

A Modelling Analysis to Assess the Impact of the New Merger and Acquisition Tax Reforms on Technology Enterprises

Yuefang GUO ^{1,2}

1. School of Management, Huazhong University of Science and Technology

Wuhan Hubei, China, 430074.

2. School of Business, Xinyang Normal University, Xinyang Henan, China, 464000.

Abstract — In this paper we model the processes of Merger, Acquisition (M&A) and reorganization related to technology enterprises income tax and personal income tax regulations. We perform modelling analysis of the special tax treatment of target enterprises for institutional and individual shareholders under different tax treatments. We: i) introduce a merger case to outline the institutional shareholders' work to ii) maximize their tax saving, iii) deal with repeated tax issues, iv) put forward the special treatment of tax exemption problems, and v) analyze the double tax treatment of individual shareholders. Finally we: i) analyze the conditions to maximize tax savings, ii) provide a new interpretation of the repetition of tax payment, iii) analyze the new tax policy to determine possible tax reduction measures, and iv) explore different methods to deal with individual shareholders.

Keywords - corporate restructuring; special tax treatment; maximize tax saving; duty-free dilemma

I. INTRODUCTION

In recent years, the Ministry of Finance and the State Administration of Taxations have formulated and implemented a series of significant tax reforms and issued many new tax regulations and tax supervision environment of enterprise merger and reorganization is gradually optimized and develops actively. Under the background of general excessive production capacity of substantial economy and overall dropping of economic growth speed, encouraging and creating policy environment beneficial to implementation of merger and reorganization by market entities is both favorable for enterprises to improve resource utilization efficiency and improve market competitiveness through resource integration and is beneficial to resolve excessive production capacity of substantial economy, optimize and adjust industry structure.

II. THE LATEST CHANGE OF MERGER TAX SYSTEM

A. The Latest Change for Corporate Income Tax for Merger

1. Corporate income tax system for enterprise merger established by CS [2009] No. 59 and No.4 announcement of the State Administration of Taxations in 2010

Since implementation of *Law of Corporate Income Tax* in 2008, the Ministry of Finance and the State Administration of Taxations have successively introduced *Notice on Several Problems for Handling Corporate Income Tax Regarding Enterprise Reorganization Business* (CS [2009] No. 59) and *Management Method for Corporate Income Tax Regarding Enterprise Reorganization Business* (No.4 announcement of the State Administration of Taxations in 2010). CS [2009]

No. 59 and No.4 announcement of the State Administration of Taxations in 2010 learn experience of commercial purpose, going-concern and continuation requirement of shareholders' interests in American tax laws and other experience related to tax policy and imposition and management modes for enterprise reorganization, preliminarily normalize and establish law system of corporate income tax applicable to enterprise merger and reorganization, most importantly, apply special tax treatment to merger and reorganization conforming to specific requirements.

2. CS [2014] No. 109 and CS [2014] No. 116 relax restriction on special tax treatment conditions applicable to enterprises

On January 8, 2015, *Notice on Promoting Related Treatment of Corporate Income Tax for Enterprise Reorganization by the Ministry of Finance and the State Administration of Taxations* (CS [2014] No. 109) and *Notice on Corporate Income Tax Policies of Investment Enterprises with Non-monetary Assets by the Ministry of Finance and the State Administration of Taxations* (CS [2014] No. 116) were issued on the official website of the State Administration of Taxations and they were dated back to be executed from January 1, 2014. CS [2014] No. 109 relaxes restriction on special tax treatment conditions applicable to enterprises: for equity acquisition, as long as equity purchased by the acquiring party is no less than 50% of all equities of purchased enterprise, it can prove that the reorganization behavior has economic essence and can special tax treatment can be selected to be applied; for asset acquisition, as long as assets acquired by the transferee are no less than 50% of all assets, it can prove that the reorganization behavior has economic essence and can special tax treatment can be selected to be applied. CS [2014] No. 109 and No. 116 policies further expand scope of enterprise reorganization

behavior governed by special tax treatment, saving tax payment capital for enterprises participating in merger, making more enterprises break through operation bottleneck through reorganization, realizing industry transformation and being significant good news for merger and reorganization transaction market undoubtedly.

