

Fundamentals Level – Skills Module

Taxation (China)

Monday 1 June 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)

ACCA

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		Rate
Income tax for domestic and foreign enterprises		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.	

ALL FIVE questions are compulsory and MUST be attempted

- 1 (a)** Company A is a manufacturing joint venture enterprise, which was established on 1 January 2008 and started operations on that date. The company is a general value added tax (VAT) payer.

The following is the statement of enterprise income tax (EIT) payable for the year 2008 as prepared by the accountant of Company A:

	RMB
Turnover	100,000,000
Cost of goods sold (Note 1)	(50,000,000)
Gross profit	50,000,000
Management and finance expenses (Note 2)	(35,000,000)
Other income	100,000
	<u>15,100,000</u>
Tax rate	25%
Tax payable	3,775,000

Notes:

- (1) The cost of goods sold includes depreciation of newly approved energy-saving equipment, purchased in 2008 with an original cost of RMB1,000,000 plus related VAT of RMB170,000. The depreciation has been calculated correctly under the tax rules.
- (2) The management and finance expenses include the following amounts:
- | | RMB |
|---|------------|
| Salaries and bonuses paid to staff | 10,000,000 |
| Interest on a loan borrowed from a non-financial institute with an interest rate of 5%; the interest rate on an equivalent loan from a commercial bank would be 4%. | 100,000 |
| Entertaining expense | 1,500,000 |
| Penalty for late payment of 2007 EIT | 20,000 |
| Payment of 2007 EIT | 200,000 |
| Staff and workers union expenses | 50,000 |
| Donation to an approved charity body | 2,000,000 |
| Direct donation to some poor families | 200,000 |
| Amortisation of approved intangible assets from self-developed research | 50,000 |

Additional information:

Other than the above items, the following events were omitted from (never recorded in) the accounting system of Company A:

- Sales of RMB10,000 (including VAT) made to customers, for which ordinary invoices were issued. The delivery cost incurred, for which transportation invoices were obtained was RMB1,000.
- The donation of a machine was received by the company, together with a VAT invoice showing the cost of the machine as RMB100,000 plus VAT of RMB17,000.

Required:

(i) State, giving reasons, whether or not the accountant's treatment of each of the items listed in Note 2 is correct. (9 marks)

(ii) Calculate the correct accounting profit of Company A for the year 2008 after consideration of the two omitted transactions. (5 marks)

(iii) Calculate the correct amount of enterprise income tax (EIT) payable by Company A for the year 2008.

Note: you should start your computation with the accounting profit figure you have calculated in (ii) above and clearly identify all the adjustments made. (6 marks)

(iv) Assuming that the tax authority has determined that Company A should pay its EIT on a quarterly basis in advance, briefly explain the procedures for the assessment and collection of those quarterly payments. (3 marks)

(v) Briefly explain how income denominated in a foreign currency should be translated for the purpose of collecting Company A's EIT. (3 marks)

(b) Company B is a manufacturing foreign invested enterprise. The company has a new product X, which was launched three years ago, for which it has an accounting provision policy of making a one-year product return guarantee of 3% of its sales turnover.

Details of the movements in the guarantee provision for each of the three years are as follows:

	Year 1 RMB	Year 2 RMB	Year 3 RMB
Sales turnover	100,000	200,000	100,000
Movement on account of the guarantee provision:			
Opening balance	0	3,000	6,000
(i) General provision for the year	3,000	6,000	3,000
(ii) Actual returns	0	(1,000)	(7,000)
(iii) (Over)/under provision	0	(2,000)	1,000
Closing balance	3,000	6,000	3,000

Required:

Briefly explain the tax treatment of each of the items (identified as (i), (ii) and (iii)) comprising the movements in the guarantee provision in the years 1, 2 and 3 respectively. (5 marks)

(c) Company C, a manufacturing company, intends to set up a branch located in a province other than the province where its manufacturing operations are registered.

Required:

State the time and location requirements for the tax registration of the branch and briefly explain the tax penalty and business operation consequences of failing to apply for registration. (4 marks)

(35 marks)

- 2 (a) Mr Wang, a Chinese citizen, is employed by a PRC enterprise as an engineering manager. In 2008 in addition to his monthly salary of RMB9,000 (gross), Mr Wang had the following income:
- (1) He received his 2007 annual one-off bonus of RMB30,000 (net), on which the tax was borne by his employer.
 - (2) He received a dividend of RMB3,800 from a company listed on the Shanghai Stock Exchange market.
 - (3) He temporarily acted as a translator for a conference in his spare time and earned RMB3,300 (net).
 - (4) He received RMB5,200 interest income derived from Government bonds.
 - (5) He provided a patent to an overseas enterprise and received RMB90,000. He paid RMB8,000 individual income tax in the source country according to the tax rules of that country.
 - (6) He published a book and a series in a newspaper, and received income of RMB66,000 and RMB3,500 from the book publisher and newspaper respectively.
 - (7) He received income of RMB4,000 (net) from selling certain listed shares on hand.
 - (8) He was engaged to proof read the English translation version of a literary work and earned RMB27,500 (gross).
 - (9) He sold a real property for RMB690,000, which he had acquired two years earlier for RMB370,000. He paid relevant business tax on the sale, plus RMB 7,000 to the real estate agency who had handled the sales transaction. (Any land appreciation tax (LAT) implications of this transaction should be ignored.)

