Accounting and Tax Treatment based on Non-monetary Asset Exchanges

Yu Zheng*, Boyang Cai
School of Accounting and Finance, Xiamen University Tan Kah Kee College, Zhangzhou, Fujian, China
**Corresponding Author.*

Abstract: The paper discusses the accounting and tax treatment of non-monetary asset exchanges under the new standard. The standard has been modified and refined to meet the needs of the market economy and international accounting standards in the new era. The new standard provides clarification and detailed analysis of the recognition and measurement, accounting, tax treatment, and tax and accounting differences for non-monetary asset exchanges. These exchanges are significant as they allow enterprises to fulfil their needs by exchanging assets in a non-monetary manner. The new standard for accounting and tax treatment has a positive impact on standardizing transaction processes and accurately recording and tracking the economic effects of asset exchange. The standard provides clear provisions on value-added tax (VAT) and enterprise income tax (EIT), and discusses the tax differences between non-monetary asset exchanges with commercial and non-commercial substance. The formulation and implementation of the new standard will promote the standardization, internationalization, and uniformity of China's accounting and tax treatment.

Keywords: Non-monetary Asset Exchanges; Accounting; Tax Treatment; Fair Value

1. Introduction

As the economy and society continue to develop, various economic models emerge, leading to increasingly complex accounting methods and tax treatments. To adapt to these changes, accounting standards are continuously updated and improved. The revised Accounting Standard for Business Enterprises (ASBE) No. 7, 'Non-Monetary Asset Exchanges,' was amended in 2006. However, it no longer meets the needs of the current times and is not aligned with international strategies. As a result, the new standard has been added, modified, and refined to make it more comprehensive and adaptable to the changing times.

The new standard has improved the determination of liability scope, finalization time and place, fair value calculation, exchange of non-monetary assets, and disclosure. These improvements make the new standard clearer, more specific, and more operable, which enhances the accuracy and reliability of accounting information.

Secondly, the formulation of the new standards aligns with the development trend of China's market economy in the new era and keeps pace with international accounting standards to some extent. This improves the international competitiveness of China's enterprises and strengthens the convergence of China's accounting with international accounting.

Additionally, the new standard includes provisions for measuring non-monetary asset exchanges. The new standard requires enterprises to first identify the assets to be exchanged and then determine the assets to be exchanged in a non-monetary asset exchange. The exchanged assets are derecognized and recognized when the recipient obtains control over the non-monetary assets. This provision is based on the transfer of control criteria and differs from the conditions outlined in the Circular of the State Administration of Taxation on Certain Issues Concerning the Recognition of Revenue for Enterprise Income Tax Purposes. It is important to pay special attention to these differences in accounting and tax treatment to avoid errors and confusion.

In conclusion, the revision and improvement of the new accounting standard aims to adapt to the rapidly changing economy and society, enhance the accuracy and reliability of accounting information, promote the international competitiveness of Chinese enterprises, and align China's accounting practices with international standards. When performing accounting and tax processing, it is essential to thoroughly study and comprehend the provisions and requirements of the new standards to ensure precise and compliant operations.

2. Concept and Significance of Non-monetary Asset Exchanges

2.1. Meaning of Non-monetary Exchange of Assets

With economic and social development, as well as scientific and technological progress, transactions are becoming increasingly diverse. One emerging form of transaction is non-monetary exchange of assets, which refers to the exchange of assets between enterprises through non-monetary means. The emergence of non-monetary asset exchange meets the needs of enterprises and improves their asset utilization and economic efficiency.[1]

The emergence of non-monetary asset exchange meets the needs of enterprises and improves their asset utilization and economic efficiency. To ensure a successful exchange, it is crucial to clarify the processing idea. For instance, if Enterprise A exchanges its fixed assets for a batch of raw materials, it essentially sells the fixed assets first and then purchases the raw materials at the same value. In this process, the treatment of the premium is crucial when it is involved. If Enterprise A receives the premium, it should debit bank deposits. If it is the party paying the premium, it should credit bank deposits accordingly. This accounting treatment provides convenience for managing and operating enterprises. It standardizes transaction processes and facilitates accurate recording and tracking of economic effects of asset exchange.

Recognition and measurement of non-monetary asset exchange are also important. According to regulations, non-monetary asset exchanges should not have a premium exceeding 25% of the proportion. If it exceeds this percentage, it is considered a monetary asset exchange. This definition provides a clear standard for distinguishing the nature of the asset exchange and its impact on business accounting and costing.[2]

In conclusion, non-monetary asset exchange is an emerging form of transaction that requires clear thinking, standardized processes, and accurate recording and tracking. Recognition and measurement are also crucial and must follow relevant regulations and standards. This type of exchange improves the efficiency of asset use and economic efficiency of enterprises, promoting their development and growth.