B. *The Latest Change of Individual Income Tax for Merger*

1. Tax treatment provisions for earnings made by natural person shareholders through equity transfer during merger in tax laws

Many people have serious misunderstanding for tax treatment of natural person shareholder in merger and they think that equity payment part of natural person shareholder can be exempted from income tax. In fact, it is specified in exiting *Individual Income Tax Law of the People's Republic of China* and its *Implementation Rules* that individual income from transferring securities and equities belongs to income from transfer of property and taxable income shall be income from transfer of property minus original value of property and reasonable expense at a rational tax rate of 20%. It is specified in *Notice on Continuing Exempting Individual Income Tax for Individual Stock Transfer by the Ministry of Finance and the State Administration of Taxations* (CSZ [1998] No. 61) that only income from individual transfer of stocks of listed companies obtained from Shanghai Stock Exchange or Shenzhen Stock Exchange is temporarily exempted individual income tax.

2. Actual imposition of individual income tax for income from equity transfer by individual shareholder in merger and reorganization

Before 2011, individual income tax in merger and reorganization was treated as per *Reply to Temporarily Not Imposing Individual Income Tax for Appreciation of Non-Monetary Asset Appraisal by the State Administration of Taxations* (GSH [2005] No. 319). It is specified in GSH [2005] No. 319 document that, in consideration of characteristics of individual income tax and actual conditions of imposition and management of individual income tax at present, individuals' non-monetary assets firstly invested in enterprise after appraisal and then invested to obtain enterprise equity after being appraised to appreciate are temporarily exempted from individual income tax and individual income tax will be exempted as specified when there is income after taking back investment, transferring or clearing equity. On January 4, 2011, No. 319 document was withdrawn explicitly as specified in No. 522 item of Notice on Directory of Normative Documents for Announcing Invalidation and Withdrawal of Terms in the Part of Wholly Invalid and Withdrawn Text (No.2 announcement of the State Administration of Taxations in 2011). Henceforth, individual income tax shall be imposed on foreign investment with non-monetary assets.

3. Tax payment obligation of individual shareholder in equity transfer further normalized and defined in No. 67 announcement of the State Administration of Taxations in 2014

Imposition scope, transfer income, determination of original value of equity, tax payment time-point, rights and

obligations of both equity transfer parties and invested enterprise and other problems concerning taxpayers and basic-level tax authorities generally were further normalized and defined in *Management Method on Individual Income Tax for Income from Equity Transfer (Trial Implementation)* implemented since January 1, 2015 and related provisions are more scientific and comprehensive, enhancing policy certainty and operability, thus greatly reducing tax payment risk of taxpayers and law enforcement risk of tax authorities, providing more favorable tax environment for normalized operation and sound development of individual equity investment behavior in China.

4. Deferring condition of individual income tax in equity transfer defined in CS [2015] No. 41 and No. 20 announcement of the State Administration of Taxations in 2015

Substantial good news of individual income tax for merger and reorganization originates from *Notice on Corporate Income Tax Policies of Investment Enterprises with Non-monetary Assets* (CS [2015] No. 41) issued by the Ministry of Finance and the State Administration of Taxations on March 30, 2015. It is specified in the *Notice* that if individuals invest with non-monetary assets, realization of transfer income of non-monetary assets shall be recognized at the time of transferring non-monetary assets and obtaining equity of invested enterprise and tax declaration shall be made to competent tax authority within 15 days in the next month. If the taxpayer has difficulty in paying tax at one time, phased payment plan can be determined reasonably and reported to competent tax authority for filing and individual income tax shall be paid by installments from the date when above taxable behavior occurs no more than 5 calendar years (inclusive). It is also specified in the *Notice* that if individuals obtain cash premiums during investment transaction of non-monetary assets, the part in cash shall be firstly used to pay tax; the part insufficient to be paid in cash shall be paid by installments. As for above part of or all equities held by individuals through transfer during phased tax payment, cash income obtained shall be firstly used to pay not completely paid tax. Imposition and management of individual income tax in individual non-monetary asset investment was defined in Announcement on Imposition and Management of Individual Income Tax in Individual Non-Monetary Asset Investment (No. 20 announcement of the State Administration of Taxations in 2015) issued by the State Administration of Taxations on April 8, 2015.

III. ANALYSIS OF SPECIAL TAX TREATMENT FOR MERGER AND REORGANIZATION

A. *Special Tax Treatment Principles and Mathematical Analysis for Merger and Reorganization*

Special tax treatment for merger and reorganization is not permanent tax exemption, but tax payment deferring specially permitted by tax laws. It is reflection of tax neutrality principles, namely, tax shall not hinder implementation of normal reorganization business of

enterprise. Generally, enterprises only have few or even have no cash income under the circumstance of special reorganization. If merger and reorganization participants are forced to pay tax as per general organization, it will obviously bring capital difficulty for related enterprises, thus preventing reorganization business to be carried out by enterprises from the perspective of commercial demand and finally causing economic efficiency loss in the whole society.

