

# Research on Legal Issues of Land Value-added Tax under Equity Transfer

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## ABSTRACT

The behavior of transferring land use right in the form of equity transfer is to realize the substantive control of the target land use right in the form of equity transfer. Using this way to replace the ordinary land use right transfer can reduce the tax cost which occupies a large proportion in the whole transaction. This method conforms to the provisions of China's company law, and has the advantages of simple procedures, low taxes and fees, concealment and so on. It has become a common practice in the real estate industry. There is no clear provision in the national law on whether this behavior should be levied land value-added tax, the policy calibre of the tax department is different, and the judicial precedent has not formed a unified standard.

## KEYWORDS

Equity Transfer; Land Use Right Transfer; Transfer of Real Estate Control Right; Land Value Added Tax.

## 1. OVERVIEW OF THE TAX LAW ON THE TRANSFER OF REAL ESTATE CONTROL RIGHTS IN THE FORM OF EQUITY

The transfer of land use right in the form of equity is a form of equity transfer to realize the substantive control of the target land use right. Using this way to replace the ordinary transfer of land use right can reduce the tax cost which occupies a large proportion in the whole transaction. Therefore, whether and how to pay land value-added tax for the substantive transfer of real estate involved in equity acquisition has become a hot dispute issue.

### 1.1. The Legal Concept of Equity

The legal circle has always had different opinions on the nature of equity. The theory of shareholder status, creditor's right and ownership can not reflect the essence of equity, and equity can only be a kind of independent right type. According to the stipulation of the specific right content of equity in the Company Law of our country, equity has both property rights and non-property rights. As for the nature of equity, equity is the civil right as the consideration for the shareholder to transfer the ownership of the investment property, equity is the organic combination of the purpose right and the means right, and has the nature of request and dominance, capital and circulation. To put it simply, equity is the legal right that shareholders enjoy to the company based on their status as shareholders. In legal nature, it is the legal relationship between shareholders and the company, excluding the legal relationship between shareholders. When the equity of a company is transferred, the rights of the company's asset income, participation in major decisions and selection of managers are transferred from the transferor to the transferee.

## **1.2. Legal Concept of Land Use Right**

Chapter 12 of the third chapter of the Title of Property of the Civil Code deals with the relevant provisions on the use right of construction land. As an important right in usufructuary right, the right to use construction land means that by establishing the right to use construction land, the owner of the right to use construction land enjoys the right to occupy, use and benefit from the land owned by the state, and the owner of the right to use the land to build buildings, structures and ancillary facilities. According to the provisions of the Land Administration Law, the land in our country is divided into agricultural land, construction land and unused land. "Land use right" is a broad concept, including agricultural land use right, construction land use right and other rights.

## **1.3. The Concept of Real Estate Control**

Under the cloak of equity transfer, the owner of the land use right has not changed, but the actual controlling right person has changed. Therefore, according to Article 2 of the Interim Regulations on Land Value Added Tax, the act of transferring the land use right, the buildings on the ground and their attachments is hereinafter referred to as the transfer of real estate. The transfer of the actual control right of the land use right in the form of equity is called the transfer of the real estate control right.

## **2. CURRENT SITUATION OF TAX LAW REGULATION OF EQUITY TRANSFER AND LAND USE RIGHT TRANSFER**

Equity transfer refers to the civil legal act in which a company's shareholders transfer their shares to others in accordance with the law so that others become shareholders of the company. Transfer of the right to the use of land means that the owner of the right to the use of the land transfers the right to the use of the land to another person by means of sale, donation or other lawful means. The transfer of the right to the use of land by means of equity transfer refers to the actual transfer of the right to the use of land by means of equity transfer for some reasons. In the transfer link, the transfer of land use right pays deed tax, business tax, land value-added tax and enterprise income tax more than the transfer of equity, so more cases use this for tax planning to reduce the amount of tax payment in the transaction link.

