Tsingtao Brewery Co., Ltd., one of the oldest beer makers in China, was founded in 1903 by German and British merchants under the name Nordic Brewery Co., Ltd. Tsingtao Branch. Today, Tsingtao Brewery is China’s largest brewery and was also an Official Sponsor of the Beijing 2008 Olympic Games.

On July 15, 1993, Tsingtao Brewery became the first-ever Chinese company to be listed on the Hong Kong Stock Exchange (stock code 0168). On August 27, 1993, it listed on the Shanghai Stock Exchange (stock code: 600600), making Tsingtao Brewery the first Chinese company to be listed in both Mainland China and Hong Kong.

China now has about 500 breweries, nearly one for every three counties, but 80 per cent have an annual production capacity of less than 50,000 tons and most have operational difficulties. This has spelled opportunities for the three heavyweights, Tsingtao, Yanjing and China Resources. They have all pursued a domestic expansion plan through numerous strategic mergers, purchasing insolvent companies, reorganization, and joint-venture partnerships. Still, in spite of its having the second largest market in the world, China still has a long way to go because per capita beer consumption annually is only about 15 liters, compared to 84 liters in the United States.

In 2007, Tsingtao Brewery achieved a total sales volume of 5.05 million kiloliters globally, with the market share of Tsingtao Beer in China reaching 13%. In that same year, World Brand Lab valued the brand at RMB 25.827 billion, placing it first in China’s brewing industry. Tsingtao Beer is exported to 62 countries and regions, including the USA, Japan, Germany, France, UK, Italy, Canada, Brazil and Mexico. The Barth Report, the authoritative report of the global beer industry, ranked Tsingtao Brewery as the 8th-largest brewery in the world based on total yield in 2006 and 2007.


Principal Tax Issues

Examine the financial statements of Tsingtao, paying particular attention to the effective tax rate, deferred taxes and related footnotes.

1. What is the effective tax rate (ETR) and how does it compare to the statutory rate?

2. What are the components of deferred income taxes? How do these arise?

The principal reason for this can be found in the acquisition strategy of the company. The company has acquired many small brewers that it operates in separate corporations. Tsingtao has had to write-down the value of many acquisitions. Because these companies are not profitable, they have provided a valuation allowance against
the deferred tax asset that would otherwise be created by the write down. A valuation allowance is required whenever a company concludes it is more likely than not that the benefit of a deferred tax asset may not be realized.

Many of the acquired companies are loss making. Because China does not allow consolidated tax returns, losses in these companies cannot be used against the profits of other companies in the group.

3. Why has Tsingtao determined that a valuation allowance is necessary?

4. What actions might Tsingtao take to monetize deferred tax assets, particularly those on which a valuation allowance has been provided?

5. There are significant tax loss carryforwards for which no benefit has been recorded.
   a. When will these potential benefits be lost?
   b. What conditions would need to exist to realize these potential benefits?
   c. What actions might the company consider to realize these potential benefits?

6. Read the Tsingtao Tax Issue Notice and the discussion of this issue in the footnotes to the financial statement.

Tsingtao was the first of nine Chinese companies listed in Hong Kong in 1993. Since these were China’s first overseas listings, every effort was made to make certain they were successful. They were given a preferential tax rate of 15% for five years, but continued to apply this rate after the five-year period expired in 1999. In 2007, SAT sent a directive to the provinces asking why this rate was still being used.

   a. Determine how the company in the 2008 financial statements dealt with this issue.
   b. What is the potential risk to the company? For what period? Can the risk be quantified?
   c. Do you agree with the company’s treatment of this issue?