With equity merger as an example, book value of target enterprise is assumed to be $V_1(V_1 > 0)$ and fair value is assumed to be $V_2(V_2 > V_1)$, with share ratio of target enterprise participating in merger split-off to be $\alpha(0 < \alpha < 1)$, ratio of legal person shareholder accounting for $\beta(0 < \beta < 1)$ and natural person shareholder accounting for $1 - \beta$ among split-off shareholders. Ratio of cash payment in acquisition payment methods is $\gamma(0 < \gamma < 1)$, with ratio of cash given to legal person shareholder as $\lambda(0 < \lambda < 1)$ and ratio of cash given to natural person shareholder as $1 - \lambda$; ratio of share payment in acquisition payment methods is $1 - \gamma$, with ratio of share given to legal person shareholder as $\mu(0 < \mu < 1)$ and ratio of share given to natural person shareholder as $1 - \mu$. In addition, it is assumed that ratio of shares of acquired enterprise held by split-off shareholders of target enterprise after split-off is $\rho(0 < \rho < 1)$ and decrease ratio of original shareholder's shares in the acquired enterprise is $1 - \rho$. Specific payment process is shown in Fig. 1.

Under special tax treatment, shareholders transferring equities in target enterprise only pay corporate income tax for the cash compensation part and the part of equity payment is exempted from tax. It has been assumed that the ratio of total cash payment part obtained by legal person shareholder is λ . Its payable corporate income tax is $t\alpha\gamma(V_2 - V_1)$. The ratio of cash payment obtained by natural person shareholder in total cash payment is $1 - \lambda$ and payable individual income tax is $20\%(V_2 - V_1)\alpha\gamma(1 - \lambda)$.

It can be seen that corporate income tax is paid less in special tax treatment of legal person shareholder than general tax treatment and the under-payment amount is $t(V_2 - V_1)\alpha(\beta - \lambda\gamma)$. Legal person shareholder transferring equities in target enterprise obtains tax saving earnings and the source of tax saving is income tax exempted in equity payment part.

It is known that the ratio of cash compensation of legal person shareholder in target enterprise in overall cash payment is λ and the ratio of equity consideration in overall equity payment is μ . As for general tax treatment, taxable income of legal person shareholder in target enterprise participating in merger can be expressed as the sum of cash compensation and share compensation:

$$(V_2 - V_1)\alpha\beta = (V_2 - V_1)\alpha \cdot \gamma \cdot \lambda + (V_2 - V_1)\alpha \cdot (1 - \gamma)\mu \quad (1)$$

Taxable income of legal person shareholder under special tax treatment is $(V_2 - V_1)\lambda\alpha\gamma$. Let $(1) \times t - (V_2 - V_1)\lambda\alpha\gamma \times t$, the saved tax

$$t(V_2 - V_1)\alpha\beta - t(V_2 - V_1)\lambda\alpha\gamma = t(V_2 - V_1)\alpha \cdot (1 - \gamma)\mu$$

Rearrange above formula to obtain

$$t(V_2 - V_1)\alpha(\beta - \lambda\gamma) = t(V_2 - V_1)\alpha \cdot (1 - \gamma)\mu \quad (2)$$

Right equation of Formula (2) represents corporate income tax caused by appreciation amount corresponding to legal person shareholders in the part of equity payment in total payment and this part of income tax will be supplemented only when this part of tax in tax-exempted acquisition is deferred to sell stocks of main merger enterprise in the future. Theoretically, if legal person shareholders of target enterprise holds stocks of main merger enterprise for a long term, this part of income tax will be deferred forever.

B. Case Analysis

For example, with acquisition of 87.86% of shares in Shanghai Tongjie Co., Ltd. held by 36 natural person shareholders including Lei Yucheng and 21 enterprises including Zhongke Yuandong through equity plus cash mode by Sichuan Chengfei Integration Technology Corp. Ltd. issuing announcement on January 12, 2013 as an example, corresponding data are shown in Table 1 and calculation process is shown in Table 2. It can be seen from Table 2 that through special tax treatment, legal person shareholders of Shanghai Tongjie participating in split-off save 23.7045 million yuan of corporate income tax in total.