### **2.1. Tax Law Regulation on Equity Transfer**

#### **2.1.1. Enterprise Income Tax**

Corporate income tax refers to the taxes that enterprises pay on their taxable income at the statutory tax rate. In equity transactions, the transferor of equity is required to pay corporate income tax on its equity transfer income. Equity transfer income refers to the income obtained by the shareholder through the transfer of equity, which is the difference between the delivery price of equity transfer less the transfer cost and equity acquisition cost. When calculating the income from equity transfer, an enterprise shall not deduct the amount that may be distributed according to the equity from the retained earnings of the shareholder such as the undistributed profits of the invested enterprise. If the equity transfer causes the equity transferee to control the equity transferee, general tax treatment or special tax treatment shall be carried out according to the relevant provisions of equity acquisition in the three documents of Finance and Taxation [2009]59, Finance and Taxation [2014]109 and State Taxation [2015]48 according to the specific transaction conditions. In the general tax treatment, the equity transferor, that is, the acquirer, shall recognize the income or loss from the transfer of the equity. In the special tax treatment, the transfer of equity needs to meet five conditions. Under this condition, the portion paid by the transferor to acquire the equity is based on the original tax basis of the transferee's equity, and the enterprise income tax is calculated and paid.

### 2.1.2. Stamp Duty

Stamp duty refers to the tax levied on documents such as equity transfer agreement and equity transfer certificate. In equity transactions, both parties to the transaction need to pay stamp duty. If no amount is specified in the equity transfer agreement or property right transfer letter, the tax basis of the stamp duty shall be determined according to the actual settlement amount. According to the Stamp Duty Law of the People's Republic of China, for equity transfer, when the transferee of equity is a listed company, tax shall be calculated at 0.1% on the transferee of equity according to the tax items of securities transactions, and no tax shall be levied on the transferee of equity. When the transferee of equity is a non-listed company, tax shall be calculated at 0.05% on both sides of the transaction according to the tax items of the property rights transfer letter. However, in the process of equity transfer, if the equity is donated to the government, social welfare units, public schools, the stamp duty can be exempted.

### 2.1.3. Individual Income Tax

Individual income tax refers to taxes that individuals pay on their taxable income at the statutory rate. In equity transactions, individual income tax mainly relates to income from equity transfer. According to the Individual Income Tax Law of the People's Republic of China, individuals shall pay individual income tax on the income obtained through the transfer of equity rights. When the transferor of equity is an individual, individual income tax shall be paid according to "income from transfer of property", and the applicable tax rate is 20%.

In general, equity transactions involve various types of taxes, which need to be reasonably planned according to specific conditions to reduce tax costs. At the same time, it is also necessary to pay attention to compliance with relevant tax laws and regulations to avoid the risk of violations.

## 2.2. Tax Law Regulations on the Transfer of Land Use Rights

### 2.2.1. Land Value Added Tax

According to the Interim Regulations on Land value added Tax, the transfer of state-owned land use rights, buildings on the land and their attachments fall within the scope of land value added tax, and the land use right transferor should file tax returns with the competent tax authorities in the place where the real estate is located. In the calculation of land value-added tax, the income is the total income obtained from the transfer of real estate, and the deduction items include: the amount paid for the acquisition of the land use right; The cost and expense of developing the land; The costs and expenses of the construction of new houses and ancillary facilities, or the assessed prices of old houses and buildings; Taxes related to the transfer of real estate and other deductions prescribed by the Ministry of Finance. For real estate enterprises, an additional deduction of 20% May be calculated according to the sum of the amount paid for the acquisition of the land use right and the cost and expenses of developing the land. The land value-added tax rate shall be a four-tier progressive tax rate: the tax rate shall be 30% for the part whose value added does not exceed 50% of the amount deducted; Where the value added exceeds 50% of the amount deducted but does not exceed 100% of the amount deducted, the tax rate shall be 40%; Where the value added exceeds 100% of the amount deducted but does not exceed 200% of the amount deducted, the tax rate shall be 50%; If the value added exceeds 200% of the deducted item amount, the tax rate is 60%.

