

# Consideration of the Application and Risk Prevention of VAT Tax Rebate Policy for Construction Enterprises at the End of the Period

Liangliang Wu\*

China Construction Municipal Engineering Co., LTD., Beijing 102627, China

\*Corresponding author: Liangliang Wu, banjin521@126.com

**Copyright:** © 2024 Author(s). This is an open-access article distributed under the terms of the Creative Commons Attribution License (CC BY 4.0), permitting distribution and reproduction in any medium, provided the original work is cited.

**Abstract:** The “Announcement on Deepening the Value-Added Tax Reform” clearly outlines the preferential policy regarding incremental retention tax rebates. With the advancement of value-added tax (VAT) reform and the improvement of VAT legislation in China, VAT tax planning for construction enterprises, particularly related to retained tax credits, has become routine. This paper, focusing on the characteristics of construction enterprises, analyzes VAT retained tax credits at the end of the period, the status of tax refunds, practical issues, and related processes, and offers suggestions for policy application and risk prevention.

**Keywords:** Construction enterprises; VAT retained tax credit refunds; Planning; Risk prevention

**Online publication:** October 24, 2024

## 1. Introduction

In March 2019, the Ministry of Finance, the State Administration of Taxation, and the General Administration of Customs jointly issued the “Announcement on Policies Related to Deepening Value-Added Tax Reform,” which stipulated that beginning April 1, 2019, a system for tax refunds on retained value-added tax (VAT) at the end of the period would be implemented on a trial basis. To assist taxpayers in handling tax rebates, the Ministry of Finance and the State Administration of Taxation issued several subsequent announcements to clarify the policy’s implementation requirements<sup>[1,2]</sup>.

Construction enterprises play a crucial role in the VAT chain. These businesses not only manage and integrate input bills from upstream subcontracting and supply but also provide engineering services and compliant invoices to downstream enterprises and departments, such as real estate and government. This broadens their involvement across production and other industries. Generally, construction enterprises face VAT input tax retention<sup>[3,4]</sup>. However, the process of obtaining a tax refund requires meeting multiple conditions, and

enterprises face significant tax risks in the refund process <sup>[5]</sup>. Thus, how to obtain legal, compliant tax refunds, improve cash flow, achieve direct tax benefits, and prevent inspection risks warrants further research and analysis <sup>[6]</sup>.

## **2. Policy analysis**

### **2.1. Current situation of VAT retained tax credit refunds for construction enterprises**

According to Article 4 of the “Provisional Regulations of the People’s Republic of China on Value-Added Tax,” VAT retained for deduction in the next period is known as a “retained VAT credit.” This refers to the VAT amount that cannot be deducted due to a mismatch between VAT input and sales, which may result from untimely sales, significant purchases of fixed assets or real estate, and other operational factors. In subsequent periods, this retained credit can be deducted against VAT output <sup>[7]</sup>.

Tax Bulletin 2019 No. 39 clearly defines the conditions for obtaining VAT tax refunds on retained credits. Aside from fulfilling practical requirements, the tax authorities may suspend tax refunds if they identify any VAT-related risks associated with the taxpayer during the refund process <sup>[8]</sup>.

For construction enterprises, the conditions for obtaining a tax rebate are particularly stringent. First, these enterprises are positioned in the middle of the industry chain, often issuing invoices to the project owner before receiving invoices from subcontracting units, typically after receiving project payments <sup>[9]</sup>. Additionally, the volatility of the market, uneven project schedules, seasonal construction periods, and tax-related issues make it challenging for enterprises to meet the requirement of having “six consecutive months of incremental retained tax credits that are positive, and a minimum retained credit of 500,000 Chinese yuan (CNY) in the sixth month.” Only large-scale enterprises with a sufficiently deep input tax pool can meet these conditions and withstand a six-month waiting period. Furthermore, the complexity of downstream operations in construction enterprises often leads to increased tax risks. Managing input invoices can be challenging, and downstream “evasion” events can affect the ability to deduct input tax.

### **2.2. Analysis of the practice of VAT tax rebate retained at the end of the period**

According to the policy, the actual allowable amount of incremental retained tax credit eligible for a refund is calculated by the following formula: the incremental retained tax credit multiplied by the proportion of input, then multiplied by 60%. The incremental retained tax credit refers to the newly increased retained tax credit compared to the end of March 2019. The proportion of input refers to the proportion of VAT deducted from special VAT invoices, customs import VAT payment letters, and VAT payment certificates in the total input tax deducted during the same period, from April 2019 to the tax refund application period. Attention should be given to the following aspects:

- (1) Formation of incremental tax credits: The incremental retained tax credit is the difference between the retained tax credit at a future point and the initial retained tax credit. There are three key factors for the incremental retained tax credit: first, the initial value must be sufficiently small, i.e., the minimum retained tax credit recorded in line 20 of the main VAT return form from March 2019; second, the process must show continuous growth, with VAT retention at the end of each month exceeding the VAT retention in March 2019 for six consecutive months; third, the retained tax credit at the end of the month must be greater than the VAT retention in March 2019 by at least 500,000 CNY for

six consecutive months. When these three conditions are met, the tax rebate may be applicable. To maximize the tax credits, it is ideal to reduce the initial phase value as much as possible (preferably to zero), alleviating process pressure and maximizing incremental tax benefits.

