2.1 Analysis of the Legal Status and Income Nature of Internet Anchors

Analyzing the tax authorities’ notices about the anchor’s tax evasion, we can find the key to its tax evasion path—changes in two tax elements. One is the transformation of the legal status of taxpayers, and the other is the nature of income. Therefore, it is necessary to analyze the status types of internet anchors and the nature of income under each type.

2.1.1 Legal status of internet anchors

Internet anchors refer to online performers who use the Internet streaming platform to conduct live performances such as talent, games, chat and communicate and interact with online audiences in real-time. In the process of live streaming, anchors can obtain virtual gifts from viewers, which are also known as “tips”, and share the revenue according to the agreement signed with the live streaming platform. In addition, many internet anchors will cooperate with brands to conduct live streaming for selling. The brand side will pay two kinds of fees for this kind of activity. One is “booth fee”, which refers to the cost of making the product appear in the anchor’s streaming room, that is, the product promotion fee; the other is “brokerage”, which refers to the sales commission paid by the brand based on sales after the anchor promotes the product.

As the basis of tax obligations arising from the civil legal relationship whose characterization is determined by the status type of the anchor, it is necessary to make a brief analysis of the identity type of the anchor.

(1) The anchor is employed by the platform or brokerage

An anchor signs a labor contract with an online streaming platform or a brokerage agency, and the two form an employment relationship. The anchor needs to complete the live streaming task according to the contract, and the platform or organization provides labor security for them. The income obtained by the anchor in the process of live streaming, including brokerage, booth fee, commission, etc., first enters the platform or institutional account, and then the anchor receives labor remuneration according to the contract.

(2) The anchor provides independent labor services for the platform or brokerage agency in their personal capacity

An anchor enters into a labor service agreement with a live streaming platform or a brokerage agency, and the two form a labor service relationship, which means the anchor does not need to follow labor regulations, and can freely decide the time and content of live streaming according to the agreement based on legal compliance. The platform or agency shall pay the anchor’s labor remuneration according to the agreement.
(3) The anchor signs a contract with the platform as an individual business, a sole proprietorship, or a partnership

The anchor signs with the platform in the name of these entities, and obtains a share of the income from the platform according to the agreement. And this mode is the focus of this article.

2.1.2 The nature of anchor income: types of income

China currently implements the personal income tax system combined with classification and comprehensive taxation. The tax system is designed by category and the corresponding tax rate is applied according to the actual income of the taxpayer.

Comprehensive income, including wages, salaries, labor remuneration and author’s remuneration, and royalties’ income four items, which applied 3%-45% excess progressive tax rate, while the excess progressive tax rate of 5%--35% is applicable to Business revenues. Income from interest, dividends, bonuses, incidental income, and income from other sources, applicable proportional tax rate which is 20%.[1]

The income earned by internet anchors through live streaming mainly includes rewards (‘tips’), basic salary, commissions for booth fees, etc., which have different legal natures according to the differences in the basic legal relationship between anchors, brokerage agencies, and platforms. Under the above-mentioned first relationship model, the anchor and the platform or brokerage agency have entered into a labor contract, and the income is relatively clear, which belongs to the labor relation income as the income from wages and salaries. In the second and third legal relationship models, since there is no labor relationship, it belongs to non-labor relation income, and its nature needs to be further discussed.

There are many academic views on the legal nature of “tips” in the streamer’s income. Some scholars believe that tipping is an act of giving, and the live streaming service provided by anchor cannot be regarded as a consideration for the reward paid by the tipper, because the tipper can enjoy the live streaming service without paying the reward at all[1]. Some scholars believe that reward acts establish service contracts[2], the anchor provides performance services, and the audience pays for the service. The reward income has various characteristics such as labor income and incidental income, and its specific characterization remains to be discussed.

2.1.3 Means for anchors to evade tax by setting up enterprises

Although there are many types of internet anchors, the anchors involved in huge tax evasion are often the third type, that is, signing a contract with the platform as an individual business, a sole proprietorship enterprise, or a partnership enterprise. The methods they commonly use are as follows:

One is to achieve tax evasion by establishing an individual sole proprietorship, use fictitious business deals to convert the nature of income. According to the current Individual Income Tax Law, for comprehensive income, the progressive rates ranging from 5 percent to 45 percent shall apply; for individual sole proprietorship or partnership, which do not need to pay the enterprise income tax, applied progressive rates ranging from 5 percent to 35 percent as business operation income. Some anchors convert salaries and labor remuneration that belong to comprehensive income into business operation income through fictitious business, so as to achieve the purpose of paying less tax. For top streamers with an annual income of tens of millions, only the difference between the two highest marginal tax rates of 45% and 35% is enough to create a huge space for tax evasion[3].