TABLE 1. DATA INDICES FOR MERGER OF SHANGHAI TONGJIE BY CHENGFEI INTEGRATION

Index Significance	Expressions	Data
Ratio of equity transfer in target enterprise	α	87.86%
Ratio of legal person shareholder for equity transfer in target enterprise	β	68.83%
Ratio of natural person shareholder for equity transfer in target enterprise	$1 - \beta$	31.17%
Book value of target enterprise	V_1	45500 万
Fair value of target enterprise	V_2	62000 万
Cash ratio in acquisition payment method	γ	7.97%
Share ratio in acquisition payment method	$1 - \gamma$	92.03%
Ratio of cash given to legal person shareholder in cash payment	λ	42.95%
Ratio of cash given to natural person shareholder in cash payment	$1 - \lambda$	57.05%
Ratio of share given to legal person shareholder in share payment	μ	71.07%
Ratio of share given to natural person shareholder in share payment	$1 - \mu$	28.93%
Ratio of shares of acquired enterprise held by split-off shareholders of target enterprise after split-off	ρ	10.35%
Decrease ratio of original shareholder's shares in the main acquired enterprise after acquisition	$1 - \rho$	89.65%
Corporate income tax rate of legal person shareholder in target enterprise	t	25%
Corporate income tax rate of main merger enterprise	t'	15%

Notes: data source: Nan Xingheng, Yang Jing, Qu Peiyang, Impact of Different Tax Treatment on Shareholders of Both Merger Parties-with Acquisition of Tongjie Innova Engineering & Technology by Chengfei Integration as an Example.

IV. DISCUSSION ABOUT SEVERAL PROBLEMS FOR SPECIAL TAX TREATMENT OF MERGER AND REORGANIZATION

A. Maximization of Tax Saving

It can be known from abovementioned analysis that tax saving realized by legal person shareholder of target enterprise through special tax treatment is $t(V_2 - V_1)\alpha(\beta - \lambda\gamma)$. Generally t (corporate income tax rate applicable to legal person shareholder of target enterprise), V_2 (fair value of

target enterprise), V_1 (book value of target enterprise. It is assumed that shareholders of target enterprise take book value as initial investment cost) have been fixed value at the time of merger negotiation. Then values of α (ratio of equity transferred in target enterprise), β (ratio of legal person shareholder transferring equity in target enterprise), γ (cash ratio in acquisition payment method), λ (ratio of cash given to legal person shareholder in cash payment) can be selected through negotiation next to maximize tax saving $t(V_2 - V_1)\alpha(\beta - \lambda\gamma)$.

