# Research on the Tax Planning of Enterprise Mergers and Acquisitions

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**Abstract:** With the in-depth development of domestic supply-side structural reforms and the continuous transformation and upgrading of economic growth patterns, corporate M&A market in China has continued to prosper, and the amount of M&A has repeatedly hit new highs. Taxation affects the success of corporate restructuring. Proper tax planning can reduce the cost of corporate mergers and acquisitions and help companies maximize the benefits of mergers and acquisitions. Based on the discussion of corporate restructuring tax policies and tax planning methods, this article conducts an in-depth analysis of the tax planning during the reorganization of China Enterprise Co., Ltd. in the merger and acquisition of Shanghai Middlestar Group Co., Ltd., so as to provide other companies with relevant experience in terms of reasonable tax planning and reducing the tax burden of restructuring.

## 1. Introduction

At present, China economy is in a critical period of transforming development mode, optimizing economic structure, and transforming growth momentum. The real economy is receiving more and more support from the capital market. Mergers and reorganizations are one of the important support channels, so many companies have carried out reorganization to adjust the development strategy and obtain external resources. Taxation according to law is indispensable in mergers and acquisitions. How to reduce the cost of restructuring through compliant tax planning is a question worth considering. Therefore, tax planning occupies an important position in the entire process of enterprise mergers and acquisitions.

Throughout the process of corporate mergers and acquisitions, taxation issues run through and even affect the success of mergers and acquisitions. With the continuous increase of corporate mergers and restructuring, mergers and acquisitions methods and payment methods are gradually diversified, and the tax issues involved are becoming more and more complicated. How to plan for taxation and apply tax incentives rationally and scientifically is the common concern of all parties. Since the implementation of the new Corporate Income Tax Law in 2008, the Ministry of Finance and the State Administration of Taxation have successively issued several merger and reorganization tax documents to regulate them. If reasonable M&A methods and payment methods can be designed according to the company’s M&A intentions and basic conditions, it will reduce M&A expenditures, lighten the burden on enterprises, and effectively control tax risks.This article will use the case of China Enterprise Co., Ltd. in the merger and acquisition of Shanghai Middlestar Group Co., Ltd. to study the tax planning in mergers and acquisitions.

## 2. Background

### 2.1 The introduction of China Enterprise Co., Ltd.

China Enterprise Co., Ltd. (abbreviated as China Enterprise) was established in 1954, and its predecessor was China Enterprise Corporation. In 1993, China Enterprise Corporation used the social IPO method to restructure into a joint-stock listed company and renamed China Enterprise Co., Ltd. The company's business scope includes: overseas remittance housing, commercial housing design, construction, trading, leasing and adjustment business, supporting services of various commercial housing, house decoration and maintenance business, building materials.

### 2.2 The introduction of Shanghai Middlestar Group Co., Ltd.

Shanghai Middlestar Group Co., Ltd. (hereinafter referred to as "Shanghai Middlestar") was established with the approval of the Shanghai Construction Committee and the Shanghai Economic System Reform Commission. It is a wholly-owned enterprise registered in Shanghai. After several capital increase and restructuring, Shanghai Middlestar became a wholly-owned subsidiary of the Real Estate Group. The real estate group invested 10 million yuan, and the actual controller was the Shanghai State-owned Assets Supervision and Administration Commission. The company's business includes development and operation of construction bases, real estate development and operation, self-owned housing leasing, real estate consulting, building materials, metal materials, mechanical and electrical equipment, architectural decoration, building materials processing, technical consulting, and affiliated branches.

### 2.3 Motivation for M&A and reorganization

The motivation of mergers and acquisitions is the first step of restructuring business. According to the information disclosed by the listed companies and the analysis of the basic situation of the case, the main reasons for the acquisition of Shanghai Middlestar by China Enterprise are as follows:

#### 2.3.1Reduce horizontal competition

The Real Estate Group is the controlling shareholder of China Enterprise. In addition to the China Enterprise and their subsidiaries, there are other subsidiaries engaged in real estate business, forming horizontal competition with China Enterprise. Through this reorganization, the Real Estate Group injected 100% equity of Shanghai Middlestar into China Enterprise to avoid competition in the same industry.

#### 2.3.2The need to integrate resources

Land resources are the core resources of real estate companies, especially the land resources of core plots in big cities. The high-quality land resources held by Shanghai Middlestar can inject great vitality into China Enterprise and improve the continuous operation and comprehensive competitiveness of China Enterprise over a period of time. After the merger, the injection of Shanghai Middlestar high-quality assets into China Enterprise has significantly promoted China Enterprise's business scale, asset quality, financial status, profitability and anti-risk ability. At the same time, China Enterprise's acquisition of Shanghai Middlestar also conformed to the wave of reforms in Shanghai's state-owned enterprises.