2.2. Significance of Non-monetary Asset Exchanges

Non-monetary exchange of assets refers to the exchange of goods or services without the use of money. It is a business strategy that helps enterprises adapt to the needs of their product operations, reduce the outflow of monetary assets, and accelerate turnover. However, it can also provide an opportunity for some companies to seek personal gain illegally, such as using non-monetary exchange of assets to achieve profitability and obtain a large amount of profit. This violates the principles of tax fairness, accounting theory, and fair tax treatment. This statement violates the principle of tax fairness and has harmful effects on both accounting theory and the fair operation of tax treatment. Non-monetary asset exchange is a typical process of bartering and mutual benefit. The purpose of holding fixed assets in the production process is to calculate the wear and tear value of goods through depreciation in the production cost of goods, and then generate benefits.[3] Non-monetary asset exchanges include exchanges with commercial substance and exchanges without commercial substance. There is no essential difference between tax treatment and accounting for exchanges with commercial substance. However, for exchanges without commercial substance, there is an essential difference between tax treatment and accounting. This difference is mainly due to the disparity in the position of the legislation. The difference in legislative position is the main reason for the discrepancy. This difference can prevent some enterprises from profiting from the exchange of non-monetary assets, which is an advantage.[4]

3. Recognition and Measurement of Non-Monetary Asset Exchanges

3.1. Recognition of Non-monetary Asset

Exchanges

Companies calculate the wear and tear value of goods through depreciation and include it in the cost of goods. In non-monetary asset exchanges, the premium amount typically does not exceed 25% of the proportion of the exchange that would be characterized as a monetary exchange. This definition establishes a clear standard for asset exchanges and helps distinguish their nature and impact on business accounting and costing.[5]

3.2. Measurement of Non-monetary Asset Exchanges

The new standard requires an enterprise to identify the assets to be exchanged initially and ultimately. The exchanged asset is terminated and recognized when the receiver obtains control over the non-monetary asset. The new standard acknowledges the disposal of exchanged assets based on the criteria for transfer of control, which differs from the conditions outlined in the 'Circular of the State Administration of Taxation on Certain Issues Concerning the Recognition of Revenue for Enterprise Income Tax Purposes.' This results in a difference in tax treatment compared to the new standard.

3.3. Carrying Value Measurement

When an enterprise initially recognizes a financial asset or liability, it must measure it at fair value to ensure the accuracy and fairness of the initial recording. In this process, if the enterprise receives additional compensation, it is necessary to use fair value to recognize the initial measurement amount of the compensation received. This approach helps to maintain the authenticity of the enterprise's financial statements and ensures that the market value of the financial assets or liabilities is accurately reflected in the initial recording stage. By utilizing fair value measurements, companies can evaluate the status of their assets and liabilities in a more comprehensive and objective manner, enhancing the transparency and reliability of financial information.

4. Recognition Principles for Accounting for Non-monetary Asset Exchanges

4.1 Accounting for Measurements at Fair Value

In accounting, it is essential to calculate the cost based on the exchanged assets. The initial calculation of the cost of the exchanged assets should take into account the book value and relevant taxes paid.[6] The fair value of the purchased assets should be used to replace the price paid for the costing of the exchanged assets. By considering the book value and related taxes of the exchanged assets, as well as their fair value, an enterprise can comprehensively assess the impact of the asset exchange on its financial statements. This enhances the accuracy and credibility of the financial information. The use of sophisticated cost accounting helps ensure that financial reports reflect the true financial position and performance of the enterprise.

The new standard allows for participation in premium calculation for non-monetary asset exchanges. It defines the concepts of monetary and non-monetary assets, which may lead to special circumstances in premium calculation. For each property, plant, and equipment exchanged simultaneously, the net fair value of all exchanged assets (including the premium amount, increased by the premium paid or decreased by the premium received) less the fair value of all exchanged financial assets shall be apportioned. This means that the amount should be divided among all exchanged assets, along with the related taxes paid. A preliminary estimate of the total value of the exchanged assets, along with the relevant taxes paid, was made by apportioning the amount between them.[7]

4.2 Accounting for Measurement at Book Value

Non-monetary asset exchanges often occur in the operations of major businesses The tax treatment under the tax law indicates that the transaction can be regarded as a sales process. According to the tax treatment under the tax law, the transaction can be treated as a sales process, and most of the time it involves VAT, consumption tax and other related tax treatments. According to the International Accounting Standards (IAS), the measurement of non-monetary asset exchanges should include both fair value and book value. However, there is no clear solution for tax-related business in the accounting standard on the calculation of book value. In view of this doubt, it is necessary to focus on the study and put forward worthy countermeasures, mainly for the enterprises to provide more truthful and reliable accounting information on tax-related business in the process of non-monetary asset exchanges.[8]

Measured on the basis of book value, the exchanged assets will be sold on the basis of fair value in the tax treatment, in which case there will be a difference between tax and accounting.