- (2) Requirements on the proportion of input: The deductible amount of VAT retained at the end of the period corresponds to the portion of VAT that the taxpayer has actually paid. If the taxpayer has not made actual payments, incremental refunds are not possible. Generally, the input tax of taxpayers includes eight items. Specifically, the input tax for four items, including air transport electronic ticket itineraries, railway tickets, and road and waterway passenger tickets with passenger identity information, is calculated using specific methods, rather than reflecting the VAT actually paid by the taxpayer. These four items are recognized by the tax authorities to reduce the tax burden on taxpayers and help business development, but they do not qualify for a tax rebate since the taxpayer did not actually pay the VAT on these items.
- (3) Tax refund cycle and application: According to policy requirements, the tax rebate cycle is six consecutive months. However, in practice, two key points need attention: first, the tax rebate cycle is ongoing, meaning that as long as the enterprise continues to meet the conditions, it can apply for a tax rebate every six months, enabling the possibility of multiple tax rebates. Second, the tax refund application is limited to the tax amount within the most recent six months and the incremental tax credit for each refund is compared with the retained tax credit amount recorded in line 20 of the main VAT return form for March 2019. In practice, the amount of the tax refund should be verified with the tax refund window at the tax service center to ensure accuracy.
- (4) Time and process for tax refund of VAT credits retained at the end of the period” As per the provisions of Announcement No. 20 of the State Administration of Taxation in 2019, taxpayers applying for a refund of retained tax credits should submit their application via the electronic tax bureau or visit the tax service center after completing their current period’s tax declaration in the month following their eligibility for a refund. The tax authorities must complete the review within 10 working days from the date of accepting the application and issue a Notice of Tax Matters to the taxpayer, approving the tax rebate. To maximize the window period, it is essential to complete the VAT declaration early in the application month. If missed, the taxpayer must maintain the incremental retention for another month, with the amount not falling below 500,000 CNY, to ensure smooth business operations and the successful processing of the tax refund.

### **3. Policy application planning**

In tax planning, construction enterprises should analyze the input tax and output tax of projects on a monthly basis, consider overall project cash flow, and plan for projects where input and output timings do not align, in order to reduce the overall tax burden.

#### **3.1. Periodic management planning**

According to the provisions of Document No. 36 of Finance and Taxation (2016), construction enterprises generally need to prepay taxes to the competent national tax authorities in the location where construction services are provided, and cross-district pre-payment is common. When calculating the tax payable, enterprises

must first deduct the input tax for the current period and the retained tax credit from the previous period, followed by the pre-paid VAT across regions. Therefore, the tax refund cycle becomes a crucial factor in enterprise tax planning. However, companies can optimize their tax management by carefully planning the timing and logic of their refunds. Specifically, after the end of a tax refund cycle, enterprises can choose either partial certification or deferred certification for input tax in the following month, depending on their pre-paid retained tax credits. This allows the enterprise to absorb pre-paid credits before initiating a new tax refund cycle, thus improving tax efficiency.

From the perspective of the VAT withholding tax refund policy at the end of the period, the tax refund cycle typically aligns with the operational cycle, and the optimal strategy is to maintain stability in the incremental withholding tax credit during the process and maximize it at the end of the period. The construction industry exhibits strong seasonal characteristics. Before the Spring Festival, tax liabilities tend to peak, while after the festival, tax liabilities decline due to lower temperatures and delays in personnel returning to work. If input tax is insufficient during this period, there is a risk of a decline in incremental retained tax credit, making it advisable to avoid starting the tax refund cycle around the Spring Festival.

The VAT rebate cycle often follows a “6+X” model, where “6” represents the six continuous months of incremental retention, and “X” represents the period of absorbing pre-payments before restarting the rebate cycle. This rest period can last for one month or more, depending on the actual situation. Enterprises should align their internal tax rebate cycles with fiscal and tax management assessment systems. During the consecutive “6” months, input tax certification should be prioritized, while “X” months should focus on issuing sales invoices to stimulate activity in grassroots project departments, thereby maximizing the balance between input and sales efforts<sup>[10]</sup>.

