

Fundamentals Level – Skills Module

# Taxation (China)

Monday 7 December 2009

**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.

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## SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest RMB.
2. All apportionments need only 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.

### Enterprise 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	Rate	Quick deduction factor RMB
1	5,000 or below	5%	0
2	5,001 – 10,000	10%	250
3	10,001 – 30,000	20%	1,250
4	30,001 – 50,000	30%	4,250
5	Over 50,000	35%	6,750

### Individual income tax

#### Employment income

Grade	Taxable monthly income RMB	Rate %	Quick deduction factor RMB
1	500	5	0
2	501 – 2,000	10	25
3	2,001 – 5,000	15	125
4	5,001 – 20,000	20	375
5	20,001 – 40,000	25	1,375
6	40,001 – 60,000	30	3,375
7	60,001 – 80,000	35	6,375
8	80,001 – 100,000	40	10,375
9	100,001 and above	45	15,375

#### For other income

each time below RMB800	Rate
	0%
each time from RMB801 to RMB4,000	20%
each time above RMB4,000 (with 20% allowance)	20%

#### Income from services provided

for the part RMB20,000 to RMB50,000	30%
for the part above RMB50,000	40%

#### Individual service income

Before tax income RMB	Rate %	Quick deduction factor RMB
1 – 20,000	20	0
20,001 – 50,000	30	2,000
50,001 or above	40	7,000

### **Business tax**

		<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 and insurance	5%
Group D	Recreation	5–20%

### **Land appreciation tax**

<b>The ratio of increased value against the value of deductible items</b>		<b>Rate</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%

### **Value added tax (VAT)**

For small size taxpayers	6% (4% for commercial enterprises)
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	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 (a) Company H is a manufacturing joint venture enterprise, which was incorporated on 1 January 2007 and started operations on that date. It was approved to enjoy the preferential treatment – namely ‘two years exempt and following three years half exempt’. For 2007 and 2008, its tax losses were RMB8,000,000 and RMB2,000,000 and the total tax losses RMB10,000,000 have been agreed by the tax bureau for carry forward.

The following is the statement of enterprise income tax (EIT) payable prepared by the accountant of Company H for the year 2009:

	<b>RMB</b>
Turnover	180,000,000
Cost of goods sold	<u>(100,000,000)</u>
Gross profit	80,000,000
Management and finance expenses	<u>(35,000,000)</u>

The following amounts were included within the management and finance expenses:

	<b>RMB</b>	<b>RMB</b>
* Salaries and bonuses paid to staff (note 1)	15,000,000	
* Office rental expense (note 2)	1,000,000	
* Entertaining expense	1,800,000	
* Advertising expense	6,000,000	
* Amortisation of intangibles (note 3)	300,000	
* Depreciation of fixed assets other than the two items below (note 4)	2,000,000	
* Depreciation of fixed assets purchased under a finance lease	100,000	
* Depreciation of fixed assets rented under an operating lease	50,000	
* Penalty imposed by the government for late filing of the annual return	100,000	
* Penalty imposed by a customer for defective products	50,000	
* Stock loss provision (note 5)	200,000	
Investment income:		
* Interest income from a national debenture		40,000
* Gain on disposal of a national debenture		100,000
* Loss on disposal of listed shares		<u>(200,000)</u>
* Share of losses from an associated company (note 6)		<u>(400,000)</u>
Taxable profits		<u>44,540,000</u>
Tax rate		25%
Tax payable		<u>11,135,000</u>

Notes:

- (1) Including individual income tax (IIT) of RMB100,000 payable in respect of an American engineer whose employment contract states that his salary is to be paid ‘tax-free’, i.e. the company will bear his IIT.
- (2) The lump sum rental payment made for two years from 1 July 2009.
- (3) The amortisation of a self-developed brand name according to an independent valuer’s report.
- (4) Including depreciation of RMB200,000 for a machine which was unused for the whole of 2009 because of a water flood.
- (5) The provision is calculated at 5% of the closing stock value.
- (6) The loss represents the share of the losses incurred by an associated company calculated under the equity accounting method.

**Required:**

- (i) Explain the correct treatment of each of the fifteen (15) items of management and finance expense and investment income (marked with an asterisk (\*)) in the income tax calculation prepared by Company H's accountant; (17 marks)
- (ii) Calculate the correct amount of Company H's taxable profit for the year 2009; (6 marks)
- (iii) State, giving reasons, how much enterprise income tax (EIT) will be payable by Company H for the year 2009. (2 marks)
- (b) (i) Define the following terms for tax purposes and briefly explain their tax treatment:
- fixed assets; (4 marks)
  - research and development expenses. (3 marks)
- (ii) Briefly explain the tax treatment of the following expenses:
- (1) a major repair of machinery; (2 marks)
  - (2) the wages paid to disabled employees. (1 mark)
- (35 marks)**

- 2 (a) Mr Gu is a local Chinese engineer working for Company F. In early 2008, Company F decided to second Mr Gu to Company S, to work on a special project. It was agreed that during the period Mr Gu worked on the special project at Company S, Company F would continue to pay him his basic salary but not a position bonus. To compensate for the loss of this bonus, Company S agreed to pay Mr Gu a subsidy of RMB13,000 per month. Mr Gu worked on the special project for 10 months from March to December 2008 inclusive.