5. Tax Treatment of Non-monetary Asset Exchanges

5.1 Value-added Tax

In a non-monetary exchange of assets, the profit generated by the exchanged assets belongs to the acquisition of other economic benefits in return for payment, and is generally subject to VAT. However, there is also a special case that in the process of enterprise asset reorganization, the physical assets or part of the physical assets in the reorganization are packaged and transferred to the relevant enterprises or individuals using various methods. The physical assets included in this process are not subject to VAT, and the main ways of this behavior are merger, separation, sale and replacement.[9]

5.2 Corporate Income Tax Aspects

In compliance with the relevant provisions of the EIT Law, there are two types of EIT treatments: the sales transaction method and the purchase transaction method. When recognizing taxable base for newly acquired long-term equity investments, it should be based on the fair price (including tax) at the time of replacement of fixed assets. For non-monetary fixed assets invested in foreign countries, they should be considered sold, and the income from fixed asset replacement should be determined based on their fair prices (excluding tax) to determine the gain from fixed asset replacement at once. This treatment is generally consistent with the accounting process for non-monetary assets with commercial substance in the outward investment business for tax purposes. Tax adjustments are necessary in the accounting process for outward investment operations that involve non-monetary assets lacking commercial substance.[10]

If the special tax treatment is selected for a non-resident enterprise with direct holdings in the process of exchanging 100% of non-monetary assets, the enterprise income tax can be evenly spread over ten years, and the tax payable in each year can be calculated.

The assets of an SOE that have been evaluated and valued can be recorded at their stated value. Simultaneously, depreciation is provided for and agreed to be deducted in accordance with the relevant laws, thus minimizing the difference between the tax treatment and the accounting treatment.

When a company purchases assets as a transferee, the value of the assets must be at least 50% of the company's total assets. Additionally, the transferee must ensure that the equity delivery of the amount payable for the transaction is not less than 85% of the total amount at the time of the asset purchase. In this case, the transferor company establishes the original tax basis as the tax basis of the interest in the transferee company acquired in the transaction, regarding the undetermined gain or risk on the transferred assets. The tax basis of the fixed assets transferred to the transferee company would be determined by the tax basis of the enterprise to which the fixed assets were transferred. This approach ensures that the tax treatment aligns with the interest delivery, maintaining transaction transparency and compliance.

6. Tax Differences on Non-monetary Asset Exchanges

6.1 Tax Differences on Non-monetary Asset Exchanges with Commercial Substance

The new standard mandates that for non-monetary asset exchanges with commercial substance, the cost of the asset should comprise relevant taxes and the value of the exchanged asset. Additionally, the standard requires that the cost of the asset should include the value of the exchanged asset. However, in some cases, the fair value of the exchanged assets is more accurate than their book value, and there is no tax difference in the case of a non-monetary exchange of assets with commercial substance.

6.2 Differences in the Measurement of Revenue Recognition

The accounting for non-monetary asset exchanges differs from their calculation for tax purposes. In tax treatment, it is necessary to determine the gain or loss on the transfer of relevant assets to reconfirm the tax basis of the exchange value of the assets at the same time as the transaction takes place. However, in the accounting process, if there is no commercial substance, no gain or loss will be recognized. This will generate delayed differences in tax treatment during the exchange process. Therefore, enterprises should make effective and timely adjustments to the tax treatment process when calculating current taxable income.

6.3 Temporary Differences Arising from Differences in the Measurement of Assets Exchanged

In accounting, the cost of a non-monetary exchange of assets is equal to the cost of the assets exchanged and the taxes on the exchanged assets. However, for tax purposes, the exchange value of the assets should be reconfirmed in their tax basis. The reconfirmed tax basis of the exchanged asset includes the fair value of the exchanged asset and the tax paid. The temporary differences in tax accounting arise from the discrepancy between these two calculations.

The new standard provides clearer and more detailed guidance on both accounting and tax treatment. It also standardizes the direction of accounting personnel in enterprises. China has emerged as the world's second-largest consumer market and the leading trading nation. It has also become the largest recipient of foreign investment and has strengthened its ability to participate in global economic governance. As one of the few countries with established accounting standards, it is expected that these standards will continue to move towards internationalization. The new accounting standards have a more international perspective than the previous ones and are in line with changes in the global environment. They provide forward-looking thinking for China's trade development.

7. Conclusion

Due to the rapid development of China's economy and society, the internationalization of economy and trade has become increasingly apparent. As a result, the accounting standards have been revised to meet the requirements of China's economic development. This article explains non-monetary asset exchanges, which can be categorized into exchanges with commercial substance and exchanges without commercial value. The tax treatment of the former is the same as that of the latter, but there are fundamental differences in their accounting principles. In practice, taxes should be determined based on the specific situation. The study of tax and accounting differences in non-monetary asset exchanges is significant for the development of international economy and trade, as well as for guiding the direction of the rapid and steady development of various enterprises in China.

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