

# Tax Analysis

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PRC Tax

## SAT clarifies VAT treatment of uncredited input VAT in an asset restructuring transaction

The State Administration of Taxation ("SAT") issued a bulletin (Bulletin of the SAT [2012] No. 55, "Bulletin 55") on 13 December 2012 to clarify the Value Added Tax ("VAT") treatment of uncredited input VAT<sup>1</sup> in an asset restructuring transaction, an area which has been fraught with uncertainty. Bulletin 55 provides that, as from 1 January 2013, a general VAT payer with uncredited input VAT before tax deregistration will be allowed to transfer the uncredited input VAT to another general VAT payer in an asset restructuring transaction for credit purposes. This significant development is positive news for taxpayers, as it may help to reduce the potential tax costs of asset restructuring.

### Background

According to China's general VAT rules, uncredited input VAT cannot be refunded; instead, it is carried forward to be offset against output VAT in future periods. As a result, uncredited input VAT incurred will become an irrecoverable cost when a general VAT payer terminates its business operations and deregisters for tax purposes. Since a restructuring usually involves tax deregistration, this is a matter of concerns for the parties involved in a restructuring transaction.

Guidance issued in 2011 (Bulletin of the SAT [2011] No. 13, "Bulletin 13") provides that the transfer of all or part of the tangible assets of an enterprise, along with associated receivables, debts and workforce in an asset restructuring transaction does not fall within the scope of VAT. However, the absence of guidance in Bulletin 13 on the tax treatment of uncredited input VAT in an asset restructuring has given rise to differing opinions. Some local tax authorities take the position that, as the transferor's operating activities are in substance being continued by the transferee, the transferor should be allowed to transfer the uncredited input VAT to the transferee for subsequent credit (particularly where the transferor immediately deregisters for tax purposes) in order to maintain the VAT credit chain; for example, in a merger, the uncredited input VAT of the enterprise being merged can be transferred to the enterprise that continues to exist. Bulletin 55 confirms the validity of allowing the transfer of uncredited VAT in an asset restructuring transaction from a regulatory perspective; previously, this practice was adopted only in special cases and it had precedential value only where the deregistered enterprise and the continuing enterprise were under the jurisdiction of the same municipal or provincial tax authorities.

<sup>1</sup> Uncredited input VAT refers to the excess input VAT where the input VAT amount for the current period exceeds the output VAT amount for the current period.

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## Highlights of Bulletin 55

According to Bulletin 55, a general VAT payers ("the original taxpayer") must simultaneously satisfy the following two conditions in order to be able to transfer uncredited input VAT to another general VAT payer ("the new taxpayer") for subsequent credit:

- The original taxpayer transfers all of its assets, debts and workforce to the new taxpayer in an asset restructuring transaction; and
- The original taxpayer deregisters for tax purposes in accordance with the relevant procedures.

The relevant procedures require the tax bureau responsible for the original taxpayer to verify the amount of uncredited input VAT before tax deregistration takes place and to complete the form, "*Transferring Uncredited Input VAT of General VAT Payers in an Asset Restructuring Transaction*". The tax bureau responsible for the new taxpayer must review the form received from the tax bureau responsible for the original taxpayer against other documents submitted by the taxpayer before granting approval for the uncredited input VAT to be credited by the new taxpayer. This means the uncredited input VAT must be verified both by the tax authorities responsible for the original taxpayer and the authorities responsible for the new taxpayer.

## Comments

Bulletin 55 is expected to provide easier and more favorable treatment for taxpayers having to deregister for tax purposes as a result of an asset restructuring transaction and that still have uncredited input VAT. Such uncredited input VAT will no longer represent an irrecoverable cost. Previously, taxpayers sometimes had to enter into tangible asset transactions before tax deregistration in order to generate output VAT against which uncredited input VAT could be set off. However, taxpayers that were unable to generate sufficient output VAT (e.g. because it did not have tangible assets to transfer or it was exempt from VAT under Bulletin 13) were sometimes unable to utilize the uncredited input VAT. Bulletin 55 resolves this problem by providing for the direct transfer of uncredited input VAT to another taxpayer.

Although Bulletin 55 introduces positive changes, it does create some uncertainties and leaves open practical issues regarding the treatment of uncredited input VAT in an asset restructuring transaction:

### 1) Definition of "asset restructuring"

Bulletin 55 only applies to asset restructuring transactions. However, the concept of "asset restructuring" is not well defined in China's VAT rules. Bulletin 13 only mentions transactions such as mergers, divisions, sales and exchanges in asset restructuring transactions. Since the government generally favors consistency among regulations in the same area, the concept of an asset restructuring in Bulletin 55 is likely also to include mergers, divisions and similar transactions. However, until the tax authorities issue further guidance, the various forms of asset restructuring may create uncertainties in practice.

### 2) Where there are several new taxpayers

Bulletin 55 does not specify a limit on the number of "new taxpayers." Specifically, it does not address the treatment of uncredited VAT where the original taxpayer transfers all of its assets, debts and workforce to two or more new taxpayers or the question of whether the credit can be allocated between/among the new taxpayers based on a certain ratio.

### 3) Limitation on input VAT credit under VAT reform pilot program

Under the VAT reform pilot program, input VAT incurred on or before the VAT reform implementation date by general taxpayers cannot be credited against output VAT derived from pilot VATable services after the implementation date. For a new taxpayer covered by the pilot program, it is unclear whether the uncredited input VAT transferred from the original taxpayer should be treated differently depending on when and how the input VAT was incurred.

### 4) Where the original taxpayer transfers only part of its business or does not deregister

If a general VAT payer transfers part of its business (including relevant assets, debts and workforce) or does not deregister for tax purposes even though it transfers all of its business, Bulletin 55 cannot be applied and it is still uncertain how to treat the uncredited input VAT corresponding to the part of business transferred. It is our understanding that some tax authorities allow the original taxpayer (if not deregistered) to continuously utilize the uncredited input VAT, while some authorities take the position that such transfer does not fall within the scope of VAT under Bulletin 13 so the corresponding uncredited input VAT will be lost and thus become an irrecoverable cost for the original taxpayer.

### Suggestions

Taxpayers contemplating asset restructuring transactions need to understand the impact of Bulletin 55 and take it into account in planning the transaction.

Taxpayers affected by Bulletin 55 should ensure they have the appropriate vouchers for uncredited input VAT to enable the carryover and subsequent crediting of the uncredited input VAT to be approved by the tax bureaus responsible for both the original taxpayer and the new taxpayer.

Deloitte is working to address the points left open by Bulletin 55 and we will provide updates once information is available. For more information or advice on the above, please contact the Deloitte Indirect Tax and M&A Team.

Note: Contents discussed in this Tax Analysis pertains to Deloitte Indirect Tax and M&A Tax Services.

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