

## Research on the relationship between tax break-even point and sales price in land value-added tax

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**Abstract:** The land value-added tax is the main tax in real estate development enterprises. There is certain tax planning space through maximizing the real estate development costs in a reasonable range, but it is too risky to emphasis the maximization in real estate development costs because of the replacing business tax with value added tax. Utilization of tax break-even point in the land VAT to decide reasonable selling price is one of the wise way to reduce the tax burden.

### 1. Introduction

With the development of national regulation and control policies, the competition among real estate enterprises is becoming more and more fierce. In this context, controlling the operating cost of enterprises has become an important way to increase earnings. Tax as a major expenditure of real estate development enterprises, plays an important role in the cost. Tax planning is one of the methods to control costs. The tax categories related to real estate enterprises involves more than ten types. Unfortunately, it does not mean that every type of tax has room for planning. Land value added tax is one of the important tax factors of high real estate price and there is a large space for planning. Therefore, it is normal for real estate development enterprises to plan land value added tax, but improper tax planning will bring tax inspection risks.

Generally speaking, the planning of land value-added tax mainly focuses on the maximization of deduction items. The items that taxpayers can deduct from their income include real estate development costs, real estate development expenses, the amount paid for obtaining the right to use land, taxes related to the transfer of real estate and other deduction items.<sup>1</sup> The traditional land value-added tax planning emphasizes on the maximization of development costs too much, which can lead to the decrease of appreciation value and the slow rise of tax rate. But after the replacing business tax with value added tax, the deduction items must be with the special invoice. But the early construction cost (including design, planning, geological survey, surveying and mapping, project feasibility research and hydrology, "seven connections and one leveling" ,etc.), public facilities fee (fine decoration, gardening, landscaping, roads, intelligence and other supporting projects), construction and installation fee make the affection of tax planning insufficient.<sup>2</sup> A lot of real estate company will try to increase the early construction cost, construction and installation fee in a reasonable scope to deduct the appreciation value. For public facilities fee, some people think that on the one hand is to set up the entity of the tax incentives to transfer profits, on the other hand is to find partners to cooperate to increase costs. There are still certain operating space, however, this paper believes that due to the impact of replacing the business tax with a value-added tax, this opinion should be reserved. It may be a scientific way to reduce the tax burden by making full use of preferential policies, setting reasonable sales price according to the break-even point of land value added tax.

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<sup>1</sup> Interim Regulations of the People's Republic of China on Land Value Added Tax

<sup>2</sup> Ying xiaolu. Tax law. Shanghai: Shanghai university of finance and economics press, 2018.266-267.

## 2. Make full use of the "starting point" preferential policies for planning

According to the <Interim Regulations of the People's Republic of China on Land Value Added Tax>, land value added tax shall be exempted for taxpayers who build ordinary standard residential buildings for sale and whose added value does not exceed 20% of the amount deducted.<sup>3</sup> This special starting point provides favorable conditions for the tax planning of land value-added tax. The residential buildings built must meet the local standard of ordinary residential buildings. According to the <Interim Regulations of Yunnan Province on Land Value Added Tax > (No. 22 order of the people's government of Yunnan province ) article 3 : " ordinary standard residential buildings that meet the provisions of article 11 of the implementation rules and meet the following conditions: (1) The plot ratio of residential buildings is more than 1.0; (2) A single residence with a floor area is less than 144 square meters; (3) The actual transaction price is less than 1.44 times of the average transaction price of residence on the same level of land."<sup>4</sup> At the same time, added value should not exceed 20% of the amount deducted, or else, tax rate will appear a sharp climb. Enterprises must focus on added value and deductions. Through the method of real estate development cost maximization, there is still some room for operation within a reasonable range, but affected by the replacement of business tax with value-added tax, it has certain risks to emphasize that the maximization of real estate development cost. So enterprises should choose exquisite sales pricing. Finally, it is important to note that taxpayers need to separately calculate the added value when they have other projects to develop at the same time. Otherwise, the general standard housing among them cannot get preferential tax treatment.