## 3. Comparison of tax planning options

The "Notice on Several Issues Concerning the Treatment of Enterprise Income Taxes on Enterprise Restructuring Business" Finance and Taxation [2009] No. 59 states that the acquisition of corporate equity and asset acquisition and restructuring transactions shall not be subject to special tax treatment regulations, and general tax treatment should be adopted. Corporate equity acquisitions and asset acquisitions and restructuring transactions that comply with the "Notice of the Ministry of Finance and the State Administration of Taxation on Issues Concerning Corporate Income Tax Policies for Non-monetary Asset Investments" Finance and Taxation [2014] No. 116 can be treated as non-monetary asset investments.

### 3.1 General tax treatment

#### 3.1.1 Applicability analysis

The "Notice on Several Issues Concerning the Treatment of Enterprise Income Taxes on Corporate Restructuring Business" Finance and Taxation [2009] No. 59 states that for corporate equity acquisition and asset acquisition and restructuring transactions, the tax treatment of related transactions shall be as follows:

(1) The acquired party shall confirm the gains or losses from the transfer of equity and assets;

(2) The taxation basis for the acquirer's acquisition of equity or assets should be determined on the basis of fair value;

(3) The relevant income tax matters of the acquired company remain unchanged in principle.

### 3.1.2 Tax effect analysis

With general tax treatment, income tax shall be paid for mergers and acquisitions = (fair value of the transferred asset-tax base of the transferred asset) * corporate income tax rate.

According to the credit evaluation report issued by Lixin Appraisal [2016] No. 1099, the valuation of the target asset of the transaction was on August 31, 2016, which was the evaluation base date. According to the evaluation on the evaluation base date, the book value of the net assets of the parent company's simulated statement of the target asset of this transaction was RMB 748,652.10 million, the estimated value of the target asset was RMB 17,472,147,700, and the valuation increase was RMB 9,985,625,700. Both parties of the transaction agreed that the transaction price of the underlying asset was RMB 17,472,147,700.

The China Enterprise’s corporate income tax rate was 25%, and the income tax required for general tax treatment was RMB 2,496,406,400 (998,562.57*25%). In addition, the taxation basis for the acquisition of equity or assets byChina Enterprise as the acquirer should be determined on the basis of fair value. The appraisal and appreciation of fixed assets and intangible assets of RMB 144,961,800 will be used to depreciate to deduct the taxable income in the future period and generate tax synergies.

## 3.2 Special tax treatment

Finance and Taxation [2009] No. 59 pointed out that if the enterprise reorganization meets the following conditions at the same time, the special tax treatment regulations shall apply:

(1) It has a reasonable commercial purpose, and the main purpose is not to reduce, exempt or postpone the payment of taxes.

(2) The proportion of assets or equity in the acquired, merged or split part meets the required proportion of 50%.

(3) The original substantive operating activities of the reorganized assets shall not be changed for 12 consecutive months after the reorganization of the enterprise.

(4) The amount of equity payment involved in the consideration of the restructuring transaction meets the required proportion of 85%.

(5) The original major shareholder who obtained equity payment in the corporate reorganization shall not transfer the acquired equity for 12 consecutive months after the reorganization.

If it meets the special tax treatment conditions, the equity payment part can be selected according to the following regulations:

(1) The tax basis for the shareholders of the acquired company to obtain the equity of the acquired company shall be determined on the basis of the original tax basis of the acquired equity;

(2) The tax basis for acquiring the equity of the acquired company by the acquiring company shall be determined based on the original tax basis of the acquired equity. To

(3) The tax base of the original assets and liabilities of the acquiring company and the acquired company and other relevant income tax matters remain unchanged. If the equity payment part of the transaction does not temporarily recognize the income or loss related to the asset transfer, the non-equity payment part should confirm the corresponding asset transfer income or loss in time, and adjust the corresponding asset tax basis. Asset transfer income or loss corresponding to non-equity payment = (fair value of the transferred asset-tax basis of the transferred asset) × (non-equity payment amount ÷ fair value of the transferred asset).

### 3.2.1 Applicability analysis

(1) Commercial Purpose

The main purpose of the merger and reorganization between China Enterprise and Shanghai Middlestar was not to reduce, exempt or postpone the payment of taxes. The main purpose was to integrate resources and resolve competition in the same industry, which had reasonable commercial purposes.

(2) Other conditions

China Enterprise’s acquisition of Shanghai Middlestar was an equity acquisition, and the acquisition was 100% of Shanghai Middlestar’s equity, which met the requirement for the proportion of acquired equity to reach 50%. In terms of payment transaction consideration, the proportion of China Enterprise equity payment was 85%, which met the requirement that the amount of equity payment involved in the consideration reaches 85%. According to the "Report on Issuance of Shares and Payment of Cash to Purchase Assets and Raising Supporting Funds and Related Transaction Implementation Report" of China Enterprise, the Real Estate Group promised that the shares subscribed by the Real Estate Group in this issuance to purchase assets would not transferred within 36 months. At the same time, after the merger and reorganization were completed, neither China Enterprise nor Shanghai Middlestar would change the original operating activities of the reorganized assets.

Combined with the analysis of business purposes, the case can apply special tax treatment.