### 2.2.2. Value-added Tax

The transfer of land use right is according to the "transfer of intangible assets" tax item VAT levied, VAT taxpayers are divided into general taxpayers and small-scale taxpayers: general taxpayers apply general tax, its applicable tax rate is 9%; For small-scale taxpayers apply simple tax calculation, apply 3% levy rate to calculate and pay VAT. Considering the smooth transition of the policy of land use right obtained by general taxpayers before transferring the "business tax to VAT", it is stipulated that: General taxpayers can choose simple tax calculation for the land use right obtained before transferring

the "business tax to VAT". There are two simple tax calculation methods to choose from: one is to calculate and pay VAT in full according to the 3% levy rate; The second is to calculate the difference according to 5% to pay value-added tax. However, the premise of levying the difference must be based on legal credentials, including land transfer fees, invoices and so on. Small-scale taxpayers transfer the land use right to apply simple tax calculation, for the transfer of the land use right obtained before the "business tax to VAT", there are two ways to choose: the full amount or the difference. However, for small-scale taxpayers, the land use right obtained after the transfer of "replacing business tax with value-added tax" can only be calculated and paid VAT at 3% of the full amount.

### 2.2.3. Enterprise Income Tax

The profits realized by the transfer of land use rights shall be incorporated into the taxable income tax of the enterprise income tax. If the real estate is the substantial operating asset of the transferred enterprise, general tax treatment or special tax treatment shall be carried out according to the relevant provisions of asset acquisition in the three documents of Finance and Taxation [2009]59, Finance and Taxation [2014]109 and State Taxation [2015]48, which are similar to the relevant provisions of equity acquisition.

### 2.2.4. Individual Income Tax

When the transferor of the land use right is an individual, individual income tax shall be levied on the basis of "property transfer income", and the profits realized from the transfer of the land use right by an individual partnership or sole proprietorship enterprise or individual industrial and commercial households shall be incorporated into the "business income" calculation and payment of individual income tax; The gains from the transfer of the land use right by other individuals, i.e. natural persons, shall be calculated and paid according to 20% of the "property transfer income tax". The tax calculation is based on the transfer income minus the amount paid for the acquisition of the land use right, the expenses for the development of the land and other reasonable expenses, and the applicable tax rate is 20%.

### 2.2.5. Deed Tax

Taxpayers who transfer ownership of land or houses within the People's Republic of China and whose units or individuals are subject to deed tax shall pay deed tax in accordance with relevant regulations. The tax rate of deed tax shall be 3% to 5%. In addition, a new provision in the "Deed Tax Law", which will be implemented from Sept 1, 2021, will also be levied on those who transfer the ownership of land and houses by investment (shares) at a fixed price.

### 2.2.6. Stamp Duty

A transfer contract shall be signed for the transfer of land use rights. Under normal circumstances, each party holds one copy of the contract. 2. The parties to the contract are the subject of stamp duty. Therefore, both the transferor and the transferee of land use right belong to stamp duty taxpayers. The taxable property right transfer document is based on the amount listed in the property right transfer document, excluding the specified VAT tax; The tax rate shall be five-thousandth of the price. The current policy stipulates that small-scale taxpayers and small low-profit enterprises "six taxes and two fees" are collected by half, including stamp duty.

It can be seen that in the vast majority of cases, the equity transfer and the transfer of land use rights are clearly defined, and there is no disagreement between the two parties and the tax authorities on the applicable tax policies. Compared with the transfer of equity, the transfer of land use right involves more taxes, and the tax payable is larger, among which the land value-added tax occupies a larger transaction cost. As a dynamic property tax, China began to set up land value added tax in 1994, and officially implemented the liquidation system in 2007 to strengthen the collection of land value added tax. Land value added tax can better and more effectively control the price rise, and reduce the profit margin of the transferor, weaken the speculative demand of the transferor. Therefore, many companies choose the way of equity transfer to transfer land use rights for tax planning.

