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New Tax Regulations on Sales of Fixed Property Attached to the Land or Real Property

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Background

The State Administration of Taxation (hereinafter referred to as "**SAT**") promulgated the *Announcement of the State Administration of Taxation on Issues Related to Tax to be Paid by Taxpayers Who Sell Fixed Assets Attached to Land or Real Estate while Transferring Land-use Right or Selling Real Estate (Announcement of the SAT [2011] No. 47)* ("**Announcement No.47**") on 17 August 2011. This announcement shall become effective as of 1 September 2011. Pursuant to the Announcement No.47, where a taxpayer simultaneously sells the fixed assets attached to the land or real property (hereinafter referred to as "**Attachments**") when transferring land use rights or selling real property:

- if the fixed assets are taxable for value-added tax ("**VAT**") purposes, the VAT shall be calculated and paid according to the provisions of *Article 2 of the Notice of the Ministry of Finance and the State Administration of Taxation on the Application of Low VAT Rate and Simplified Collection Method to Certain Goods (Cai Shui [2009] No. 9)* (hereinafter referred to as "**Notice No.9**");

- if the fixed assets are real property, the business tax payable shall be calculated and paid according to the tax rate for the taxable item of "sale of real property" as stipulated in *the Interim Regulations of the People's Republic of China on Business Tax*.

Application of the Announcement No.47

- **Applicable Conditions**

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The premise of applying Announcement No.47 is that the fixed assets attached to the land or real property (namely the attachments) and the land right or real property are sold simultaneously. However, the No.47 document does not further clarify the definition of the "attachments", thus we consider the issues listed as follows shall be discussed:

- Whether auxiliary equipments and supporting facilities belong to the "attachments"?

  No.47 document does not explain or illustrate the "attachments". According to the explanation of Xiamen Local Taxation Bureau (hereinafter referred to as Xiamen Local Taxation) when forwarding the No.47 document, the "fixed assets attached to the land or real property" which belong to VAT taxable goods according to the No.47 document <u>does not include</u> "Auxiliary equipments and supporting facilities" of buildings or structures which are stipulated in Notice on Issues Concerning Input VAT Credit on Fixed Assets (Cai shui [2009] No.113) (hereinafter referred to as No.113 document). According to the No.113 document, "auxiliary equipments and supporting facilities" of buildings or structures shall be deemed as integral parts of the buildings or structures and therefore the input VAT shall not be credited in the output VAT. "Auxiliary equipments and supporting facilities" which are stipulated in No.113 document shall refer to equipments and ancillary facilities for water supply and drainage, heating, sanitation, ventilation, lighting, communication, gas, fire-fighting, central air-conditioning, elevator, electricity, intellectual buildings. Thus it can be seen that Xiamen Local Taxation uses No.113 as reference and defines the "Auxiliary equipments and supporting facilities" as integral parts of the real property, so the above list of "Auxiliary equipments and supporting facilities" shall not be subject to No.47 document.

  It should be noted that the SAT has not yet issued a normative document directly to expressly explain the question, although Xiamen Local Taxation claims in the forwarding document that they have requested instructions from SAT. Additionally, since the purpose of No.113 document is just to stipulate the scope of input VAT credit of fixed assets, the doubt remains that whether the "attachments" stipulated in the No.47 document can be explained by quoting the definition in No.113 document directly. Thus the tax authorities in other areas have rights to decide whether or not to apply the opinion of Xiamen Local Taxation based on their own understanding and discretion.

- Whether the goods simultaneously sold belong to the "attachments"?

  According to the regulations of No.47 document, only the "attachments" can be subject to No.47 document to decide whether the "attachments" are VAT taxable goods or business tax taxable real properties. There is a viewpoint that the attachments are the properties attached to the real property of which the function will lose if separated from the real property. Additionally, whether the "attachments" belongs to real property or moveable property shall be analyzed according to its independence. Therefore, we consider that the electronics and furniture which are sold simultaneously when selling house, i.e. well decorated house, shall be defined as "goods sold simultaneously" rather than the "attachments", and that the said goods therefore shall not be subject to No.47 document.

- Scope of the "attachments"

  We understand that the No.47 document repeals the provision "where entities and individuals transfer the electromechanical equipment attached to the land or real property simultaneously when transferring the use rights of coal mine land and selling the real property, business tax shall be collected according to the tax rate for 'sale of real property'" stipulated in the Reply of the SAT on Issues Concerning the Collection of Business Taxes on Transfer of Pit Heads by Coal Enterprises (Guo Shui Han [1997] No. 556) and the Reply of the SAT on Issues Concerning the Collection of Business Taxes on Transfer of Coal Mines (Guo Shui Han [2007] No. 1018). Thus, the electromechanical equipments (including transformers and flame-proof switches which are undetachable to the mines) which are sold simultaneously when transferring the use rights of coal mine and its land, shall be taken as the "attachments" and be taxable for VAT. Therefore, according to the said repealed articles, it shall not only rely on whether a support is needed or whether the equipment is undetachable to judge whether an equipment belong to an "attachment" or an integral part of real property. Considering that the No.47 document does not stipulate the "attachments" expressly and that different understanding exists in practice, there is uncertainty regarding the application of No.47 document. Thus there might be disputes between tax authorities and taxpayers.

➢ **Applicable VAT tax rate**

Pursuant to No.47 document, the fixed assets that are taxable for VAT purposes shall be calculated and paid according to the provisions of Article 2 of No.9 document. The VAT tax rates for selling used fixed assets stipulated in the Article 2 of No.9 document are as follows:

- Where the general taxpayers sell their used fixed assets which paid VAT shall not be set off and did not set off, or sell the fix assets which were purchased before 31 December 2008, the levy of VAT shall adopt simple method with 4% as the tax rate and half of the tax amount shall be deducted. Where the general taxpayers sell their used fixed assets which paid VAT can be set off and has been set off, VAT shall be levied at applicable tax rate when the fixed assets are transferred.

- Where small-scale taxpayers sell their used fixed assets, the VAT shall be levied with 2% as the tax rate.

Based on the stipulations above, for taxpayers, pursuant to No.47 documents, when taxpayers sell attachments simultaneously when selling real property, the VAT might be levied with 4% and half of the tax amount shall be deducted or the VAT might be levied with 2% as the tax rate. Therefore the tax burden actually borne by taxpayers is lightened compared to the 5% tax rate.

➢ **Issue on calculating sales amount separately**

It should be noted that if the No.47 document shall be applied when selling the attachment and transferring the land simultaneously, a taxpayer shall calculate the sales amount of the fixed assets that are subject to VAT and that of real property separately. If a taxpayer fails to make the calculation separately, the competent tax authorities have the power to verify and determine the sales amount.

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