TABLE 2. CHANGE OF SHAREHOLDERS' TAX IN TARGET ENTERPRISE UNDER SPECIAL TAX TREATMENT

Merger Type Merger Participants			Income tax payable for taxable acquisition (general tax treatment) taxable income (unit: ten thousand yuan)	Income tax payable for tax-exempted acquisition (special tax treatment)			
				Taxable income		Tax deferring	
				Absolute value (2) (unit: ten thousand yuan)	Absolute value (2)/(1)	Absolute value(3) (unit: ten thousand yuan)	(3)/(1) Absolute value(3)/(1)
Legal person shareholder of target enterprise	Cash payment	Expression	$t(V_2 - V_1)\alpha\lambda\gamma$	$t(V_2 - V_1)\alpha\lambda\gamma$	$\lambda\gamma/\beta$	0	
		Case value	$(62000 - 45500) \times 87.86\% \times 7.97\% \times 42.95\% \times 25\% = 124.06$	124.06	4.97%	0	
	Equity payment	Expression	$t(V_2 - V_1)\alpha(1 - \gamma)\mu$	0		$t(V_2 - V_1)\alpha(\beta - \lambda\gamma)$	$1 - \lambda\gamma/\beta$
		Case value	$(62000 - 45500) \times 87.86\% \times 92.03\% \times 71.07\% \times 25\% = 2370.45$	0		$2494.51 - 124.06 = 2370.45$	95.03%
	Subtotal (1)	Expression	$t(V_2 - V_1)\alpha\beta$	$t(V_2 - V_1)\alpha\lambda\gamma$	$\lambda\gamma/\beta$	$t(V_2 - V_1)\alpha(\beta - \lambda\gamma)$	$1 - \lambda\gamma/\beta$
		Case value	$(62000 - 45500) \times 87.86\% \times 68.83\% \times 25\% = 9978.22 \times 25\% = 2494.51$	124.06	4.97%	2370.45	95.03%
Natural person shareholder of target enterprise	Cash payment	Expression	$(V_2 - V_1)\alpha\gamma(1 - \lambda)20\%$	$(V_2 - V_1)\alpha\gamma(1 - \lambda)20\%$	—	0	—
		Case value	$(62000 - 45500) \times 87.86\% \times 7.97\% \times 57.05\% \times 20\% = 131.83$	131.83	—	0	—
	Equity payment	Expression	$t(V_2 - V_1)\alpha(1 - \gamma)(1 - \mu)$	$t(V_2 - V_1)\alpha(1 - \gamma)(1 - \mu)$	—	0	—
		Case value	$(62000 - 45500) \times 87.86\% \times 92.03\% \times 28.93\% \times 20\% = 771.94$	771.94	—	0	—
	Subtotal	Expression	$(V_2 - V_1)\alpha(1 - \beta)20\%$	$(V_2 - V_1)\alpha(1 - \beta)20\%$	—	0	—
		Case value	$(62000 - 45500) \times 87.86\% \times 31.17\% \times 20\% = 903.77^1$	903.77	—	0	—
Total	Expression	$(V_2 - V_1)\alpha[\beta t + (1 - \beta)20\%]$	$(V_2 - V_1)\alpha[\lambda\gamma t + (1 - \beta)20\%]$	—	$t(V_2 - V_1)\alpha(\beta - \lambda\gamma)$	—	
	Case value	$2494.51 + 903.77 = 3398.28$	$124.06 + 903.77 = 1027.83$	—	2370.45	—	

For legal person shareholder of target enterprise, special tax treatment can reduce current tax payment amount $t(V_2 - V_1)\alpha(\beta - \lambda\gamma)$, with saving ratio of income tax being $1 - \lambda\gamma/\beta$. Specifically, with other conditions unchanged, the larger ratio α of equity participating in merger is, the more income tax saved will be; the larger ratio β of legal person shareholder participating in merger is, the more income tax saved will be; the larger ratio γ of cash payment in acquisition payment is, the less income tax saved will be; the larger ratio λ of cash paid to legal person shareholder in cash payment is, the less income tax saved will be. Saving ratio of income tax is in direct proportion to ratio β of legal person shareholder transferring equities in target enterprise and inversely proportional to ratio γ of cash payment in acquisition payment, inversely proportional to ratio λ of cash

paid to legal person shareholder in cash payment. When ratio of cash payment in acquisition payment method takes minimum value $\gamma=0$, saving ratio of income tax is maximum, realizing 100% of income tax saving. Ratio of cash payment in the cash is 7.97% and it is relatively small, thus obtaining tax saving up to 95.03%.

B. Repeated Tax Payment

Although legal person shareholders of target enterprise can pay less or pay no income tax under special tax treatment, it lays foundation for repeated tax payment of both merger parties in the future. As both merger parties record as per original book value V_1 of transaction equity, income tax payable when legal person shareholders of target enterprise transfer and merger enterprise equities in the future is:

¹ There is error in calculation for the last position of decimal point and adjustment has been made.

(transfer price of share held in merger enterprise - V_1) $\times t =$ (transfer price - V_2) $\times t + (V_2 - V_1) \times t$. However, when merger enterprise transfers equities of target enterprise in the future, income tax payable is: (transfer price of equities corresponding to target enterprise - V_1) $\times t =$ (transfer price of equities corresponding to target enterprise - V_2) $\times t + (V_2 - V_1) \times t$. Namely, when both merger parties transfer shares held from merger in the future, they will additionally corporate income tax for appreciation part ($V_2 - V_1$) of equities of target enterprise at the time of merger and repeated tax payment arises therefrom under special tax treatment. Unless future transfer price of both merger parties is small than or equal to V_2 , repeated tax payment cannot be avoided. However, at this time, it means investment failure for both merger parties.