### **3.2. Planning of construction projects at all stages**

- (1) Project bidding stage: Analyze different tax models based on whether the owners have input tax deduction needs. For government and public institutions, which do not have input tax deduction needs, their focus is more on cash flow outflows. They are more inclined to choose the simple tax calculation mode to achieve a win-win situation through communication with the owners. On the other hand, social enterprises with input tax deduction needs tend to prefer the general tax calculation mode, leaving little room for tax planning in practice.
- (2) Contract negotiation stage: If it is determined that the simple tax mode is more favorable, it is necessary to increase the provision of materials in the contract and specify the variety, model, and technical specifications of materials to meet the requirements of tax authorities' laws and regulations. If the project location and the organization's location differ, the tax authority in the project's location is likely to prefer the simple tax calculation mode to achieve a win-win between the tax authority's tax source index and the enterprise's tax-saving index.
- (3) Project bidding stage: When dealing with the downstream parties, construction enterprises should classify and select high-quality suppliers based on their nature. A blacklist of enterprises with serious tax-related issues, such as “false and absconding” activities, should be established, and the practice of entrusting non-actual supply units to issue invoices on behalf of the company should be eliminated. Financial and commercial departments should work closely in contract signing, reasonably estimating the total contract price of subcontracting and sub-supplying for the entire project period. They should



assess the proportion of subcontracting and sub-supplying contracts based on the total contract value, pre-paid VAT across regions, and VAT remitted by the project, ensuring that input tax invoices are collected in a timely and sufficient manner.

- (4) Project construction phase: Due to the mismatch between the timing of input and sales invoices, construction projects often pay more VAT than necessary. The project should promptly obtain subcontracted invoices to avoid delayed settlements, which could lead to a failure to offset the subcontracted invoice in time, resulting in overpayment of VAT in advance. Especially for projects under simple tax calculation, it is essential to obtain pre-payment and final payment invoices promptly to avoid retaining a large number of invoices after project completion. This will reduce tax deduction waste and lower the project's tax burden.

### **3.3. Management planning of special matters**

- (1) Advance accounts management: The timing of the tax payment obligation for construction services is no longer on the day of receiving an advance payment but follows the provisions of Article 45 of the Implementation Measures of Finance and Taxation (2016) No. 36. If these conditions are met, the project department may choose to pay the tax in advance at a rate of 2% to the local tax authority of the project. Subsequently, the output tax will be declared when the actual tax liability arises. This practice can significantly reduce the risk of a decline in VAT retention due to insufficient input tax during the early stages of the project.
- (2) Quality guarantee management: According to the provisions of the State Administration of Taxation No. 69 (2016), after the project's final settlement is completed, the full invoice should not be issued based on the settlement amount. Instead, the invoice should be issued when the quality guarantee money is actually received, corresponding to the time when the tax obligation arises.
- (3) Accounting system: The debit balance of the account item "Tax Payable - Value-added Tax - Input Tax to be Certified" represents the input tax that the company has obtained but has not yet been certified. To manage this effectively, the special VAT invoice received should be accounted for promptly, creating a clear, visible "reservoir" mechanism for managing the balance of input tax to be certified. During the tax refund cycle, enterprises can reasonably adjust the balance of the account "Tax Payable - VAT - Input Tax to be Certified," thereby enabling flexible control of this "reservoir" in terms of receiving and releasing input tax.

## **4. Tax risk prevention**

While optimizing tax rebate processing services, tax authorities are also intensifying their crackdown on violations, strictly preventing tax rebate risks, and severely punishing tax fraud. Construction enterprises should assess their own situation before and after applying for tax rebates, ensuring proper self-examination, self-correction, and risk prevention <sup>[11]</sup>.

Close attention should be paid to whether they meet the basic conditions for tax rebates. In terms of industry classification, the industry is determined by the main economic activities; regarding classification standards, special care should be taken to note differences in tax policy provisions when applying for tax rebates, ensuring accurate understanding and application of relevant policies. Furthermore, tax credit ratings

are an important factor, with a tax credit rating of Grade A or B being one of the prerequisites for applying for tax credit. Therefore, enterprises should take the initiative to correct any tax trust-breaking behaviors to maintain a good tax credit record, meet the conditions for tax rebate retention, and apply for credit repair in a timely manner. For deductible voucher compliance, special invoices should include all necessary details and be consistent with the actual transaction. Accuracy in tax credit data is also vital, with a focus on ensuring that sales are confirmed completely, promptly, and accurately and that income tax transfers are properly handled, ensuring that output and input taxes are calculated according to tax policy. If an excess tax refund occurs due to misunderstandings of the policy or calculation errors, the excess refund should be returned promptly <sup>[12]</sup>.