The second is the abuse of the verification collection system and the local tax incentives of “tax lowland” after the establishment of a sole proprietorship. The business operation income of a sole proprietorship enterprise may be collected by means of verification.[4] In practice, the verification tax rate is usually much lower than the progressive tax rate. And there is no need to pay tax twice when withdrawing from a sole proprietorship business account to a private account. Taking Fan Bingbing’s tax evasion as an example, his personal studio did not use audit collection but verification collection, and the lowest personal income tax rate was only 3.5%.[4]

A “tax lowland” refers to some economically underdeveloped areas that formulate preferential tax policies in order to encourage entrepreneurship and stimulate local economy and employment, such as “Khorgos”, “Chongming”, “Yichun”, etc. Some of these areas have lower tax rates. Some of them formulate various incentives, rebates, and subsidy policies so that taxpayers can pay less tax.

Taking Wushan, Chongqing as an example, for enterprises in the industrial park, considering the actual operation of the enterprise, the overall tax saving for the enterprise can be 30%-50%. The business operation income of a sole proprietorship enterprise here adopts the verification collection method, which is approved at the tax rate of 1.5%, the VAT rate of 3%, the additional tax rate of 0.36% (0.18% if the additional tax is reduced by half), and the comprehensive tax burden is 4.68%.

3. Difficulties in the Regulation of Anchor Tax Evasion

3.1 Issues on the Determination of Internet Anchors Tax Evasion by Setting up Enterprises

3.1.1 Unclear characterization of anchor income

The tax law does not clearly define the standard of business operation income and remuneration income for personal services, and there is a lot of overlap in the scope of business between the two. The income of a registered sole proprietorship is not necessarily business operation income, because the criteria of business content and economic substance are not the same.

According to the principle of substantial taxation, even if a sole proprietorship is registered or the name of an individual industrial and commercial household, sole proprietorship, or partnership, etc. is used, if all activities are carried out in the name of an individual, or the income and costs are not related to the registered entity, it is still not necessarily recognized as business operation income.
3.1.2 Ambiguous identification of converting income nature through a sole proprietorship

Some believe that the anchor’s behavior of converting the comprehensive income into the operating income of the sole proprietorship and getting the verification collection can be regarded as “tax planning” rather than tax evasion, and as Individual Income Tax Law of PRC allows taxpayers to freely choose the way of providing labor services to correspond to different income types and tax burdens, the tax avoidance of anchors should not be considered illegal acts.

3.2 Low Judicial Enforcement Efficiency of Internet Anchors Tax Evasion by Setting up Enterprises

3.2.1 Disconnect between traditional tax collection and management models and digital transactions

Traditional tax agencies rely on paper invoices and account books for tax collection. However, the transaction process of online streaming is based on the Internet, which is separated from the traditional transaction method, and the records of the transaction exist in electronic form. Especially the use of electronic payment methods in streaming is undoubtedly a huge challenge to traditional tax collection and management. Part of the income is even realized through platforms such as Alipay, which is more hidden and difficult to track.

3.2.2 Inefficiency in tax collection and management collaboration

First of all, although the location of the living streaming platform is fixed, Internet anchors are distributed all over the country with the help of Internet technology. This requires local tax authorities to strengthen cross-regional collaboration to achieve supervision of them. However, at present, the tax-related information of various tax departments in China has not been fully shared, and they are still in a state of independence and isolation. Under the influence of traditional concepts and the tax collection and management model, this working method is inconsistent with the requirements of online live tax collection and management in the information age. Secondly, there are also problems in tax collaboration within tax authorities and information sharing between tax authorities and financial institutions or live streaming platforms. In the context of the era of financial informatization, the tax department needs to strengthen the connection with financial institutions including banks, grasping the inflow of the property of the internet anchor’s accounts, so as to have direct and accurate control of the income of the anchors. Meanwhile, the online streaming platform has the first-hand transaction information of the anchors, but its tax-related information is not shared with the taxation department, which leads to the taxation department’s “ex-post collection and management”.