Required:

Calculate the individual income tax (IIT) payable by Mr Wang for the year 2008, clearly identifying any amounts which are tax exempt. (15 marks)

- (b) Mr Roberson, a US national, is employed by a US company to work in China on a temporary assignment (i.e. an assignment of not more than 20 days in a year).

Required:

- (i) **State the conditions that must be satisfied for a temporary resident to be exempt from the individual income tax (IIT) and explain what Mr Roberson must do to obtain this exemption.** (3 marks)
- (ii) **Briefly explain the effect on Mr Roberson's IIT position if he were to be the chief representative of the representative office established by the US company in China.** (2 marks)

(20 marks)

- 3** During the month of October 2008, Company D, a furniture manufacturing company, carried out the following transactions:
- (1) Certain raw materials acquired in the previous month were damaged in an accident. The stock loss was RMB213,950 (excluding VAT), including gross freight charges of RMB13,950.
 - (2) Sold certain furniture products to several small-scale commercial entities by issuing general invoices and received RMB269,100 (including VAT). Freight charges of RMB7,605 (including VAT) were also received from the customers for the delivery service.
 - (3) Acquired wood for RMB480,000 (excluding VAT) from a timber mill. 20% of the wood purchased was used for the construction of a canteen for Company D's employees.
 - (4) Paid RMB280,000, plus related VAT of RMB47,600 for materials. Also, RMB16,000 (including VAT) to the transportation company for delivery of the materials. During the unloading of the materials, a shortage amounting to RMB28,000 (representing 10% of purchase amount) was noted.
 - (5) Sold 20 sets of self-manufactured sofas to its own staff at a cost of RMB140,000 and donated two sets of sofas to the Beijing Olympic Games. The market price of a set of sofas is RMB11,000 (including VAT).
 - (6) Six sets of self-manufactured office furniture were taken for self-usage by Company D. The cost per set is RMB21,000 (excluding VAT). The comparable profits rate is 10%.
 - (7) Sold a batch of furniture to a hotel under an installment contract, for a total price of RMB900,000 (excluding VAT). Under the contract, RMB300,000 should have been paid in October 2008. However, by the end of the month, only RMB180,000 had been collected from the hotel.
 - (8) Sold a used machine for RMB100,000 (including VAT). At the time of the sale the machine had a net book value of RMB96,000 and accumulated depreciation of RMB35,000.
 - (9) Launched a sales scheme to allow for furniture trade-in. In October 2008, the money received from furniture sales under this scheme was RMB140,000 (excluding VAT), after netting off the RMB20,000 allowance given for the old furniture traded in.
 - (10) Delivered 1,050 tea tables at a selling price of RMB175.5 (including VAT) each. Fifty of the tables were sold to ultimate customers directly; 850 were sold to furniture wholesalers; and the remaining 150 were given to certain customers as gifts. The wholesalers all received an immediate discount of 25% of the selling price and were offered a further 5% discount if they made payment of the money due within five days of delivery. All the wholesalers paid the money within five days.

Required:

Calculate the input and output value added tax (VAT) of Company D in respect of each of the above transactions, clearly identifying any disallowed amounts.

(20 marks)

- 4 (a) (i) Briefly explain the term 'arm's length principle' in the context of transactions between associated enterprises pursuant to the enterprise income tax law. (2 marks)
- (ii) State the circumstances in which the tax bureau may presume an associated relationship to exist between enterprises pursuant to the enterprise income tax law. (3 marks)
- (iii) Company E and Company F are associated enterprises with registered capitals of RMB400,000 and RMB200,000 respectively. On 1 January 2008 Company E made a loan to Company F of RMB500,000 at a rate of interest of 2%. The normal rate of interest on such a loan would be 5%.

Required:

Explain the enterprise income tax (EIT) implications of the loan for Company E and Company F respectively, for the year 2008. (4 marks)

- (b) Company G is considering hiring Mr P to work on a construction project. The project is expected to last about five years. Mr P can provide his services either as an independent contractor or as an employee.

Required:

- (i) Briefly explain the individual income tax (IIT) implications for Mr P under each of the two alternatives (independent contractor and employee). (3 marks)
- (ii) State any THREE things that Company G could do to increase the chance of Mr P being classed as an employee. (3 marks)

(15 marks)

- 5 (a) (i) Briefly explain the business tax (BT) and/or value added tax (VAT) treatment of mixed sales activities. (4 marks)
- (ii) In relation to each of the following companies state, giving reasons which tax (BT/VAT) is applicable, together with the tax rate:
- (1) Company H is a retail shop, which specialises in selling air-conditioners to individuals for home use. The sales price includes the cost of the installation service.
- (2) Company J is a construction company, which provides both labour and materials for the building of houses. (2 marks)

- (b) Company K is a pharmaceutical company. In October 2008, Company K:

- (1) Purchased materials for the manufacture of medicines on which it paid value added tax (VAT) of RMB68,000. The freight charge for transporting the purchased medicines was RMB19,000.
- (2) Sold VAT taxable medicines for RMB360,000 (excluding VAT) and VAT exempted medicine for RMB150,000.
- (3) Raw materials, which had cost RMB28,000 (excluding VAT but including freight charges of RMB930) were consumed in the manufacture of the VAT exempted medicines sold (as in (2) above).

Required:

- (i) Calculate Company K's allowable input VAT for the month of October 2008, on the basis that all transactions have been fully recorded. (2 marks)
- (ii) Calculate Company K's allowable input VAT for the month of October 2008, on the basis that the company failed to record separately the materials consumed in the manufacture of the VAT exempted medicines and the VAT taxable medicines. (2 marks)

(10 marks)

End of Question Paper