Mr Gu's income from all sources in 2008 was as follows:

- (1) RMB5,000 per month for basic salary from Company F.
- (2) RMB6,000 per month for position bonus from Company F for the months of January and February.
- (3) RMB13,000 per month as subsidy from Company S, for the months of March to December, inclusive.
- (4) RMB120,000 in December from Company F as annual bonus for completing the special project satisfactorily.
- (5) RMB15,000 service income for acting as a translator at a meeting.
- (6) RMB60,000, after deduction of 20% German tax, for publishing a book in Germany.
- (7) RMB1,500,000 net proceeds from the sale of an antique, which he originally acquired in 2007 for RMB780,000.

For January and February 2008, Mr Gu's monthly tax allowance was used for the calculation of the tax withheld by Company F. From March to December 2008, Mr Gu's monthly tax allowance was used for the calculation of the tax withheld by Company S.

**Required:**

- (i) Calculate the individual income tax (IIT) which would have been withheld from the payments made to Mr Gu by Company F and Company S in the year 2008; (5 marks)
  - (ii) Calculate the additional IIT payable on Mr Gu's employment income for the year of 2008 and state how it will have been reported to the tax authorities; (3 marks)
  - (iii) Calculate the IIT payable (if any) on each item of Mr Gu's non-employment income for the year 2008. (6 marks)
- (b) Briefly explain the criteria used to determine whether an individual is a resident taxpayer or a non-resident taxpayer in the PRC. (6 marks)

**(20 marks)**

- 3 (a) Mr A is a chemical expert, who knows a lot of suppliers of rare chemicals in China. Mr A is considering setting up a new company to help the suppliers to find customers in China. There are two alternative structures for the business: (1) purchasing the chemicals from the supplier and selling to the customers on an indent basis only after identifying the customers; or (2) receiving a certain percentage of commission from the suppliers only after identifying the customers.

**Required:**

**Briefly explain the turnover tax implication for the new company of each of the two alternative business structures.** (7 marks)

- (b) Company X is a service company. It finds suppliers of jade in China on behalf of its overseas customers. After negotiation between the suppliers and customers, Company X receives the consideration from its customers and then passes the money on to the sellers. Once they have received the money, the sellers issue VAT invoices in the name of the customers and pass the goods and invoices directly to the customers. Company X receives a certain percentage of commission from the customers.

**Required:**

(i) **Explain the turnover tax implications of the above scenario for Company X;** (5 marks)

(ii) **State how the tax bureau may assess tax on the service income if it considers the income declared to be too low and without proper justification and list the methods which may be used.** (4 marks)

- (c) Company W made the following sales of taxable consumer goods in the month of September 2009:

- (1) To Customer P who is a regular customer and to whom Company W sells on 30 days credit terms. The goods were shipped to P on 10 September, an invoice issued on 14 September and payment received on 22 October.
- (2) To Customer Q for cash. The goods were collected in person by Q, an invoice issued and payment made on 18 September.
- (3) To Customer R who had never previously dealt with Company W. R was therefore required to pay in advance and a proforma invoice was issued on 28 August against which payment was received on 16 September. The goods were shipped to R on 21 September.

**Required:**

**State, giving reasons, the date on which Company W will be liable to consumption tax on each of the above sales.** (4 marks)

**(20 marks)**

- 4 (a) Company M imports a production line with a CIF (carriage, insurance and freight) value of USD6 million, including ocean freight of USD200,000, ocean insurance premium of USD60,000 and installation and testing fee of USD300,000. Company M also paid customs handling fees of RMB5,000, inwards transportation from the port to the company of RMB20,000 and an additional service fee to an overseas agent of USD120,000. After the importation, Company M will sell the production line for RMB60 million, inclusive of value added tax (VAT) to a customer.

**Required:**

- (a) **State the general principle used to determine whether or not an item should be included in the composite value of an import and explain how it will be applied to Company M's import of the production line.** (2 marks)
- (b) **Calculate the customs duty and VAT payable (if any) by Company M on the importation and sale of the production line, if the customs rate is 10%.**  
Note: you should use a USD:RMB exchange rate of 1:6.8. (4 marks)
- (c) **Assuming that there are no other expenses incurred, calculate the enterprise income tax payable by Company M on this transaction.** (4 marks)
- (d) **List the methods by which Customs may assess the dutiable value of an import if it considers the value declared to be too low and without proper justification.** (5 marks)

**(15 marks)**

- 5 Company E is a property developer which sold an office building on 30 April 2009 for a consideration of RMB65 million. All relevant PRC taxes in relation to the sale transaction, including 5% business tax, were paid immediately. Company E had paid RMB7 million for the acquisition of the land use right and other registration fees; real estate development expenses of RMB19 million; and interest expenditure of RMB1,500,000 (supported with certificates from a financial institution). The interest expenditure was RMB250,000 higher than the interest that would have been charged by the China Construction Bank for a loan of the same type and same period.

According to the regulations of the local government for the jurisdiction where Company E is located, the percentage allowable deduction of other property development cost is 5% for land appreciation tax purposes.

**Required:**

**Calculate the land appreciation tax payable by Company E in relation to the sale of the office building and state by when it would have been payable.**

**(10 marks)**

**End of Question Paper**