3.2.3 Insufficient supervision of tax sources

Under the current tax legal system in China, tax registration and industrial and commercial registration are linked, but there are still some live streaming platform companies that have not registered with the industrial and commercial department, which makes the most basic basis for tax collection. According to statistics, there are more than 100 online streaming platforms in China, but only a few are established in accordance with laws and regulations and have professional qualifications. This makes the financial and accounting systems of many platform companies not yet sound, hindering tax collection and management.

Moreover, with the trend of popularization of online streaming, many independent anchors, and even just ordinary users become a member of the streamer, and they only need a mobile phone number or another non-real-name account to complete the registration on the platform. So that even if the registration information of the live streaming platform is shared with state administration for industry and commerce and the tax authority, it is impossible to locate the taxpayer or collect tax on them.

4. Breaking Through the Predicament: Suggestions on the Regulation of Tax Evasion by Online Anchors

4.1 Premise of Regulation: Redefinition of Relevant Concepts

For the definition of the relevant concepts of anchors tax evasion by setting up enterprises, this paper believes that two basic principles of tax laws should be followed.

Firstly, adhere to the “ability-to-pay” principle, which is an important manifestation of tax fairness. The so-called “ability-to-pay” means that the tax burden of each taxpayer should be consistent with the economic ability and tax payment ability. “‘ability-to-pay’ principle which shoulders the pursuit of substantive justice, is not only the embodiment of the principle of constitutional equality but also the requirement of the concept of tax fairness.”[5]

Secondly, stick to the substantive taxation principle. The ‘ability-to-pay’ principle is the spirit and goal of the tax law.[6] Therefore, tax justice can only be truly realized by tearing off the veil of the external form of income and understanding the existence and attribution of tax burden capacity through substantive economic interests and their essential attributes.

4.1.1 Distinction of income types

The tax bureau’s investigation results on Huang Wei pointed out that “through the establishment of a number of sole proprietorship enterprises and partnership enterprises to create fictitious businesses deals, the commissions, booth fees and other labor remuneration income obtained by the personal engagement in live streaming and online delivery of goods are converted into business operation income”. So, does this means that even if the anchor in live streaming industry establishes a sole proprietorship, they still have no choice but pay personal income tax based on labor remuneration? No, the core of the problem is the correct distinction between different types of income.

Among them, wages and salaries are obtained based on a clear employment relationship, which is not controversial. However, the current individual tax system’s definitions of personal service remuneration income and business operation
income have many overlapping on business scopes, both in theory and practice. From Article 6 of the Regulations on the Implementation of the Individual Income Tax Law, it seems that all the income obtained through the establishment of a sole proprietorship enterprise is business operation income. However, according to the principle of “ability-to-pay”, the tax burden should be based on the ability to pay them, and the most direct standard to measure the ability to pay taxes is the economic efficiency of income. From the perspective of the way of income, labor is the main cost paid by the anchors. Some leading anchors have monthly incomes exceeding one million yuan, with extremely high net profit margins and strong payment ability, so they should naturally bear higher tax burdens.

Therefore, on the one hand, according to the principle of substantive taxation, the core of the judgment is whether there is a stable institution location, whether it is income from independent personal activities, and whether it is a continuous operation.

Case 1: The host personally signed a contract with the platform, but registered a sole proprietorship for tax evasion during settlement, and issued an invoice to the platform through the sole proprietorship.

Case 2: The anchor signs a cooperation agreement with the platform in the name of a sole proprietorship, and settles with invoices. However, the sole proprietorship enterprise is a “shell enterprise”, with no actual office location, no staff with social security relations, and no continuous actual business operations. The meaning of such “enterprise” is only to use for the verification collection to pay tax and get invoices.

Case 3: The anchor signs a cooperation agreement with the platform in the name of a sole proprietorship, and settles with invoices. The enterprise leases a fixed office address, carries out continuous practical business activities, has actual production equipment investment, and has consistent contract flow, invoice flow, and capital flow.

