

Fundamentals Level – Skills Module

Taxation (China)

Monday 1 December 2008

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are 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)

The ACCA logo consists of the letters 'ACCA' in a bold, white, sans-serif font, centered within a solid black square.

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 and foreign enterprises	Rate
	25%
Entrepreneurs who receive production or operation income derived from private industrial or commercial enterprises	

Level	Annual taxable income (RMB)	Tax rate (%)	Fast deduction factor (RMB)
1	Under 5,000	5%	0
2	5,000 – 10,000	10%	250
3	10,000 – 30,000	20%	1,250
4	30,000 – 50,000	30%	4,250
5	Over 50,000	35%	6,750

Income tax for individuals

For monthly salary

Taxable income (RMB)	Rate	Fast deduction factor (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

	Rate
each time below RMB 800	0%
each time from RMB 801 to RMB 4,000	20%
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%

Business tax

	Rate
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%

Land appreciation tax		
The ratio of increased value against the value of deductible items		Rate
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%

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

Allowances

Funds for domestic enterprises

Trade union fund	2% of total basic wages
Employee welfare fund	14% of total basic wages
Employee training fund	2.5% of total basic wages

Donations

Enterprises	up to 12% of the taxable income
Individuals	up to 30% of the taxable income
	100% if donation made to certain funds approved by the government

Entertainment expenses

For domestic and foreign enterprises	60% of the amount subject to a maximum of 0.5% of the sales/business income of the year.
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ALL FIVE questions are compulsory and MUST be attempted

- 1 Company F is a manufacturing joint venture enterprise, which was established and started operations on 1 January 2008.

The company's statement of enterprise income tax (EIT) payable for the year 2008, as prepared by the accountant of Company F is summarised below:

	Note	RMB
Turnover		150,000,000
Cost of goods sold		(100,000,000)
Gross profit		50,000,000
Management and finance expenses	1	(35,000,000)
Investment income	2	410,000
Other loss: fixed assets written off	3	(400,000)
Taxable profits		15,010,000
Tax rate		25%
Tax payable		3,752,500

Notes:

- (1) The management and finance expenses included the following:
- | | RMB |
|---|------------|
| Salaries and bonuses paid to staff (including RMB 300,000 of individual income tax (IIT) for the general manager, whose employment contract states that his salary will be paid tax free, i.e. the company bears the IIT) | 10,000,000 |
| Interest expense (including interest of RMB 100,000 on a loan borrowed to construct a canteen. The construction work will not be completed until February 2009.) | 100,000 |
| Entertainment expense | 1,500,000 |
| Advertising expense | 600,000 |
| Research and development expense | 200,000 |
| Staff and worker benefits | 2,000,000 |
| Staff and worker education expenses | 100,000 |
| Staff and worker union expenses | 50,000 |
| Direct donation to some poor families (in cash) | 200,000 |
- (2) The investment income comprises:
- | | RMB |
|---|---------|
| Gain on disposal of listed A-shares | 270,000 |
| Interest income on national debenture (gross) | 40,000 |
| Gain on disposal on national debenture (net) | 100,000 |
| | 410,000 |
- (3) The original cost of the fixed assets was RMB 1,000,000, the accumulated depreciation was RMB 600,000 and the accumulated tax allowances claimed were RMB 700,000.

Required:

- (a) (i) **State, giving reasons, whether or not the accountant's treatment of each of the 13 items referred to in notes 1 to 3 is correct;** (13 marks)
- (ii) **Calculate the correct amount of enterprise income tax (EIT) payable by Company F for the year 2008.** (7 marks)
- (b) (i) **Briefly define the term 'resident enterprise' for the purposes of enterprise income tax (EIT) and explain the effect of an enterprise being classed as resident (as opposed to non-resident) on the scope of its EIT assessment;** (5 marks)
- (ii) **In each of the following cases, state whether the enterprise is a resident enterprise, the scope of its EIT assessment and the applicable tax rate(s):**
- (1) **Company A, which is incorporated in China.**
 - (2) **Company B, which is incorporated overseas but has an establishment in China. All of Company B's China-sourced income is effectively connected to its establishment in China.**
 - (3) **Company C, which is incorporated overseas but has an establishment in China. None of Company C's China-sourced income is effectively connected to its establishment in China.**
 - (4) **Company D, which is incorporated overseas. Company D does not have an establishment in China but it does have China-sourced income.** (10 marks)

(35 marks)

- 2 (a) Company G wants to set up a bonus plan for its general manager. The general manager, a Chinese national, has a basic monthly salary of RMB 20,000 and the company is planning to grant him a bonus for the year of RMB 120,000.

The company is considering two alternative ways of paying the bonus distributions:

- (1) the bonus will be distributed by means of four quarterly payments of RMB 30,000 each; or
- (2) the whole bonus will be distributed once at the end of the year.

Required:

Calculate the individual income tax (IIT) payable by the general manager for the whole year under each of the two options and comment on which of the options is the more tax efficient from the point of view of IIT.

