

Fundamentals Level – Skills Module

# Taxation (China)

Monday 3 December 2007

**Time allowed**

Reading and planning: 15 minutes

Writing: 3 hours

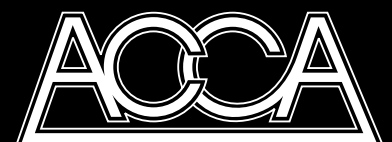
ALL FIVE questions are compulsory and MUST be attempted.  
Rates of tax and tables are printed on pages 2–3.

**Do NOT open this paper until instructed by the supervisor.**

**During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.**

**This question paper must not be removed from the examination hall.**

The Association of Chartered Certified Accountants



# Paper F6 (CHN)

**SUPPLEMENTARY INSTRUCTIONS**

1. The final result of all calculations and workings need only be made to the nearest RMB.
2. All apportionments should be made to the nearest month.
3. All workings should be shown.

**TAX RATES AND ALLOWANCES**

The following tax rates and allowances are to be used in answering the questions.

**Income tax**

**Income tax for domestic enterprises**

Annual taxable income (RMB)	Rate
1 – 30,000	18%
30,001 – 100,000	27%
100,001 and above	33%

**Preferential tax rates:**

High-tech enterprises established in high-tech development zones	15%
Newly set up enterprises may be exempted from income tax for two years from its first production	
Services provided to agriculture	0%
Technical services provided by universities and research institutions	0%
Newly set up consultant enterprises	2 years' tax exemption from its establishment
Newly set up transportation or communication enterprises	1 year tax exemption then 1 year at 50% of the original tax rate from its establishment
Newly set up service enterprises	1 year tax exemption or deduction with the approval of the tax authorities

**Income tax for joint ventures and foreign enterprises**

For ordinary joint ventures	33% (30% national and 3% local)
Group A lower rate	15%
enterprises in Special Economic Zones and manufacturing enterprises in Economic and Technology Development Zones	
Group B lower rate	24%
manufacturing enterprises in the old urban districts of Special Economic Zones and manufacturing enterprises in Economic and Technology Development Zones, and in Coastal Open Zones	

**Income tax for individuals**

For monthly salary	Rate	Fast deduction factor
Taxable income (RMB)		(RMB)
below 500	5%	0
the part 501 – 2,000	10%	25
the part 2,001 – 5,000	15%	125
the part 5,001 – 20,000	20%	375
the part 20,001 – 40,000	25%	1,375
the part 40,001 – 60,000	30%	3,375
the part 60,001 – 80,000	35%	6,375
the part 80,001 – 100,000	40%	10,375
the part 100,001 and above	45%	15,375

**For other income**

each time below RMB 800	Rate
each time from RMB 801 to RMB 4,000	0%
each time above RMB 4,000 (with 20% allowance)	20%
Income from services provided	
for the part RMB 20,000 to RMB 50,000	30%
for the part above RMB 50,000	40%

<b>Business tax</b>		<b>Rate</b>
Group A	transportation, construction, communication, culture and sports	3%
Group B	hotels, restaurants, tourism, warehousing, advertising, transfer of intangible property, sale of real estate	5%
Group C	finance	5%
Group D	recreation	5~20%

<b>Land appreciation tax</b>		<b>Rate</b>
<b>The ratio of increased value against the value of deductible items</b>		
for the part	50% or below	30%
for the part	above 50% to 100%	40%
for the part	above 100% to 200%	50%
for the part	above 200%	60%

<b>Value added tax (VAT)</b>	
For small size taxpayers	6%
For ordinary taxpayers	17% for the sale or import of itemised goods, processing, and repairing 13% for the sale or import of itemised goods 7% for transportation charges

#### **Allowances**

##### **Funds for domestic enterprises**

Trade union fund	2% of total basic wages
Employee welfare fund	14% of total basic wages
Employee training fund	1.5% of total basic wages

##### **Donations**

Enterprises	up to 3% of the taxable income
Individuals	up to 30% of the taxable income 100% if donation made to certain funds approved by the government

##### **Deductible entertainment expenses**

###### **For domestic enterprises**

<b>Annual net sales (RMB)</b>	<b>Rate</b>
1 – 15,000,000	5‰
15,000,001 – 50,000,000	3‰
50,000,001 – 100,000,000	2‰
100,000,001 and above	1‰

###### **For joint ventures and foreign enterprises**

###### **Manufacturing and trading businesses**

<b>Annual net sales (RMB)</b>	<b>Rate</b>
1 – 15,000,000	5‰
15,000,001 and above	3‰

###### **Service providers**

<b>Annual net sales (RMB)</b>	<b>rate</b>
1 – 5,000,000	10‰
5,000,000 and above	5‰

**ALL FIVE questions are compulsory and MUST be attempted**

- 1 (a) Company K is a wholly foreign owned hotel enterprise located in Shanghai. It started operations in 1995 and has earned profits since the commencement of its business.

