

# Research on the Accounting Treatment of Incremental Value-added Tax Credit

Li Jiao

Shandong Institute of Commerce and Technology, Jinan, Shandong Province, China

**Keywords:** value added tax; incremental tax credit; accounting treatment.

**Abstract:** Incremental value-added tax credit is the latest preferential policy issued by our government in 2019. It involves all enterprises. At present, only the Accounting Department of the Ministry of Finance has issued a simple interpretation on the accounting treatment of financial affairs affected by this policy. But there are some problems in its interpretation, which is the main topic of this paper.

## 1. Introduction

On March 20, 2019, the Ministry of Finance, the State Taxation Administration and the General Administration of Customs jointly issued the Announcement on Deepening VAT Reform (hereinafter referred to as the announcement), which stipulates that from April 1, 2019 to December 31, 2021, taxpayers of production and life services are allowed to add 10% of the current deductible input tax to offset the tax payable. On April 18, the Accounting Department of the Ministry of Finance issued the Interpretation on the Application of Announcement on Deepening VAT Reform to Regulation on the Accounting Treatment of Value-added Tax (hereinafter referred to as the interpretation), which clearly stipulates the accounting treatment of the incremental value-added tax credit. This article mainly analyzes the interpretation, puts forward personal viewpoints and provides improvement suggestions.

## 2. Analysis and Research on the Interpretation

The interpretation stipulates that when taxpayers in production and life service industries acquire assets or receive labor services, they shall conduct accounting treatment of relevant businesses in accordance with relevant provisions in the Regulation on the Accounting Treatment of Value-added Tax (Finance and Accounting Document [2016] No. 22); when actually paying VAT, they shall debit and record "Taxable Fees - Unpaid VAT" and other subjects according to the amount of tax payable, credit "Bank Deposit" according to the actual amount of tax, and credit "Other Income" according to the amount of incremental tax credit. The above-mentioned provisions can be explained as follows. The essence of incremental credit of input tax is to deduct the value-added tax payable, not the input tax. So the input tax is still treated in accordance with normal treatment provisions. In the link of tax credit, the company needs to credit "Other Income" according to the amount of tax credit. The accounting treatment of accrual and deduct links of the incremental input tax credit is unnecessary and not allowed. "Other Income" is a new accounting subject stipulated in No. 16 Accounting Standard for Enterprises: Government Subsidies issued by the Ministry of Finance in May 2017 (which came into effect on June 12, 2017). This subject is used to calculate the amount of government subsidies which are related to the daily activities of enterprises but are not suitable to be confirmed as income or expenses offset. It belongs to the category of profit and loss. To sum up, although the direct tax deduction is not included in government subsidies, it is more appropriate to be included in other income since it is closely related to daily activities. The accounting circle has basically reached a consensus on this treatment (there is no "other income" subject in the accounting standards for small enterprises, which is a problem remains to be solved). If an enterprise wants to clearly reflect the accrual, transfer and actual deduction of the incremental value-added tax credit, memorandum books can be set up to record relevant information in detail. However, there are also some problems in above viewpoints. If the enterprise realizes the fine

accounting management, according to the requirements of the No. 39 announcement (which stipulates that taxpayers should separately record changes in the amount of incremental value-added tax credit due to accrual, offset, deduction and balance) and relevant internal management documents, it is required to realize accounting treatment in the whole process of the input tax credit, so as to achieve the consistency of accounts and forms. In some cases, the business of the incremental tax credit is very simple with low frequency and small amount of money. It should be completely feasible to do accounting treatment only in the link of credit. Therefore, the author holds that there is no conflict between the whole-process accounting and the credit link accounting. Under the premise of obeying basic principles, enterprises can apply different accounting treatment methods suitable for them. At the same time, the method of managing the standing book accounting through forms also has its drawbacks. For example, to use the Schedule IV of VAT declaration in account management is static management, which can not reflect the changing process of incremental tax credit; the method can only show the amount of balance. This is also an issue worth considering.

### **3. Problems in the Interpretation**

#### **3.1 The interpretation does not consider the scope of “Other Income”**

At present, most enterprises do not implement the Accounting Standards for Enterprises, but still follow the Accounting Standards for Small Enterprises. However, the Accounting Standards for Small Enterprises did not set up the subject of “Other Income”. When the Ministry of Finance mentioned the “Other Income” subject in the Notice on Revising and Issuing the Format of Financial Statements for General Enterprises in 2018 (Finance and Accounting Document, [2018] No. 15), it is also stated that the subject was only applicable to the Accounting Standards for Enterprises. It did not clearly specify that the subject was applicable to the Accounting Standards for Small Enterprises. That is to say, taxpayers who implement the Accounting Standards for Small Enterprises do not use this subject; they continue to record relevant government subsidies as “Non-business Income”. The author suggests that the Ministry of Finance may supplement the interpretation as, crediting the amount incremental tax credit in the subjects of “Other Income” or “Non-business Income”.