Note: you should use the tax rates for 2008 as given on page 2. (6 marks)

- (b) Mr Chen, a Chinese citizen, is a professional artist. He had the following income in 2008:

- (1) Sold two of his works for RMB 230,000 and RMB 180,000 respectively.
- (2) Published a collection of his paintings overseas for USD 40,000 (gross) from which tax of USD 6,000 was withheld.
- (3) Received bank interest of USD 3,000 (gross) for the second half of 2008, from a foreign bank, from which tax of USD 100 was withheld.
- (4) Received RMB 2,400 for giving three separate public lectures.

Required:

Calculate the individual income tax (IIT) payable by Mr Chen for the year 2008.

Note: you should use the exchange rate of USD1 = RMB7. (8 marks)

- (c) Company H is considering employing an expatriate from Singapore.

Required:

List the fringe benefits that can be provided to an expatriate, which will not be subject to individual income tax (IIT) in China. (6 marks)

(20 marks)

- 3 (a)** Company K, an electronic radio manufacturing company, had the following transactions for the month of October 2008. All amounts, except for the used machine (item 4) are stated excluding value added tax (VAT).
- (1) Sold 10,000 units directly to retail consumers and 300,000 units to wholesale distributors at a 20% discount. The discount was shown on the same VAT invoices as the sales to the distributors. The standard unit selling price of Company K's products is RMB 100.
 - (2) Gifted 500 units to schools and 300 units to its own staff for promotional purposes.
 - (3) Sold obsolete radios as scrap for RMB 30,000.
 - (4) Sold a used machine for RMB 20,000, which had had an original cost of RMB 10,000.
 - (5) Because of mistakes made by the management, raw materials, which had cost RMB 200,000, had to be totally written off.
 - (6) A customer provided raw materials for assembly for which Company K received a sub-contracting fee of RMB 100,000.
 - (7) Purchased raw materials for the month for RMB 20,000,000.

Required:

Calculate the value added tax (VAT) payable by Company K in respect of each of the above transactions, briefly explaining your treatment in the case of items (4) and (5). (8 marks)

- (b) Briefly explain the business tax (BT) treatment of the sales activities of a company that operates a bowling centre and provides both bowling and electronic games machines.**

Your answer should include details of the applicable tax rate(s). (4 marks)

- (c)** Company M is a manufacturing company, which manufactures products for both the domestic market and for export. The following information relates to the company's business transactions for the month of November 2008:

- (1) Imported materials for production for the equivalent of RMB 280,000 (including freight and insurance to the Chinese port) paying customs duty of RMB 20,000. The imported materials related both to the production of export and domestic products.
- (2) Purchased materials for production on the domestic market for RMB 350,000.
- (3) Paid domestic transportation costs of RMB 20,000.
- (4) Sold products on the domestic market for RMB 500,000.
- (5) Exported products for the equivalent of RMB 450,000.

The VAT refund rate applicable to Company M's products is 14%.

Required:

- (i) Calculate the value added tax (VAT) payable by/refundable to Company M for the month of November 2008, clearly identifying the VAT applicable to each of the transactions (1) to (5) as well as in total;**

(5 marks)

- (ii) Show how the value added tax (VAT) payable by/refundable in (i) above would change if the imported materials related only to the exported products and had been imported tariff free.**

Note: you are not required to repeat calculations in this part for any of the individual transactions where the VAT applicable is the same as in (i) above. (3 marks)

(20 marks)

4 (a) Briefly define the term 'evasion of tax'. (2 marks)

(b) During a tax investigation conducted by the tax bureau, the following mistakes were found in respect of the activities of Company P in 2007. All amounts, except for the cash sales figure (item 2) are stated excluding value added tax (VAT).

- (1) Company P had sold goods for RMB 1,000,000 to one of its customers. Because the customer paid 30 days earlier than required, Company P granted a cash discount of RMB 100,000 and recorded the sales revenue as RMB 900,000.
- (2) Company P did not record cash sales of RMB 2,000,000 because the cash sale customers did not request Company P to issue any invoices.
- (3) Company P distributed some of its purchased raw materials from the warehouse to its workers as workers' benefits but no record was made of the distribution. The raw materials distributed cost Company P RMB 300,000.

Other than for the above three errors, the tax liabilities of Company P had been correctly calculated as RMB 500,000 for value added tax (VAT) and RMB 600,000 for enterprise income tax (EIT).

The rates of VAT and EIT applicable to Company P in 2007 were 17% and 25% respectively.

Required:

(i) Calculate the under recorded tax liabilities of Company P as a result of the three errors identified by the tax bureau; (8 marks)

(ii) State, giving reasons, the possible fines and penalties faced by Company P as a result of the under recorded tax liabilities calculated in (i) above. (5 marks)

(15 marks)

5 (a) Explain the consequences, including any fines or other penalties that may be imposed, in the case of a taxpayer or withholding agent who:

- (1) pays the tax due after the time required under the relevant tax laws (i.e. pays 'late');** and
- (2) fails to co-operate with a tax inspection.** (4 marks)

(b) State the time limits for action that apply to the ability of the tax authorities to pursue an under payment of tax due to the fault of the taxpayer or his/her withholding agent. (4 marks)

(c) Explain the limitations on the power of the tax authorities to require a taxpayer to submit his books and records from previous years to the tax bureau for detailed examination. (2 marks)

(10 marks)

End of Question Paper