C. Tax Exemption Dilemma

As it is unavoidable for natural person shareholders of target enterprise to pay individual income tax at the time of merger, we have reason to believe that, in a perfect special tax treatment case for merger, natural person shareholders shall be made to have sufficient cash to pay individual income tax. Once natural person shareholders do not have sufficient cash to pay tax, failure case that Bewinner Communications mergers Hangzhou Zhangmeng may occur. It is tax exemption dilemma defined by us. Specifically, tax exemption dilemma is that special tax treatment for merger and ability of natural person shareholders to have sufficient cash to pay cannot occur at the same time. Either that conditions of special tax treatment are achieved but it is unable to disburse natural person shareholders sufficient cash to pay individual income tax or ratio of cash payment is increased to satisfy tax payment demand of natural person shareholders but not satisfy ratio of cash payment of special tax treatment occurs.

To express with mathematical language, cash payment obtained by natural person shareholders is $(V_2 - V_1) \alpha \gamma (1 - \lambda)$ and individual income tax to be paid by natural person shareholders is $(V_2 - V_1) \alpha (1 - \beta) 20\%$. Then conditions of perfect special tax payment can be obtained:

$$\begin{cases} 50\% < \alpha \leq 1 \\ \gamma < 15\% \\ (V_2 - V_1) \alpha \gamma (1 - \lambda) \geq (V_2 - V_1) \alpha (1 - \beta) 20\% \end{cases} \quad (3)$$

Formula (3) can be written as $\gamma (1 - \lambda) \geq (1 - \beta) 20$ to obtain

$$\gamma \geq \frac{1 - \beta}{5(1 - \lambda)}$$

As minimum value of λ (ratio of cash payment obtained by legal person shareholders) is 0. After substituting into above formula, value scope of ratio of cash payment in payment consideration can be written as

$$\frac{1 - \beta}{5} \leq \gamma < 15\%$$

Obviously, precondition for establishment of the in equation is $\frac{1 - \beta}{5} < 15\%$. We can solve the inequation to obtain $1 - \beta < 75\%$ or $\beta > 25\%$.

The solution means that if ratio β of legal person shareholder participating in merger is less than 25% or ratio of natural person shareholder ($1 - \beta$) is larger than 75%, even all cashes are paid to natural person shareholders, perfect special tax treatment will still be unable to be realized, then tax exemption dilemma occurs. For example, when $\beta = 20\%$, $1 - \beta = 80\%$. We can calculate from Formula (3) that $\gamma > 16\%$. At this time, the requirement that ratio of cash payment under special tax treatment is less than 15% cannot be satisfied and tax exemption dilemma occurs.

D. Tax Difference Treatment of Natural Person Shareholder

Seen from policy-making intention, special tax treatment is intended to make parties participating in reorganization reduce capital pressure and decrease merger cost through deferring paying income tax. However, discounts of special tax treatment for merger are only tax savings obtained by legal person shareholders of target enterprise and corporate income tax is paid only for cash compensation part; individual shareholders for split-off of target enterprise still pay individual income tax for cash compensation and equity payment part. For natural person shareholder of target enterprise, tax difference has no change under two tax treatment conditions and individual income tax is levied as per income from transfer of property without exceptions. Therefore, for shareholders of target enterprise, two different tax treatment methods occur at the same time.

Regardless of taxable acquisition or tax-free acquisition, payable individual income tax of natural person shareholders of target enterprise is $(V_2 - V_1) \alpha (1 - \beta) 20\%$. In the case that Chengfei Integration acquired Tongjie Innova Engineering & Technology, payable individual income tax of natural person shareholders of Tongjie Innova Engineering & Technology is totally $(62000 - 45500) \times 87.86\% \times 31.17\% \times 20\% = 9,037,400$ yuan. Total cash payment is obtained cash payment $V_2 (1 - \lambda) \alpha (1 - \gamma) = 62000 \times 87.86\% \times 7.97\% \times 57.05\% = 24,760,000$ yuan, satisfying demand to pay individual income tax.

V. HIGHLIGHTS OF PROBLEMS IN SPECIAL TAX TREATMENT IN MERGER AND REORGANIZATION

A. Maximum Conditions of Tax Saving: Cash Payment Accepted by legal Person Shareholders if 0

According to related regulations of merger tax, conditions of special tax treatment can be satisfied when $50\% < \alpha \leq 1$ and $\gamma < 15\%$. It can be known from above analysis that tax saving realized by legal person shareholders of target enterprise is brought by equity payment part and cash payment part cannot be exempted from tax. Therefore, to maximize tax saving, $\lambda \gamma = 0$. When shareholders of target

