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Observation of the Corporate Restructuring Tax Policy

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China tax alert

Recently, the State Administration of Taxation (hereinafter referred to as SAT) released the Announcement of the SAT [2012] No.55 (hereinafter referred to as No.55 Announcement), which clarifies the tax treatment of the remaining VAT credit during the asset restructuring process as follows: where a general VAT taxpayer (hereinafter referred to as former taxpayer) transfers all of its physical assets, debts and labor force to other general VAT taxpayer (hereinafter referred to as new taxpayer) during the asset restructuring process and it applies to cancel tax registration, the remaining VAT credit which occurs before the cancellation registration and is not credited can be carried forward to the new taxpayer.

Background

In March, 2011, the SAT released Announcement of the State Administration of Taxation on Relevant Issues Concerning Value-Added Tax for Asset Restructuring of Taxpayers (hereinafter referred to as Announcement of the SAT [2011] No.13, or No.13 Announcement), which indicated that "where an former taxpayer transfers all or part of its physical assets, debts and labor force related thereto to new taxpayer or individuals through combination, division, sale and replacement in the course of asset restructuring, such transfer shall not be subject to value-added tax, and value-added tax shall not be levied for the transfer of goods involved therein."

No.13 Announcement has a positive effect on encouraging the industry integration and the corporate restructuring, however, it is not clear that how the input VAT which is not credited from the former taxpayer shall be carried forward to the new taxpayer as input VAT in Jinshui Management System. The enterprises and in-charge tax authorities are confused by the above problem for a long time since the issue of No.13 Announcement. No.55 Announcement clarifies the problem and formulated the detail procedures. The problem is effectively solved during the restructuring process.

Key points need to be considered as follows when implementation:

Scope: Not all the restructurings, which apply No.13 Announcement and are not subject VAT, can apply No.55 Announcement. No.55 Announcement is applicable for the taxpayer that transfers all of its physical assets, debts and labor force to other entities and individuals and applies to cancel tax registration. If an enterprise does not need to cancel tax registration or it only transfers part of its physical assets, debts and labor force, No.55 Announcement is not applicable. In this case, the former taxpayer will handle the remaining VAT credit by itself; another type of taxpayers which transfer all the VAT business and remain the business tax (BT) business, if a large sum of remaining VAT credit exists, the taxpayers may face the risk that the remaining VAT credit may not be credited in the long term.

Procedures: No.55 Announcement clarifies the remaining VAT credit transfer procedures for the in-charge tax authorities of the former taxpayer and the new taxpayer. The in-charge tax authorities of the former taxpayer is responsible for reviewing the related documents of asset restructuring, checking the remaining VAT credit and filling in the <transfer sheet of the remaining VAT credit for general VAT taxpayer>. The transfer sheet will be checked and confirmed by the in-charge tax authorities of the new taxpayer, then, the remaining VAT credit can be credited by the new taxpayer.

Implementation time: No.55 Announcement comes into effect as of January 1, 2013. We understand that regarding the restructuring which occurred before the effective date, we recommend that the enterprise should communicate with the in-charge tax authorities on whether it can be applicable to No.55 Announcement as reference or not.

Our Observation and Suggestions

This year, under the environment of economic restructuring, the State Council and Ministries gradually introduced policies to encourage industry integration and corporate restructuring, but the cost of the high tax burden during the restructuring process is likely to become a major obstacle. To adapt to the needs of economic development, the SAT issued a series of tax policy to encourage corporate restructuring to support the normal corporate restructuring. However, some tax policies, which are still not clear and whose procedures are not clear, have an impact on the taxpayers to have difficulties in enjoying the restructuring tax policy. The examples are illustrated as follows.

Circular on Issues Concerning Treatment of Enterprise Income Tax in Enterprise Restructuring Business (hereinafter referred to as Cai Shui [2009] No.59) indicated that the qualified restructuring can choose the tax treatment of special reorganization, the taxable income will not be determined in restructuring. The policies which need to be further clarified in practical are as follows: if an acquiring enterprise purchased more than 75% of the total equities of the acquired enterprise from two or more shareholders of the acquired enterprise, whether it will apply the special tax treatment or not; if an acquiring enterprise purchased the equities from personal shareholders or oversea shareholders, whether the amount will be included in the 75% or not; if an acquiring enterprise used more than 75% equity of its subsidiary as the consideration to take control over more than 75% equity of the acquired enterprise (owned by only one shareholder), how to determine the acquired enterprise and tax base; in the asset acquisition, 75% of the total transferring enterprise's assets is the book value or the fair market value, whether it includes the cash or not; in addition, the key point that whether the restructuring can be implemented smoothly depends on whether the special reorganization filing procedures can be formulated and executed accordingly by the in-charge tax authorities.

Announcement of the State Administration of Taxation on Issues Relating to the Business Tax for the Assets Reorganization of Taxpayers (hereinafter referred to as Announcement of the SAT [2011] No.51) indicated the restructurings which are not subject to business tax. However, it is not clear in the announcement that if the restructurings involve the intangible assets, whether it can apply the business tax exemption terms in this announcement or not; the transfer of real estate and land use rights involved is not within the scope of business tax collection for the qualified restructuring, whether it is subject to the land VAT or not.

Circular on the Deed Tax Policy for Restructuring and Reorganization of Enterprises and Public Institutions (hereinafter referred to as Cai Shui [2012] No.4) indicated that the transfer of the lands and houses ownership between internal enterprises with the same investment objects is not subject to deed tax. How to define the

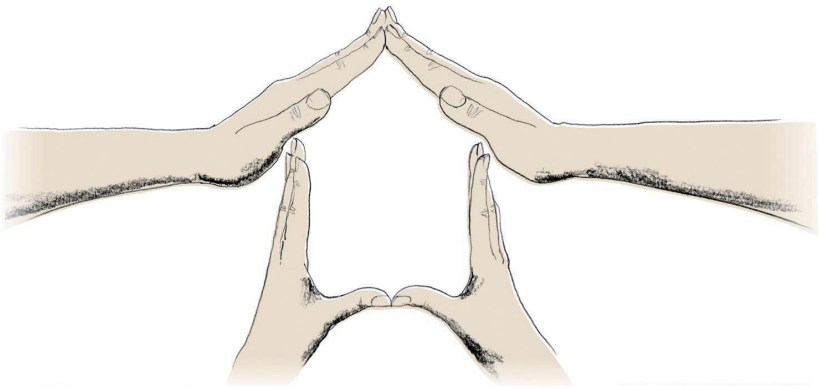
"transfer" and if the parent company invests lands and housing ownership or increase capital to the subsidiaries, then subsidiaries transfer lands and housing ownership back to the parent company after their liquidation, whether it can be regarded as "transfer" or not.

Corporate restructuring activities are complex and specialized and different restructuring plans may face different tax uncertainties. The determination by each tax authorities may have significant differences.

We recommend that prior to the restructuring, the enterprise should carefully analyze the restructuring plan and compare the tax burden between the restructuring process and the operations after the restructuring. For the uncertain tax considerations, the enterprise should communicate with the in-charge tax authorities in advance in a timely manner, if possible, to avoid tax losses and risks.

How Can Grant Thornton Help You

Grant Thornton has a specialized China tax team that is fully committed to your business needs. Our team consists of experienced restructuring advisors. We aim to deliver the most efficient and flexible restructuring solutions that help you deal with restructuring problems.



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