In the first case above, both its original form and essence are the remuneration for the personal services of the streamer. In the second case, the sole proprietorship has no transaction essence, no real investment in capital equipment and human resources, does not conform to the essence of business operating income, and should be recognized as the personal remuneration. Only in case 3, the form and essence of the income meet the requirements of business income.

On the other hand, according to Article 5, paragraph 1, of Notice of the State Administration of Taxation on the Issuance of the Agreement “Interim Measures for Administration of Individual Income Tax Collection in Advertising Market”,[3] in the online streaming and selling, the personal image and reputation used by the anchor are personal rather than belong to enterprise, it obviously meets the “name and image” mentioned in this article, and it should be taxed according to the income from the remuneration of personal service.

4.1.2 Distinction between tax planning and tax evasion

For these two concepts, the former is a legal tax-saving behavior, which is a financial management technique, while the latter is a behavior that violates the law and infringes upon the national finances. The core difference between the two lies in the objective aspect - whether there is a fraud, and the subjective aspect - whether there is a “reasonable commercial purpose”.

(1) Objective aspect

Under normal circumstances, as long as the transaction actually occurs, the taxpayer can choose to change the transaction form and income type within the scope of the law, which belongs to the category of civil transaction freedom. Even if there is an abuse of rights, it should only be regarded as tax avoidance. Conversely, if taxpayers take advantage of information asymmetry, deceive tax authorities through fictitious transactions, or conceal their income, they may be identified as tax evasion.

As in above cases 1 and 2, the sole proprietorship does not have a real business, and it is very likely to be identified as tax evasion.

(2) Subjective aspect

According to Article 8[4] of the Individual Income Tax Law, if one of the prescribed circumstances exists, the tax authorities have the right to make tax adjustments in a reasonable manner. This article proposes legal regulation based on the purpose of anti-tax avoidance, that is, considering whether the only or main purpose is to reduce the tax burden. For example, a streamer may register a sole proprietorship in a “tax lowland”, but he/she does have the purpose of expanding business in the area. Then, even if the anchor chooses an unconventional transaction form and results in tax relief, the taxpayer can be exempted from the anti-tax avoidance adjustment because it does have a reasonable business purpose.[7]

In general, this article believes that the real “tax planning” should be the unity of the subjective and objective aspects, otherwise there will be suspicion of tax evasion and legal risk.

4.2 Regulatory Measures: Suggestions on the Tax Collection and Management of Online Anchors

4.2.1 Improve tax policy

A major development of the Individual Income Tax Law revised in 2018 compared to the previous version is the establishment of the personal income tax system combined with classification and comprehensive taxation. Among them, the income from wages, salaries, remuneration of personal service, etc., as they all have the commonality of labor income, are combined into the scope of comprehensive taxation, and a unified progressive tax rate is applied on them, which effectively improves the fairness of taxation.

Nowadays, in the face of tax evasion represented by the conversion of the nature of income, it is an inevitable trend to eliminate the tax loophole between business operation income and labor income and include business operation income into comprehensive taxable income.

First, business operation income is similar in principle to labor
income, especially in the context of online streaming. Traditionally, business income is a combination of labor income and capital investment. However, under the platform economy model, anchors rely on their personal image and performance ability to sell goods, and the proportion of capital investment in business operating income has been significantly reduced, laying a realistic foundation for their inclusion in comprehensive income.

Secondly, in terms of the tax collection and management model, the tax rate structure, deduction methods, and reporting methods of business operation income and comprehensive income are relatively similar, and the connection in tax collection and management is also easier, laying a feasible foundation for their inclusion in comprehensive income.

Of course, policies are not achieved overnight, and there are still many practical problems. From the point of view of tax collection and management, the number of taxpayers of business operating income is huge, and there are a wide range and variety of business income, which leads to the difficulty to accurately calculate the income and cost of taxpayers.[8]

At present, the tax authorities mainly rely on the verification collection method when collecting business income. Therefore, after the business income is included in the scope of comprehensive tax collection, it is firstly faced with the problem of how to accurately calculate the amount of it. With the greater difficulty of tax collection and management, the reporting burden of most taxpayers without business income will increase.

However, such reforms are still necessary based on the starting point of tax fairness and filling tax avoidance loopholes. And a step-by-step reform route can be adopted: after business income is included in comprehensive income, the practice of verification collection can still be implemented for most taxpayers in the short term, but the method of fixed collection should be abolished as much as possible, and mainly retain the measurement method of taxable income rate and verification collection rate. And in the long term, the collection method of business operating income will be further improved from verification collection to the audited collection.