### **2.3. On the Transfer of Land Use Right in the Form of Equity Tax Regulation**

In China's tax laws, regulations and normative documents, there is no special provision for the transfer of land use right in the form of equity studied in this paper. On the contrary, article No. 4 of Finance and Taxation [2012] makes a distinction between equity transfer and land use right transfer, and no deed tax is levied on equity transfer. After the expiration of this document, the subsequent tax policies also follow this provision. In terms of land value-added tax, the focus of the dispute, according to the clear provisions of Article 2 of the Interim Regulations on land value-added Tax, the taxpayer and the scope of taxation of land value-added tax have been defined, and the transfer of equity does not belong to the scope of taxation of land value-added tax. However, in the reply, notice and online consultation reply of the State Administration of Taxation and local taxation Bureau, different opinions are given for this kind of special transfer of land use right in the form of equity. In documents No. [2000]687, [2009]387 and [2011]415, the State Administration of Taxation made a decision to collect the land value-added tax related to the equity transfer. The Local Taxation Bureaus of Hunan and Henan made the decision to levy the land value-added tax, while the local taxation bureaus of Chongqing and Qingdao held that the land value-added tax should not be levied.

Based on the three replies of the State Administration of Taxation, if the assets in the form of equity in the transaction mainly include land use rights, above-ground buildings and attachments, and the amount of equity transfer is equivalent to the assessed value of real estate, then according to the provisions of land value-added tax, land value-added tax should be levied. Some local tax authorities may choose to levy land value-added tax with reference to the three approvals issued by the State Administration of Taxation. Some believe that the approval of the State Administration of Taxation is a case-by-case approval without universal effect, the ownership of land use right has not changed, and there is no legal provision for the collection of land value-added tax.

From the perspective of tax policy, there is obvious policy tax avoidance space for equity transfer and real estate asset transfer. The current tax policy has certain loopholes to prevent enterprises from using equity transfer to achieve the purpose of transferring housing and land and other assets. It is not uncommon for some enterprises to obtain land use rights through the cloak of equity transfer. Tax authorities and companies often dispute the substance of transactions, with companies causing significant tax losses through so-called "reasonable tax avoidance." Therefore, the three approvals of the State Administration of Taxation aim to crack down on the use of equity transfers to evade land value-added tax payments and protect the tax interests of the country, but at the same time, the disputes brought by such activities have also brought certain difficult problems to tax collection.

### **3. WHETHER THE EQUITY TRANSFER INCOME FROM THE TRANSFER OF REAL ESTATE CONTROL RIGHTS IN THE FORM OF EQUITY BELONGS TO THE SCOPE OF LAND VALUE-ADDED TAX TAXATION**

The object of land value-added tax is the transferred real estate, while the object of the transferred equity is the enterprise equity. Equity is a comprehensive right enjoyed by shareholders according to the number of shares they hold. According to the provisions of the Company Law, it includes the right to vote, the right to vote, the right to benefit, the right to distribute, the right to stock options, the right to Sue, the right to know and so on. Equity transfer is not simply manifested as the domination of the real estate land use right. For the transferee of equity, its management of the company's land and other assets represents the normal operation of the company. For shareholders, real estate is just an asset of the company, which does not transfer ownership with the change of shareholders of the company, nor can it represent all the property rights and interests of a company. However, in practice, some courts and tax authorities believe that land value-added tax should be levied based on the three approvals from the State Administration of Taxation, through such "name-share and on-the-ground" behavior.

### **3.1. The Equity Transfer Income from the Transfer of Real Estate Control Rights in the Form of Equity is the Object of Land VAT Taxation**

The legislative purpose of Article 38 of the Urban Real Estate Administration Law is obvious, which is to prevent land speculation and to ensure the smooth implementation of land development through strict transfer conditions. The transfer of land by means of equity transfer obviously legitimately nullifies both legislative purposes. Land can be transferred arbitrarily and legally without the conditions of statutory transfer. The phenomenon of "speculation" of land in the form of equity transfer even seeks space for power rent-seeking, which is not conducive to the healthy development of the real estate market. Therefore, in order to avoid the loss of national tax revenue, the State Administration of Taxation issued three approvals to provide reference for solving such problems. Article 47, Article 48 of the Enterprise Income Tax Law and Article 8, paragraph 1, paragraph 3 and paragraph 2 of the Individual Income Tax Law also provide corresponding legal support. According to the approval of the State Administration of Taxation, some courts, starting from the principle of substantive taxation, will be in the form of equity transfer of real estate control rights of equity transfer income into the scope of land value-added tax. In this view, if the land value-added tax is not collected according to the principle of substantive taxation, it will lead to a large number of real estate enterprises in the transfer of land use rights to avoid the payment of land value-added tax by equity transfer, take advantage of the loopholes of the equity transfer tax system to carry out unconventional legal arrangements, resulting in a large loss of national tax, which is not conducive to creating a stable tax collection and management environment.