enterprise participating in merger are all legal person shareholders ($\beta=1$), theoretically there is such possibility that to pursue maximization of tax saving, cash payment ($\gamma=0$) is avoided; when there are natural person shareholders among shareholders of target enterprise participating in merger ($0<\beta<1$), in consideration of natural person shareholder without tax exemption treatment, ratio of cash payment $\gamma\neq 0$ at this time. Then legal person shareholders shall not accept cash payment but pay all cashes to natural person shareholders ($\lambda=0$). Namely, ratio of income tax saved under special tax treatment for merger of target enterprise is $1-\lambda\gamma/\beta$. Tax saving degree is irrelevant to equity ratio α participating in merger. Regardless of change of ratio β of legal person shareholders among shareholders participating in merger and ratio γ of cash payment, tax saving amplitude is maximum when ratio of cash payment obtained by legal person shareholders $\lambda=0$. Namely, saving ratio is 100%.

B. Repeated Tax Payment under Special Tax Treatment for Merger: Encourage Long-term Investment

Since it is impossible to solve repeated tax payment under existing framework of merger tax system, we might as well deem repeated tax payment as a protection system for long-term equity investment, for if the enterprise holds acquisition equity for a long term after acquisition, the longer time it is held, the smaller present value of payable income tax in the future will be. Then deferred tax bearing can be diluted to reach the policy purpose of encouraging long-term investment and punishing short-term speculation. Therefore, special tax treatment for merger and reorganization provides more active policy supporting in the process of supporting industry structure upgrading and improving core competitiveness of enterprise and plays an important role in promoting enterprises to enhance resource integration, realize rapid development, improve competitiveness, defuse contradiction of seriously excessive production capacity, adjust and optimize industry structure and improving benefit of development quality.

C. Ratio α of Transferred Equities (or Assets) Reducing to 50%: Reflection of Tax Neutrality Principle

Ratio α reducing to 50% from 75% is not only reduction of threshold of tax exemption treatment, but also reflection of tax neutrality principle. According to company governance theory, when shareholding ratio exceeds 50%, controlling shareholders have owned absolute controlling right for the Company. However, before introduction of CS [2014] No. 109 document, merger enterprises shall additionally hold at least 25% of equities of target enterprise to enjoy tax exemption treatment to cater to 75% as specified in tax laws, which undoubtedly increases acquisition cost including negotiation, appraisal and others and increasing and increases pressure for the company to raise merger funds. At the same time, reduction of ratio α will decrease ratio of natural person shareholders of target enterprise

participating in merger. Correspondingly, cash required by natural person shareholders to pay individual income tax owing to appreciation of non-monetary assets is decreased and pressure for the merger company to raise merger funds will be reduced, thus reflecting requirements of tax neutrality principle.

D. Answer to Tax Exemption Dilemma has been Provided in New Regulation and Tax Difference Treatment of Natural Person Shareholder has been Solved Thoroughly

As for the dilemma that special tax treatment of legal person shareholder of target enterprise and cash payment by natural person shareholder no less than payable individual income tax cannot be satisfied at the same time, answer is provided No.20 announcement of the State Administration of Taxations in 2015. Namely, individual income tax insufficient to be paid with cash in the current period can be deferred within 5 years. Then the dilemma that insufficient initial estimation of individual income tax causes merger failure in the merger practice for the reason of system is solved. It reflects enormous progress of tax neutrality principle in laws on individual income tax in merger tax system. However, the initiative has not fundamentally solved differential tax treatment of natural person shareholder.

Although tax can be deferred within 5 years, tax payment obligations within 5 years are statutory. Cash used to pay individual income tax comes from two sources, namely, additionally raising funds or selling stocks exchanged from merger. Additionally raising funds means adding investment. Selling stocks means taking back investment. The two methods are to change investment cost. Treatment of legal person shareholders in merger enterprise is that as long as they continue holding stocks exchanged from merger, they will not assume tax payment obligations and investment cost will not be changed at all. Tax deferring can be termless. Therefore, there is an enormous difference between tax treatment of natural person shareholders and legal person shareholders in target enterprise.

VI. CONCLUSIONS

To support technological innovation and adjustment of industry structure more energetically, attempt should be made to allow individual shareholders to target enterprises in the merger and reorganization event of encouraging industry to be exempted from tax temporarily. Individual income tax can be supplemented at the time of equity transfer in the future, thus changing current status of differential tax treatment of the same equity with different rights in merger and reorganization practice. This attempt will be a beneficial exploration of current status of policy separation of corporate income tax and individual income tax at present.

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