Assume one enterprise will sell common standard residence whose total deduction amount is 8400 yuan/m<sup>2</sup>. Two prices of schemes can be chosen: 10000 yuan/m<sup>2</sup> or 10500 yuan/m<sup>2</sup>. The first method, the rate of added value to deduction item is 19.04%[(10000-8400)/ 8400], which is under 20%, no land value added tax. The profit is 1600 yuan/m<sup>2</sup>. The second method, due to an increase of 500 yuan/m<sup>2</sup>, which leads to an increase of the related taxes and additional for [VAT × (7% + 3% + 2%)] yuan/m<sup>2</sup>. Assuming that the current land price and the input tax are fixed, and will not affect the land value-added tax, VAT = 500 × 10% = 50. The related taxes and additional increased for [50 × (7% + 3%, + 2%)] = 6 yuan/m<sup>2</sup>. The deduction of the project amount is 8406 yuan/m<sup>2</sup>. The rate of added value to deduction item rose to 24.91% [ (10500-8406)/8406]. Land value-added tax of 628.2[(10500-8406) × 30%] yuan/m<sup>2</sup> shall be paid, and the profit of the enterprise is 1465.8 (10500-8406-628.2) yuan/m<sup>2</sup>. It can be seen that the profit decreased by 134.2 yuan/yuan/m<sup>2</sup> after the price increased. Real estate companies often choose to raise their selling prices in pursuit of high returns, but the increased selling prices may lead to the increase of tax burden and ultimately lower their incomes. The original intention of tax planning has gone far beyond reducing the tax burden itself. How to find a balance between tax burden and income is a scientific land value-added tax planning.

## 3. Set reasonable sales price based on tax break-even point

Taxpayers can only set a lower sales price if they want to enjoy the exemption of land value-added tax. But lower prices yield lower returns. If they want to make bigger profits by raising prices, how much do they need to raise prices to cover the higher taxes due to the tax rates rise? In order to balance the tax burden and income, taxpayers can make "rational" sales price by calculating the tax break-even point. Assuming that the sales price is S, the amount of deduction items other than relevant taxes and surcharges is D, the total amount of deduction items is: D+VAT × (7%+3%+2%)=D+12% VAT. The value added must less than or equal to 20% of the deduction items in order to enjoy the preferential tax policy of tax exemption, that is, [S-(D+12% VAT)] /

<sup>3</sup> Interim Regulations of the People's Republic of China on Land Value Added Tax

<sup>4</sup> Interim Regulations of Yunnan Province on Land Value Added Tax (No. 22 order of the people's government of Yunnan province ) article 3

( $D+12\% \text{ VAT}$ ) is less than or equal to 20%. So that  $S$  is less than or equal to  $1.2 d-0.096 \text{ VAT}$ . At this point,  $\text{VAT}=S \times 10\% - \text{input tax}$ , sales volume  $=(\text{total price} - \text{the land price allowed to be deducted in the current period})$ . Assuming that the land price and input tax allowed to be deducted in the current period are certain, and will not affect the land value added tax,  $\text{VAT}=S \times 10\%$ , put into the above formula to get  $S \leq 1.2 D-0.096 \times S \times 10\% \text{ VAT}$ ,  $S \leq 1.189D$ . That is, when the sales amount of taxpayers does not exceed 1.189 times of the amount of deduction items except relevant taxes and additional, they can enjoy the preferential treatment of exemption from land value added tax, otherwise, the land value added tax of 30% will be levied. If the real estate companies are not willing to accept the ordinary income behind the tax exemption, they can try to raise the selling price to increase profits.

If a real estate enterprise intends to increase its income by raising the price, assuming that the selling price is increased to  $S+a(1.189D+a)$ , the corresponding tax and additional are increased by 12% VAT. When  $\text{VAT}=a \times 10\%$ , the corresponding tax and additional are increased by 1.2%  $a$ . Then the amount of deduction allowed is  $D+12\% \text{ VAT}+1.2\% a$ . When  $\text{VAT}=S \times 10\%$ , the amount of deduction allowed is  $D+1.2\% S+1.2\% a$ . Land value added tax payable  $=[(S+a)-(D+1.2\% S+1.2\% a)] \times 30\% = 5.24\% D+29.64\% a$ . If the real estate enterprise wants to increase the income by increasing the unit price, it is necessary to make  $a > (5.24\% D+29.64\% a)+1.2\% a$ ,  $a > 0.0758D$ . That means, the unit price must be 0.075 times of the amount of deduction items except relevant taxes and additional in order to obtain greater profits.