#### **3.2 The interpretation does not stipulate how to accrual and reduce.**

The interpretation only stipulates the accounting treatment of the actual deduction of “incremental tax credit” on tax payable; it does not explain how to accrual or deduct the incremental tax credit. In my opinion, one possible reason is that the Ministry of Finance considers that the accounting treatment of the accrual and deduction of incremental VAT credit is unnecessary; another explanation is that the incremental VAT credit is only a temporary policy (valid from April 1, 2019 to December 31, 2021). It seems unnecessary to adjust the secondary subject of “Tax Payable” for a temporary policy. However, the announcement has clearly stipulated that “taxpayers should separately account the changes in the amount of incremental value-added tax credit due to accrual, offset, deduction and balance”, so it can be said that relevant provisions are incomplete and should be improved.

### **4. Improvement Suggestions**

For the author’s perspective, a second-level subject “Incremental VAT Credit” could be added under the “Tax Payable” subject to separately account the accrual, offset, deduction and balance of the amount of incremental tax credit. The reasons are as follows. (1) The announcement stipulates that if the input tax after incremental tax credit should be transferred out according to regulations, the amount of incremental tax credit shall be deducted accordingly in the period of input tax transferring. If the company wants to calculate the amount of offset separately, it must set up a separate subject to record detailed information. (2) The announcement stipulates that taxpayers should calculate the amount of tax payable according to the general taxation method (hereinafter

referred to as the amount of tax payable before credit) in accordance with current provisions, distinguish different situations of accrual credit, and then carry out the treatment. For the author's perspective, above statement means that the accrual tax credit does not participate in the calculation of the "VAT Payable" subject, which is different from the VAT balance offset. Therefore, the company should not set up a subject under "VAT payable". It is suggested that relevant accounting treatment can be carried out in following methods.

#### 4.1 Incremental tax credit accrual for the current period

The first method is to refer to the accounting treatment of input tax/balance; "accrual tax credit" is equivalent to the offset of input tax. [2016] No. 22 accounting document on the "Accounting Treatment of Balance Taxation" stipulates that, accounting treatment of deducting sale volume is allowed for the occurrence of related costs and expenses of the enterprise. The accounting treatments for enterprises which are allowed to deduct sale volume when cost occurs go as following. If the enterprise is allowed to deduct sales volume according to the current value-added tax system, when cost occurs, it shall debit "Main Business Cost", "Inventory", "Engineering Construction" and credit "Accounts Payable", "Notes Payable" and "Bank Deposit" according to the amount payable or actually paid. When the compliant tax credit documents for VAT are obtained and the tax liability occurs, according to the allowable amount of tax deduction, the subjects of "Tax payable - VAT Payable (offset tax credit)" or "Tax Payable - Simple Taxation" are debited (small-scale taxpayers should debit the subject of "Tax payable - VAT Payable"), and the subjects of "Main Business Cost", "Inventory" and "Engineering Construction" are credited.

In accordance with above ideas, when the amount of incremental tax credit accrual for the current period is calculated, the accounting should be as follows.

Debit: Main Business Cost/Management Cost/Fixed Assets, etc.

Tax Payable: Incremental VAT Credit

Credit: Bank Deposit/Accounts Payable/Notes Payable

For example, for a general taxpayer (meeting the policy conditions of incremental tax credit), in October 2019, the manager buys an airline ticket for a business trip, and obtains airline ticket itineraries with the fare of 15,000 yuan, fuel surcharge of 500 yuan, and airport construction fee of 2,000 yuan. The total amount is 17,500 yuan. The input tax credit should be  $15,500 / (1+9\%) \times 9\% = 1279.82$  yuan. [Note: According to the latest value-added tax regulations, airport construction fee cannot be calculated in input tax credit. The input tax of air transportation is equal to  $(\text{fare} + \text{fuel surcharge}) / (1 + 9\%) \times 9\%$ ]. Other circumstances are not considered.

Debit: Management Cost - Travel Cost 16092.2

Tax Payable - Value Added Tax Payable (Input Tax) 1279.82

Tax Payable - Incremental VAT Credit 127.98 ( $1279.82 \times 10\%$ )

Credit: Bank Deposit 17500

The second treatment is business accounting according to government subsidies. Notice on Revising and Issuing the Format of Financial Statements for General Enterprises in 2018 (Finance and Accounting Document, [2018] No. 15) stipulates that "Other Income" reflects government subsidies included in income. The accounting subject should be filled according to the amount of "Other Income". The item "Non-business Income" reflects the enterprise income other than operating profits, including debt restructuring gains, government subsidies unrelated to the daily activities of enterprises, inventory profits, and donation gains (enterprises receive direct or indirect donations from shareholders or shareholders' subsidiaries, except for the capital investment of shareholders in enterprises). The subject should be filled according to the amount of the "Non-business Income" subject. The Accounting Department's Interpretation on Issues Relevant to Government Subsidies issued on February 22, 2018 stipulates that, "the 'Other Income' Subject is used to calculate government subsidies which are related to the daily activities of enterprises, as well as items related to the daily activities of enterprises and should be directly included in this subject." In accordance with above ideas, when the amount incremental VAT credit accrual in the current period according to provisions, the treatment should be as following. Debit: Tax Payable -

Incremental VAT Credit; Credit: Other Income/ Non-business Income.