It is also important to monitor the risk of falsely inflating tax amounts. For example, when offsetting input tax with VAT invoices, it is critical to verify that the invoices are valid and legal. Additionally, it should be ensured that invoices match the actual inbound goods, and that input tax is not being offset by shipping invoices unrelated to the purchase and sale of goods, or by invoices for non-VAT taxable items, VAT-exempt projects, collective welfare, or personal consumption. It is also necessary to confirm that international cargo transportation agency invoices and international cargo transportation invoices used to deduct input tax are legitimate <sup>[13]</sup>.

In addition, close attention to the risk of falsely reducing tax is necessary. In tax administration, special focus should be placed on purchases and imports where VAT is payable, ensuring that VAT is paid in accordance with the law. The accounting of duty-free goods must also strictly comply with legal provisions. VAT-exempt goods or taxable services enjoyed by VAT taxpayers must meet the relevant tax law requirements, and care must be taken to avoid unauthorized expansion of tax exemptions. For general VAT taxpayers involved in both taxable and tax-exempt items, the accuracy of tax allowances and non-deductible input tax must be verified. It is also necessary to ensure the correct recognition of income and the proper timing of VAT withholding obligations to avoid errors in calculating VAT based on the different tax methods <sup>[14]</sup>.

## 5. Conclusion

The business processes of construction enterprises are complex, long in duration, and involve significant capital. The impact of VAT retention tax refunds at the end of the period on enterprise profitability is far-reaching. Tax risk management is an essential aspect of internal control and risk management for enterprises <sup>[15]</sup>. Therefore, from a scientific perspective, reasonable planning and risk prevention and control are crucial to safeguarding legitimate interests, maintaining a positive market image, and advancing toward world-class enterprise status.

## Disclosure statement

The author declares no conflict of interest.

## References

- [1] Tang Q, 2021, Tax Planning of Construction Projects with Different Methods of Value-Added Tax. *Finance and Accounting*, 2021(19): 67–69.
- [2] Xiang G, 2021, Discussion on the Performance Evaluation Index System of Value-added Tax Management in Construction Enterprises. *Tax Research*, 2021(8): 140–145.

- [3] Zhao F, 2019, Thoughts on Improving Tax Risk Prevention and Control of Construction Enterprises. *Taxation Research*, 2019(9): 118–122.
- [4] Guo H, Deng Z, 2022, A Brief Analysis of the Positive Fiscal Policy of VAT Residual Tax Rebate Policy Implementation Effect and Problem Suggestions: Taking Xilingol League as an example. *North Finance*, 2022(8): 104–106.
- [5] Li X, 2024, Analysis on the System of VAT Retention to Refund in China. *China Price Regulation and Anti-Monopoly*, 2024(7): 101–104.
- [6] Li A, 2024, Reform of VAT Retained Tax Credit and Auditor’s Risk Response Behavior: Based on the Empirical Evidence of A-Share Listed Companies. *Technology and Market*, 31(7): 177–180.
- [7] Fang X, 2024, Value Added Tax Rebate, R&D Innovation and Enterprise ESG Performance. *Friends of Accounting*, 2024(13): 133–140.
- [8] Cheng J, Ye A, Guo J, 2024, Research on VAT Retained Tax Refund, Financial Flexibility, and Corporate Innovation Incentives. *Journal of Qiqihar University (Philosophy and Social Sciences Edition)*, 2024(7): 69–74.
- [9] Hao Y, 2024, Research on the Risks and Countermeasures of VAT Retained Tax Refund for Enterprises. *Money China*, 2024(17): 168–170.
- [10] Xu J, 2024, Research on the Impact of VAT Retained Tax Rebate on Corporate Financial Risk, dissertation, Jilin University.
- [11] Zhang H, 2024, Analysis on the Accounting Treatment and Risk Prevention of VAT Retained Tax Rebates for Real Estate Enterprises. *Finance and Economics*, 2024(19): 126–128.
- [12] Xu M, 2023, The Application and Management Analysis of the Policy of Enterprise Value-Added Tax Retained to Refund. *Enterprise Reform and Management*, 2023(3): 145–147.
- [13] Wang W, Yin L, 2021, Application and Fine Management of Tax Refund System of Construction Value-Added Tax Retained at the End of the Period. *Fine Products*, 2021(22): 9–10.
- [14] Gui Z, 2020, Some Thoughts on the VAT Tax Refund System. *China Civil Business*, 2020(11): 161 + 177.
- [15] Guo Y, 2022, Risk Prevention of Enterprises in the Application of VAT Retained Tax Rebate Policy. *Contemporary Accounting*, 2022(16): 99–102.

**Publisher’s note**

Bio-Byword Scientific Publishing remains neutral with regard to jurisdictional claims in published maps and institutional affiliations.