The following is the statement of foreign enterprise income tax (FEIT) payable prepared by the accountant of Company K for the year 2006:

	RMB	RMB
Turnover		30,000,000
Cost of services (including salaries and bonuses paid to workers RMB 2,000,000)		(20,000,000)
Gross profit		10,000,000
Management expenses		(3,500,000)
The following amounts were included within the management expenses:		
Salaries and bonuses paid to staff	1,000,000	
* Refurnishing expense of the office	50,000	
* Business tax and late payment penalty (150,000 + 1,500)	151,500	
* Entertaining expense	200,000	
* Donation to an unrelated scientific research centre	15,000	
* Staff and workers benefits	500,000	
* Union expenses	100,000	
* Staff and workers education expenses	50,000	
Investment income		
* Overseas dividend (net of foreign income tax at 10%)		27,000
Financial expenses		
* Interest expense for a loan borrowed by the investor for fulfillment of its capital contribution obligation		(200,000)
Other loss:		
* Writing off of fixed assets (note 1)		(30,000)
Other income:		
* Writing off of a liability due to a creditor (note 2)		200,000
* Membership fee income (note 3)		100,000
Taxable profits		6,597,000
Tax rate		33%
Tax payable		2,177,010

Notes:

- (1) The original cost of the fixed assets was RMB 100,000 and the accumulated depreciation was RMB 70,000, while the accumulated tax allowances claimed were RMB 80,000.
- (2) The creditor was liquidated three (3) years ago.
- (3) The membership fees received during the year were RMB 500,000. The fee entitles Company K's customers to use Company K's recreation facility in a holiday resort for a period of five (5) years.

**Required:**

- (i) **Briefly comment on the correctness of the accountant's treatment of the twelve (12) items marked with an asterisk (\*) in his income tax calculation sheet.** (17 marks)
- (ii) **Calculate the correct amount of foreign enterprise income tax (FEIT) payable by Company K for the year 2006.** (6 marks)

- (b) Company A is a manufacturing foreign invested enterprise and has an accounting policy of making a general bad debt provision of 5% of its year end debtor balance.

Details of the movements in the provision for the first two years since the commencement of its business are as follows:

	Year 1 RMB	Year 2 RMB
Year end debtor balance	100,000	70,000
Movement on account of the bad debt provision:		
Opening balance	0	5,000
(i) General provision for the year	5,000	–
(ii) Amount written off	–	(1,000)
(iii) Amount written back	–	(500)
Closing balance	5,000	3,500

**Required:**

**Briefly explain the tax treatment of the items (identified as (i), (ii) and (iii)) comprising the movements in the provision in years 1 and 2.** (6 marks)

- (c) Company F is a foreign company, which is entitled to 60% of the distributable profits of Company P. Company P is a qualified export-oriented foreign investment enterprise, which pays income tax at the rate of 33% (30% national plus 3% local). Its current investment has been highly successful, and Company F is considering increasing its investment in Company P.

**Required:**

- (i) **Calculate the maximum tax refund on the reinvestment of Company P's profits that Company F could obtain for the year 2007, if Company P's after-tax profits for that year are RMB 500,000.** (3 marks)
- (ii) **State the conditions that Company F must satisfy in order to be eligible for the refund.** (3 marks)

**(35 marks)**

- 2 (a)** Mr C, a local Chinese national, is an independent singer. He had the following income during the year 2006:
1. He performed at a concert and received RMB 100,000, but donated half of this amount to the approved social welfare institute holding the concert.
  2. He received an insurance compensation of RMB 20,000 for the loss of his car.
  3. He won a lottery prize of RMB 50,000.
  4. He received interest of RMB 40,000 from a personal loan he made to a company.
  5. He received interest of RMB 30,000 from a national debt.
  6. He performed a speech in overseas country H and received the gross equivalent of RMB 10,000. Overseas withholding tax equivalent to RMB 1,500 was deducted at source from this amount.
  7. He published a book in overseas country X and received the gross equivalent of RMB 10,000. Overseas withholding tax equivalent to RMB 2,000 was deducted at source from this amount.

**Required:**

- (i) Calculate Mr C's total individual income tax (IIT) liability for the year 2006.** (10 marks)
- (ii) Assuming that Mr C has chosen not to request consolidated reporting, state the location(s) in which he must report and pay his tax for self-reporting purposes.** (2 marks)
- (b)** Mr D sold his personal ordinary home for RMB 2,000,000. His related expenses were the purchase cost of RMB 600,000, decoration expense of RMB 200,000 and mortgage loan interest of RMB 400,000.

