

Fundamentals Level – Skills Module

Taxation (China)

Tuesday 4 December 2012



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. 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.

Enterprise income tax

Income tax for domestic and foreign enterprises	Rate 25%
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Individual income tax

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	15,000 or below	5%	0
2	15,001– 30,000	10%	750
3	30,001 – 60,000	20%	3,750
4	60,001 – 100,000	30%	9,750
5	Over 100,000	35%	14,750

Employment income

Grade	Taxable income on which employee bears the tax/employer bears the tax (RMB)	Rate %	Quick deduction factor (RMB)
1	1,500/1,455 or below	3	0
2	1,501 – 4,500/1,456 – 4,155	10	105
3	4,501 – 9,000/4,156 – 7,755	20	555
4	9,001 – 35,000/7,756 – 27,255	25	1,005
5	35,001 – 55,000/27,256 – 41,255	30	2,755
6	55,001 – 80,000/41,256 – 57,505	35	5,505
7	Over 80,000/57,505	45	13,505

For other income

Each time below RMB 800	Rate 0%
Each time from RMB 801 to RMB 4,000	20%
Each time above RMB 4,000 (with 20% allowance)	20%

Individual service income

Net of tax income (RMB)	Before tax income (RMB)	Rate %	Quick deduction factor (RMB)
1 – 16,000	1 – 20,000	20	0
16,001 – 37,000	20,001 – 50,000	30	2,000
37,001 and above	50,001 and above	40	7,000

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-scale taxpayers		3%
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 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 accounting profits
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 Y is a manufacturing joint venture enterprise, which was established and started operations on 1 January 2011.

The statement of enterprise income tax (EIT) payable prepared by the accountant of Company Y for the year 2011 is as follows:

	RMB	RMB
Turnover		90,000,000
Cost of goods sold		<u>(50,000,000)</u>
Gross profit		40,000,000
Management and finance expenses		(17,500,000)
The following amounts were included within the management expenses:		
(1) Salaries and bonuses paid to staff (note 1)	7,500,000	
(2) Office rental expenses (note 2)	500,000	
(3) Entertaining expense	900,000	
(4) Advertising expense	3,000,000	
(5) Amortisation of intangibles (note 3)	150,000	
(6) Depreciation of fixed assets other than items 7 and 8 (note 4)	1,000,000	
(7) Depreciation of fixed assets purchased under a finance lease	50,000	
(8) Depreciation of fixed assets purchased under an operating lease	25,000	
(9) Penalty imposed by the government for the late filing of the annual return	50,000	
(10) Penalty imposed by a customer for defective products	25,000	
(11) Stock loss provision (note 5)	100,000	
Investment income		(230,000)
The investment income comprises the following:		
(12) Interest income from a national debenture	20,000	
(13) Gain on the disposal of a national debenture	50,000	
(14) Loss on the disposal of listed shares	(100,000)	
(15) Share of losses from an associated company (note 6)	(200,000)	
Taxable profits		<u>22,270,000</u>
Tax rate		25%
Tax payable		<u>5,567,500</u>

Notes:

- (1) This amount includes bonuses of RMB 300,000 paid in December 2011.
- (2) The office rental expense comprises a lump sum rental payment made for a period of two years from 1 July 2011.
- (3) The amortisation of a self-developed brand name according to an independent valuer's report.
- (4) This amount includes depreciation of RMB 100,000 for a machine which was unused for the whole of 2011 because of a water flood.
- (5) The provision is calculated at 5% of the closing stock value.
- (6) This loss represents Company Y's 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 items (1) to (15) of management expense and investment income included in the income tax calculation prepared by Company Y's accountant; (16 marks)
- (ii) Calculate the correct amount of enterprise income tax (EIT) payable by Company Y for the year 2011. (5 marks)

- (b) Company C is a manufacturing foreign invested enterprise which commenced business two years ago. It has an accounting policy of making a general provision for obsolescence equal to 3% of its year-end stock balance.

Details of the movements in this provision for the two years since the commencement of Company C's business are as follows:

	Year 1 RMB	Year 2 RMB
Year-end stock balance	500,000	400,000
Movement on account of the stock provision:		
Opening balance	0	15,000
(1) General provision for the year	15,000	–
(2) Amount written off	–	(500)
(3) Amount written back	–	(2,500)
	<u>15,000</u>	<u>12,000</u>

Required:

Briefly explain the tax treatment of the items identified as (1), (2) and (3) comprising the movements in the provision in years 1 and 2. (4 marks)

- (c) **Briefly explain the enterprise income tax (EIT) treatment of the interest expense in each of the following cases:**

- (i) **Interest incurred on a loan used for the purchase or construction of fixed assets prior to the assets being put into use;** (1 mark)
- (ii) **Interest paid between operational units within a non-financial enterprise;** (1 mark)
- (iii) **Interest incurred on a related party debt.** (2 marks)

- (d) **Define the term 'intangible assets' for tax purposes and state the valuation bases used initially for such assets and their subsequent tax treatment.** (6 marks)

(35 marks)