### **3.2. The Equity Transfer Income from the Transfer of Real Estate Control Rights in the Form of Equity Does Not Belong to the Object of Land Value-added Tax**

From the perspective of the object of land value-added tax, only the transfer of real estate can meet the conditions of the object of land value-added tax. The tax law does not clearly stipulate that the transfer of equity should pay land value-added tax, so the transfer of equity does not belong to the object of taxation of land value-added tax. According to Article 2 of the Interim Regulations on Land value-added Tax, the tax liability of the real estate land value-added tax is the owner of the real estate or the person who obtains the real estate income tax, emphasizing that the scope of application of the land value-added tax is limited to the transfer of real estate, and the transfer of equity is not the tax object of the land value-added tax. The transfer of equity and the transfer of land use right are completely different behaviors. When the transfer of equity occurs, the target company does not have the taxable behavior of the transfer of state-owned land use right. The current tax law does not stipulate whether to levy land increment tax and deed tax on the equity transfer of the project company involving land use right. According to the doctrine of tax legality, if the tax law does not stipulate that tax should be paid, the parties concerned may not pay tax.

Article 3 of the Law on the Administration of Tax Collection and the Notice of The State Council on Issuing the Outline for Comprehensively Promoting the Implementation of Law-based Administration make it clear that statutory taxation is the basic requirement of the tax law, and tax collection and suspension must be in accordance with the provisions of the law. At the same time, the Outline for the Implementation of the Construction of a Government under the Rule of Law (2021-2025) puts forward that "legal duties must be adhered to, and no action shall be taken without the authorization of the law." Therefore, some courts in the judgment of such cases, did not cite the approval of the State Administration of Taxation as the basis, but from the perspective of the statutory principle of tax judgment, in the "Interim Regulations on Land value-added Tax" stipulated the scope of taxation for the transfer of real estate, did not make an expanded judgment on the scope of collection.

## 4. CONCLUSION

Objectively, "transfer of land use right by means of equity transfer" does not violate the prohibitive provisions of land administration regulations, nor does it evade land administration regulations, nor can it be evaluated as "substantially illegal". Equity transfer is not the transfer of land use right, the two are completely different legal acts, and equity transfer cannot be identified as asset transfer. Equity transfer should not be confused with the transfer of land use right because it can have the same economic effect as the transfer of land use right as the company's asset. The transfer of equity rights does not violate the mandatory provisions of laws and administrative regulations, so the contract of equity rights transfer including land use rights is legal and effective. Although there are different opinions on the nature of the behavior of "name shares in the field", tax law liability does not necessarily lead to civil liability, so even if the act of tax evasion, the contract cannot be deemed invalid. From the perspective of the tax statutory principle, some tax bureaux only rely on the three approvals made by the State Administration of Taxation as the basis for taxation, and include the equity transfer involving the transfer of land use rights into the tax scope of land value-added tax, which not only violates the tax statutory principle, but also arbitrarily expands the discretionary power of the tax authorities. From the point of view of the principle of substantive taxation, this kind of equity transfer is a normal business behavior with interests as the core, and the commencement of the principle of substantive taxation should be based on the premise of tax legalization, and limited to the case of abuse of transaction forms such as anti-tax avoidance to extract tax benefits. The approval of the State Administration of Taxation mentioned in this article does not belong to the normative legal documents and cannot be used as the basis for judgment. In addition, the form of private law under voluntary autonomy should be fully respected, and the tax authority's willful imposition of tax through the transfer of equity will destroy tax fairness.

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