**Required:**

- (i) Explain the business tax (BT) and individual income tax (IIT) implications of the sale of the home if it was bought ten (10) years ago.** (2 marks)
- (ii) Explain how your answer in (i) would change if the home was bought only three (3) years ago.** (3 marks)
- (iii) Explain how your answer in (i) would change if the property was Mr D's non-ordinary home.** (3 marks)

**In each case support your explanations with calculations of the tax payable (if any).**

**(20 marks)**

- 3** Company G, a cigarette company, had the following transactions in the month of January 2007:

1. Bought tobacco for RMB 234,000 (including VAT and CT) from a supplier who is a general VAT payer.
2. Bought tobacco for RMB 42,000 (invoice value) from a local farmer and paid the related transportation cost of RMB 30,000 (invoice value).
3. Subcontracted the tobacco in (2) to an outside subcontractor and paid the fee of RMB 93,600 (including VAT) stated in the VAT invoice received from the subcontractor.
4. Received goods back from the subcontractor in (3), but the contractor did not pay the related consumption tax (CT) on Company G's behalf.
5. 50% of the goods in (1) and (4) were used in production during the month of January.
6. Sold 18,000 cases of cigarettes for RMB 36 million (excluding VAT).
7. Distributed two (2) cases of cigarettes for staff welfare.

The consumption tax rate for tobacco is 30% and for cigarettes is RMB 150 per case plus 45% of turnover.

**Required:**

- (a) Calculate the value added tax (VAT) liability of Company G for the month of January 2007.** (7 marks)
- (b) Calculate the consumption tax (CT) liability of Company G for the month of January 2007.** (8 marks)

**(15 marks)**

- 4 (a) (i) An advertising company received a production service fee of RMB 500,000 and commission income of RMB 100,000. The company paid production service fees to other companies of RMB 300,000 and a broadcasting fee to a radio company of RMB 200,000. (2 marks)
- (ii) A hotel received room rental income of RMB 100,000, plus a 15% service charge (RMB 15,000). It also earned night club entrance fees of RMB 10,000 and RMB 15,000 from the sale of drinks in the night club; and RMB 50,000 for the sale of food and RMB 5,000 for the sale of drinks in the restaurant. In addition, the kiosk in the hotel lobby earned RMB 8,000. (4 marks)

**Required:**

**In relation to each of the above sets of transactions ((i) and (ii)) which relate to the month of February 2007, calculate the business tax (BT) and/or value added tax (VAT) payable.**

- (b) Company M, a real estate developer sold an office building for RMB 100 million. The developer paid RMB 25 million for the land use right; RMB 30 million in construction costs; RMB 5 million in business tax (BT); and RMB 1 million in city construction tax and education surcharge.

The rate of real estate development expense provided for by the provincial government is 10%.

All figures are stated excluding value added tax (VAT).

**Required:**

- (i) Calculate the land appreciation tax (LAT) payable by Company M. (6 marks)
- (ii) Calculate the land appreciation tax (LAT) payable by Company M if it had not been a real estate developer. (3 marks)

**(15 marks)**

- 5 (a) Mrs A holds 100,000 shares in Company B, a company based in Shanghai. In 2006, Company B distributed RMB 0.1 per share.

**Required:**

**State, giving reasons, the amount of income tax which should be withheld by Company B in each of the following situations:**

- (i) Company B is a listed domestic company and Mrs A is a local Chinese national. (2 marks)
- (ii) Company B is an unlisted domestic company and Mrs A is a local Chinese national. (2 marks)
- (iii) Company B is a listed domestic company and Mrs A is a foreigner. (2 marks)
- (iv) Company B is an unlisted domestic company and Mrs A is a foreigner. (1 mark)
- (v) Company B is a foreign invested enterprise and Mrs A is a foreigner. (1 mark)

For the purposes of parts (iii), (iv) and (v) you should assume that the applicable rate of withholding tax, according to the double tax treaty between Mrs A's home country and the PRC, is 10%.

- (b) In relation to a person or organisation obliged to withhold individual income tax (IIT) on payments made (a withholding agent):

- (i) State by when the tax withheld must be remitted to the State Treasury. (1 mark)
- (ii) List the documents that should be submitted together with the tax payment in (i) above. (3 marks)
- (iii) State the consequences if the agent fails to submit the required documents in (ii) above. (2 marks)
- (iv) State the possible reward that can be claimed by a withholding agent from the tax authority. (1 mark)

**(15 marks)**

**End of Question Paper**