For example, for a general taxpayer (meeting the policy conditions of incremental tax credit), in October 2019, the manager buys an airline ticket for a business trip, and obtains airline ticket itineraries with the fare of 15,000 yuan, fuel surcharge of 500 yuan, and airport construction fee of 2,000 yuan. The total amount is 17,500 yuan. The input tax credit should be  $15,500 / (1+9\%) * 9\% = 1279.82$  yuan. [Note: According to the latest value-added tax regulations, airport construction fee cannot be calculated in input tax credit. The input tax of air transportation is equal to  $(\text{fare} + \text{fuel surcharge}) / (1 + 9\%) * 9\%$ ]. Other circumstances are not considered.

Debit: Management Cost - Travel Cost 16220.18

Tax Payable - VAT Payable (Input Tax) 1279.82

Credit: Bank Deposit 17500

Debit: Tax Payable - Incremental VAT Credit 127.98

Credit: Other Income/Non-business Income 127.98

#### 4.2 The actual deduction of tax payable

If the amount of tax payable before deduction is greater than zero and greater than the amount of deductible incremental tax credit in the current period, the deductible incremental tax credit accrual for the current period shall be deducted in full from the amount of tax payable before deduction, i.e. deducting the Tax Payable- Unpaid Value Added Tax, crediting the Incremental VAT Credit, and transferring the deferred income to Non-business Income or Other Income.

For example, Company A is a general taxpayer engaged in modern service industry (which meets the conditions stipulated by the incremental tax credit policy). In June 2019, the value-added tax payable is 100,000 yuan, and in the current period, the amount of incremental tax credit is 20,000 yuan.

Debit: Tax Payable - Incremental VAT Credit 2      Credit: Deferred Income 2

Debit: Tax Payable - Unpaid Value Added Tax 2      Credit: Tax Payable - Incremental VAT Credit 2

Debit: Deferred Income 2      Credit: Non-business Income 2

If the tax payable before the deduction is greater than zero, but less than or equal to the amount of deductible incremental tax credit accrual for the current period, the accounting treatment is the same as the above example. The difference is, the uncompleted amount of deductible incremental tax credit accrual for the current period can be carried forward to the next period.

For example, Company A is a general taxpayer engaged in modern service industry (which meets the conditions stipulated by the incremental tax credit policy). In June 2019, the value-added tax payable is 100,000 yuan, and in the current period, the amount of incremental tax credit is 120,000 yuan.

Debit: Tax Payable - Incremental VAT Credit 12      Credit: Deferred Income 12

Debit: Tax Payable - Unpaid Value Added Tax 10      Credit: Tax Payable - Incremental VAT Credit 10

Debit: Deferred Income 10      Credit: Non-business Income 10

If the current taxable amount is zero, only the accrual should be made. The total amount of incremental tax credit for that period can be carried forward to the next period.

For example, Company A is a general taxpayer engaged in modern service industry (which meets the conditions stipulated by the incremental tax credit policy). In June 2019, the value-added tax payable is 0, and in the current period, the amount of incremental tax credit is 20,000 yuan.

Debit: Tax Payable - Incremental VAT Credit 2      Credit: Deferred Income 2

#### 4.3 After the policy expires

The taxpayer no longer accrual the amount of incremental VAT credit; the balance of incremental VAT credit ceases to offset; balance of incremental VAT credit is transferred to corresponding cost.

Debit: Main Business Cost or Management Cost

Credit: Tax Payable - The Amount of Incremental VAT Credit

For example, in January 2022, when the policy of the incremental tax credit expires, Company A still has 20,000 yuan value-added tax which has not yet been deducted. The credit is transferred to current expenses at one time.

Debit: Management Expenses 2

Credit: Tax Payable - The Amount of Incremental VAT Credit 2

## **5. Conclusion**

The latest preferential policy on VAT credit is related to all kinds of enterprises. The correct and reasonable accounting treatment also directly affects the accounting of enterprise expenses and profits. It is suggested that relevant departments need to improve provisions on the accounting treatment of incremental value-added tax credit as soon as possible, so as to facilitate the rational accounting treatment of enterprises.

## **References**

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