4.2.2 Prudent treatment of preferential tax policies

At present, there are many types of different tax preferential policies in China. Tax incentive policies are differentiated depending on regions, industries, or even groups within the same industry. Due to the widespread existence of such regional preferential tax policies, the originally unified market has formed multiple “tax lowlands” in fact, and the flow of resources is no longer dominated by the market, but by the strength of preferential tax policies, which seriously violates tax neutrality principle, and the phenomenon of tax arbitrage is becoming more and more serious. From the perspective of the market, if taxpayers with different tax-paying abilities pay the same amount of tax, or if taxpayers with the same tax-paying abilities pay hugely different taxes, it will be unfair and hinder economic development.

To sum up, tax incentives must be carefully used. Even if the original intention is legitimate, these policies should still be timely adjusted according to the actual situation, and their beneficiaries should be strictly controlled. Finally, ensure that the policies are truly implemented for the local economy and industries’ needs.

4.2.3 Taxpayer identification code

The taxpayer identification code system is an important system proposed by the Chinese government for the reform of tax collection and management. Based on the taxpayer identification code, an internet anchors tax-related information management system can be established, which allows nationwide networking and multi-department communication. Any transaction activity of the anchors can be carried by the personal identification code, so that the tax department can use it to inquire and realize real-time monitoring of the anchor’s income, and form a complete and systematic personal electronic tax file.

4.2.4 Big data supervision

Faced with the current situation of poor information communication among taxation departments in various regions, it is necessary to establish a unified national tax-related information sharing platform to realize unified and complete supervision of tax-related information. Relying on the personal identification code system, all financial institutions including banks, by providing financial products or services, incorporate taxpayers’ personal income information into the platform. In this way, any tax department can query the tax-related information of the internet anchor through the taxpayer identification code.

5. Conclusion

Finance plays a fundamental role in national governance and development and is the most important thing related to the national economy and people’s livelihood. In the emerging field of online streaming, the traditional tax collection and management model is difficult to adapt to and is even abused by criminals. Tax evasion and fraud erode national finances, undermine social equity, widen the gap between the rich and the poor, and destroy the authority of the constitution and laws. According to the characteristics of the online live streaming economy, it is the only way to solve the current problem of tax evasion by strengthening tax governance, identifying the essence of taxable income, and filing tax evasion loopholes through reforms, so that tax incentives can be truly implemented in innovation and entrepreneurship to prompt the local economy.

References


For the determination of “reasonable commercial purpose”, the practical standards of Western countries are different. For a detailed study, please refer to Wang Zongtao. Anti-tax avoidance legal regulation research[D]. Wuhan: Wuhan University, 2013.


[2] According to Article 35 of Law of the People’s Republic of China on the Administration of Tax Collection, the tax authorities may tax the business operating income in accordance with the verification tax collection methods for the business entities that do not have an account book or cannot accurately check the accounts of income.

[3] According to Article 5, paragraph 1, of Notice of the State Administration of Taxation on the Issuance of the Agreement ‘Interim Measures for the Administration of Individual Income Collection in Advertising Market’, taxpayers’ income obtained by providing name and image in the process of advertising design, production and publication should be calculated according to the income from the remuneration of personal service.

[4] According to Articles 8 of the Individual Income Tax Law of the People’s Republic of China, Tax authorities shall have the right to make tax adjustment in a reasonable manner under any of the following circumstances:

(1) The business transactions between an individual and its affiliated party do not conform to the principle of independent transaction and reduce the tax payable by himself or his affiliated party without justifiable reasons;

(2) Where an enterprise controlled by an individual resident or jointly controlled by an individual resident and a resident enterprise is set up in a country (region) with a significantly lower actual tax burden and has no reasonable operation needs, the corresponding angelica profits belonging to the individual resident shall not be distributed or shall be distributed less;

(3) individuals obtain improper tax benefits from other arrangements that do not have reasonable commercial purposes.

Where tax authorities make tax adjustments in accordance with the provisions of the preceding paragraph and need to levy tax in arrears, the taxpayer shall pay the tax in arrears and be charged additional interest in accordance with the law.