The same method can be used to calculate that when taxpayers accept different levels of tax rates, how many times the price increased would over the amount of deduction items except relevant taxes and additional. The increase of sales leads to the increase of value-added rate. The tax rate rises to a new level, which accelerates the tax burden growth of taxpayers. Taxpayers must think carefully about the relationship between the benefits brought by price increase and the costs of not being able to enjoy tax preferential policies, and pay close attention to the relationship between the benefits brought by price increase and tax burden increase caused by tax rate climbing. However, in the brutal market competition, high sales prices will lead to a decline in sales volume, and enterprises should carefully analyze the relationship between price changes and changes in supply and demand. Real estate enterprises can try to measure the ratio amount of value added to deduction of project. When the ratio will be more than a critical point, and the amount of value added could not increase more, they can give proper preferential policies such as lump-sum payment, old customers with special price to control prices crossing the line. This way not only controls the value-added rate, reduces the tax burden, but also improves the sales, speeds up the efficiency of capital turnover.

#### **4. Transfer the leased commercial residence from "development commodity" to "rental development commodity"**

Sometimes the residences built by real estate development enterprises are unsalable. At this time the taxpayer can lease the unsalable residence. Once the real estate development enterprises transfer the commercial residence to rent from "development commodity" to "rental development commodity", they can plan and withdraw depreciation and deduct it before tax, which makes the cost of commercial residence more objective. It also reduces the tax burden due to the reduction of tax base. Secondly, because taxpayers get rental income, they cannot avoid the payment of VAT and real estate tax. The amount of VAT and real estate tax payable depends on the size of tax base. The key to reducing the tax base is the need to separate the rental and other collection costs. When signing a contract, some real estate enterprises will include some collecting fees such as water and gas fees, property fees and cleaning fees into the rental. Finally they use a leasing price that includes other expenses as the tax base, which will inevitably lead to the increase of real estate tax and VAT tax burden. In order to reduce the tax base of payable tax, the taxpayer shall separate the above collection fees and rents and pay them independently by the tenant, or calculate them through other account receivable (payable). It has become a normal situation for real estate development enterprises to plan the land value added tax. However, improper tax planning will bring tax

inspection risks.

## **5. Risks faced by real estate enterprises in the planning of land value-added tax**

The legality of the application of preferential tax policies. Currently, there are six types of land value-added tax exemption and reduction. Tax authorities will carefully examine whether enterprises enjoying preferential policies meet the applicable requirements of policies. For example whether to achieve each area's "common residence" regulation, whether to achieve the standard the estate taken over lawfully because of national construction, whether computation separately to whom built average residence also engaged in other estate development.

The authenticity of the amount of deduction items. Tax authority can pay attention to the authenticity of land requisition and relocation compensation, construction and installation expenses, early stage project costs, infrastructure costs.<sup>5</sup> Whether stamp duty, real estate tax which should be included in administrative expenses, is wrongly included in the development of indirect costs. Whether all kinds of costs have legal evidence, whether the cost allocation is legal, whether the collection fees have been wrongly deducted, etc.

Accuracy of sales revenue calculation. No matter in the land value-added tax per-paid or clear stage, the tax authorities will check whether the real estate enterprises conceal the sales income. For example, whether the sales price is true, whether the total price and related economic benefits have been included, whether the price of the decoration contract is accurate, whether the price of the purchase and sale contract is reasonable, and whether the liquidation unit is legal, whether the collection fee is properly handled, etc.

There is certain tax planning space through maximizing the real estate development costs but it is too risky to emphasis the maximization in real estate development costs. Utilization of tax break-even point to decide reasonable selling price, making full use of the "starting point" preferential policies, transferring the leased commercial residence from "development commodity" to "rental development commodity" could be scientific method of reducing tax burden. At the same time, real estate development enterprises should pay enough attention to the risks brought by tax planning, correctly and scientifically understand the meaning of planning, and reduce the tax burden of enterprises through legal tax planning to achieve profit maximization.

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