### 3.2.2 Tax effect analysis

If the equity payment part of the transaction did not temporarily recognize the income or loss of the relevant asset transfer according to the regulations, the non-equity payment part shall confirm the corresponding asset transfer income or loss on a regular basis. The non-equity payment ratio was 15%, and the non-equity payment corresponding to the asset transfer income was 1,497,843 million yuan (998,562.57*15%). The corporate income tax rate is 25%, so the partial income tax paid in cash this time was 374,461,100 yuan (149,784.39*25%). Compared with the income tax of RMB 2,496,406,400 (998,562.57*25%) required for general tax treatment, the enterprise income tax was reduced by RMB 2,211.9454 million by adopting special tax treatment.

### 3.3 Non-monetary asset investment tax treatment

"Notice of the Ministry of Finance and the State Administration of Taxation on Issues Concerning Income Tax Policies for Non-monetary Asset Investment Enterprises" Finance and Taxation [2014] No. 116 stipulates that non-monetary asset transfer income confirmed by non-monetary asset investment by non-monetary assets by resident companies can be used for no more than 5 years. Within the time limit, the taxable income of the corresponding year shall be evenly included in installments, and the enterprise income tax shall be calculated and paid in accordance with the regulations.

The tax treatment of related transactions shall be in accordance with the following regulations:

(1) The company's investment in non-monetary assets to obtain equity in the invested company should be based on the original taxable cost of the non-monetary assets, plus the income from the transfer of non-monetary assets recognized each year, and adjusted year by year.

(2) The tax basis for non-monetary assets acquired by the invested enterprise shall be determined according to the fair value of the non-monetary assets.

### 3.3.1 Applicability analysis

Finance and Taxation [2014] No. 116 does not set requirements on the ratio of the assets of the merger and acquisition of the two parties and the ratio of equity payment. It only needs to have resident enterprises and meet the requirements of non-monetary assets. Therefore, in this case, that China Enterprise issued shares to purchase 100% equity of Shanghai Middlestar met the requirement.

### 3.3.2 Tax effect analysis

On May 22, 2018, China Securities Depository and Clearing Co., Ltd. Shanghai Branch issued the "Securities Alteration Registration Certificate". The registration of the newly-added shares to purchase assets has been completed, so the non-monetary asset transfer income is recognized on May 22, 2018.

The fair value of Shanghai Middlestar's non-monetary assets after deducting the tax basis was RMB 9,985,625,700, which can be evenly included in the taxable income of the parent company Shanghai Real Estate in the corresponding year within a five-year period. This article discounts the corporate income tax payable due to mergers and acquisitions within 5 years to 2018. The specific calculation is shown in Table .1.

Table.1. Calculation table of present value of deferred tax

| Year | Transfer Income | Taxation Adjustment | Taxable Income | Tax Payable （25%） | PV(4.27%) |
|---|---|---|---|---|---|
| 2018 | 998,562.57 | -798,850.06 | 199,712.51 | 49,928.13 | 49,928.13 |
| 2019 | 0.00 | 199,712.51 | 199,712.51 | 49,928.13 | 47,883.50 |
| 2020 | 0.00 | 199,712.51 | 199,712.51 | 49,928.13 | 45,922.61 |
| 2021 | 0.00 | 199,712.51 | 199,712.51 | 49,928.13 | 44,042.01 |
| 2022 | 0.00 | 199,712.51 | 199,712.51 | 49,928.13 | 42,238.43 |
| Total | 998,562.57 | 0.00 | 998,562.57 | 249,640.64 | 230,014.69 |

The China Enterprise income tax rate is 25%. Compared with the income tax of RMB 2,496,406,400 (998,562.57*25%) that is under general tax treatment, the non-monetary asset investment tax treatment will save RMB 196,257,600.

## 4. Results

By calculating the income tax payable for mergers and acquisitions, it can be seen that under the three tax treatment methods, the special tax treatment pays the least income tax, the general tax treatment pays the most income tax, and the income tax paid for the special treatment is far lower than the general tax treatment and the special tax treatment. After analyzing the tax synergy brought by various tax treatment methods and tax planning principles, this article believes that China Enterprise should choose special tax treatment.

## 5. Conclusions

Tax planning for mergers and reorganizations not only needs to consider tax synergies, but also the principles of tax planning to minimize corporate tax burden. Based on the principle of legality, the three types of tax treatments in this article have rules to follow, and they need to be planned and submitted in accordance with the regulations. For example, special tax treatments must be filed, otherwise it will be regarded as tax evasion. Based on the principle of comprehensiveness, planning from a strategic perspective cannot be limited to a single tax category. Since there is little public information about other related taxes, this article does not discuss it, but the actual tax planning should comprehensively consider all taxes to minimize the comprehensive tax burden. Based on the principle of risk, the applicability of corporate tax policies should be dynamically monitored, such as the impact of changes in the use of operating assets on the application of special tax treatments, and the impact of the transfer of equity within 5 years on the implementation of deferred tax policies.

## References

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