China alert

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Properties and attached fixed assets to be taxed differently when sold together

Regulation discussed in this issue:

- Announcement on Certain Tax Issues in relation to Transactions in which Land Use Rights or Immovable Properties Are Sold Together with Fixed Assets Attached to the Land or Immovable Properties, SAT Announcement [2011] No. 47 (Announcement 47), issued by the State Administration of Taxation on 17 August 2011, effective from 1 September 2011

Background

The State Administration of Taxation (SAT) issued Announcement 47 on 17 August 2011 to deal with indirect tax treatment of transactions in which land use rights or immovable properties are sold together with fixed assets attached to the land or immovable properties. Announcement 47 takes effect from 1 September 2011.

The salient features of Announcement 47 and our comments on them are set out below.

Announcement 47 provides that where land use rights or immovable properties are sold together with fixed assets attached to the land or properties, the sale of the VATable goods attached to the land or properties should be subject to Value Added Tax (VAT) in accordance with Article 2 of the announcement, Cai Shui [2009] No. 9 (Circular 9) while the sale of the immovable properties should be subject to Business Tax (BT) under the item, "immovable properties".

According to Article 2 of Circular 9, the VAT treatment of the fixed assets will depend on the status of the taxpayer and the nature of the goods, as follows:

1. General VAT taxpayers

1.1 Fixed assets that fall with scope of "Article 10 items"

If the fixed assets fall within the scope of items set out in Article 10 of the Provisional Regulations on VAT, the taxpayer shall charge VAT at two percent (i.e. four percent x 50 percent) on the sales of these used fixed assets.

These are fixed assets that:

- have been used for non-VATable or VAT-exempt activities, staff welfare or personal consumption
- have been related to abnormal losses
- fall within the category of specified personal consumption goods.

The input tax credit for the abovementioned goods has been specifically disallowed pursuant to Article 10 of Provisional Regulations on VAT.

1.2 Fixed assets other than those which fall within the scope of "Article 10 items"

The taxpayer shall charge VAT at the rates applicable to those goods (i.e. 13 percent or 17 percent).

However, according to the circular, Cai Shui [2008] No. 170, there are some grandfathering reliefs on fixed assets that were purchased before 1 January 2009 or before the application of the relevant regional pilot schemes on VAT refunds in the past.

2. Small-scale taxpayers

The taxpayer shall charge VAT at a reduced levy rate of two percent.

If the taxpayer does not or cannot separately account for the turnover amounts for VATable goods and immovable properties respectively, the tax authority in charge can arrive at the turnover amounts of VATable goods and immovable properties on a deemed basis.

KPMG observations

The provisions in Announcement 47 are consistent with Article 7 of the Implementation Rules for Provisional Regulations on VAT. According to Article 7, where a VAT taxpayer is also involved in non-VATable items, it should separately account for the turnover amounts of VATable goods or services on the one hand and non-VATable items on the other. If it does not do so, the tax authority in charge can arrive at the turnover amounts of VATable goods or services on a deemed basis.

As such, prior circulars that contain rules that contradict the rules in Article 7 (and hence Announcement 47) will be abolished at the same time such as the circulars, Guo Shui Han [1997] No. 556 and Guo Shui Han [2007] No. 1018. These two circulars provided that where coal companies transferred land use rights or immovable properties together with mechanical or electrical equipment attached to the land or properties, the whole transaction would be subject to Business Tax under the item of "immovable properties".

Under Announcement 47, it is, therefore, important for the taxpayers to separately account for the sale of land use rights or properties and the sale of fixed assets attached to them. Otherwise, the tax authorities will have the power to make such distinction on a deemed basis. It is also useful to note that even if the taxpayers account for such items separately, the tax authorities have the power to make adjustments to the respective prices for the land use rights / properties and the fixed assets attached to the land / properties if they are of the view that the prices attributed to the land / properties are not reasonable.

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