Homework 2

Case study

The P&G tax avoidance case

P&G Guangzhou, P&G Paper Products Ltd.( P&G Paper) and, P&G Oral Health Supplies Ltd. ( P&G Oral) are all subsidiaries of P&G China. In 2002, some of members of the group got stuck in consecutive losses and lost the ability of borrowing money from banks. So P&G Guangzhou borrowed 2 billion yuan from Bank of China Guangdong Branch, and then tried to transfer the funds to other companies in the group.

P&G Guangzhou signed agreements with P&G China, P&G Paper and P&G Oral to receive payment for goods on behalf of them. Since it was agreed that P&G Guangzhou’s collection of payment for goods can be transferred to other companies within one week, P&G Guangzhou made prepayment to these companies in name of offsetting the amount of funds occupied during the transfer. But in 2002, the funds occupied by P&G Guangzhou for receiving payment for goods on behalf of the three companies was merely RMB44.3 million on average, but the amount of prepaid funds was as huge as 1.54 billion. In accounting, P&G Guangzhou just recorded the above prepaid amounts as “other receivables” and made no adjustments.

P&G China shared joint offices with P&G Guangzhou and 2 other subsidiaries in order to improve the work efficiency. According to their agreement, all the expenses would be paid by P&G China, P&G China would then allocate the expenses to the subsidiaries and get its funds back at the end of month, and P&G Guangzhou should prepay a certain amount of funds to P&G China as a deposit for the expenses P&G China paid. But the amount of funds P&G Guangzhou prepaid to P&G China was much higher than P&G China actually paid for P&G Guangzhou’s expenses. In accounting, P&G Guangzhou also recorded the prepaid amounts as “other receivables” and made no adjustments.

Please try to explain:

1. The tax benefits the P&G group can get from the above transactions.
2. Do you think the tax avoidance measures taken by P&G group can finally succeed? Why?

* Please send the answers to TA Miss Zhengyuwen

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