- 2 (a)** Mr Chang, a Chinese citizen, is a university professor. He had the following income for the month of January 2012:
- (1) Monthly employment income of RMB 16,000 and a bonus for the year 2011 of RMB 36,000.
 - (2) A dividend of RMB 10,000 received from an unlisted company.
 - (3) A translation fee of RMB 5,000 from a book publisher.
 - (4) Interest income of RMB 5,200 derived from Government bonds.
 - (5) Provided a patent to an overseas enterprise and received RMB 80,000. He paid RMB 7,000 individual income tax in the source country according to the tax rules of that country.
 - (6) Published a book and a series in a newspaper, and received income of RMB 60,000 and RMB 4,000 from the book publisher and newspaper respectively.
 - (7) Income of RMB 4,800 (net) received from selling certain listed shares on hand.
 - (8) Income of RMB 30,000 (gross) earned from proof reading the English translation version of a literary work.
 - (9) Sold a real property for RMB 700,000, which he had acquired two years earlier for RMB 400,000. He paid the relevant business tax on the sale, plus RMB 8,000 to the real estate agency which had handled the sales transaction. (Ignore any land appreciation tax (LAT) implications of this transaction)

Required:

Calculate the individual income tax (IIT) payable by Mr Chang for the year 2012, clearly identifying any amounts which are tax exempt.

Note: The monthly personal allowance for a Chinese local is RMB 3,500. (14 marks)

- (b) Briefly explain the individual income tax (IIT) treatment of each of the following transactions and calculate the tax payable (if any) by Mr A, Mr B and Mr C:**
- (i) Mr A is one of the investors in a limited company, Company J. During the year, Company J bought a car for RMB 300,000 for Mr A's personal use. Mr A is the registered owner of the car;** (2 marks)
 - (ii) Mr B is one of the investors in a limited company, Company K. During the year, Company K lent RMB 300,000 to Mr B so he could buy a car for his personal use;** (2 marks)
 - (iii) Mr C is the sole owner of private enterprise L. During the year, enterprise L bought a car for RMB 300,000 for Mr C's personal use. Mr C is the registered owner of the car.** (2 marks)

(20 marks)

3 (a) Company P manufactures fans. The standard selling price per fan, net of value added tax (VAT), is RMB 80 each. For the month of May 2012, the following sales were made and the VAT on the goods sold was recorded by the company accountant:

(i) Sale of 10,000 fans to a supermarket at RMB 76 each; this price is net of a discount of 5% because of the large volume. RMB 700,000 was received to settle the transaction, which was net of a cash discount of RMB 60,000.

Output VAT: $\text{RMB } 700,000 \times 17\% = \text{RMB } 119,000$

(ii) Sale of 100 (new) fans, partly paid for by the trade-in of 100 old fans, resulting in a net sales value of RMB 50 each. The old fans were used as a staff benefit.

Output VAT : $100 \times \text{RMB } 50 \times 17\% = \text{RMB } 850$

(iii) Sale of 10,000 fans to a wholesaler at RMB 80 each. As a part of the contract terms, Company P agreed to pay back the whole consideration of RMB 800,000 to the wholesaler, at the end of four years.

Output VAT: $\text{RMB } 800,000/4 \text{ years} \times 17\% = \text{RMB } 34,000$

(iv) Exchanged 1,000 fans for raw materials with a market value of RMB 68,000, for use in production.

Output VAT: $\text{RMB } 68,000 \times 17\% = \text{RMB } 11,560$

All amounts are stated excluding VAT.

Required:

Calculate the correct value added tax (VAT) output and input arising from items (i) to (iv), clearly explaining the treatment applied in each case. (9 marks)

(b) A trading company, Company W, imported some goods costing USD 2 million. The additional costs of importing these goods were ocean freight of USD 40,000, an ocean insurance premium of USD 4,000, inland transportation and customs declaration fees of USD 20,000 and a middle-man agent fee of USD 2,000.

All amounts are stated excluding VAT.

Required:

Calculate the customs duty and value added tax (VAT) on the importation of the goods, stating by when they must be paid.

Notes:

1 The exchange rate is USD 1 to RMB 6.

2 The customs tariff rate is 30%.

(4 marks)

(c) (i) Briefly explain the criteria used to determine the status of a small value added tax (VAT) payer and its tax implication; (5 marks)

(ii) Calculate the VAT payable by a small scale VAT payer who sold goods for RMB 20,600 and a used car for RMB 46,350 in February 2012. (2 marks)

(20 marks)

- 4 Company M, a cigarette company, had the following transactions in the month of January 2012:
- (1) Bought tobacco for RMB 250,000 (including value added tax (VAT) and consumption tax (CT)) from a commercial supplier who is a general VAT payer.
 - (2) Bought tobacco for RMB 40,000 (invoice value) from a local farmer and paid the related transportation cost of RMB 20,000 (invoice value).
 - (3) Subcontracted the tobacco in (2) to an outside subcontractor, Company N, and paid the fee of RMB 90,000 (including VAT) stated in the VAT invoice received from Company N.
 - (4) Received goods back from the subcontractor in (3), but Company N had not paid the related CT on Company M's behalf.
 - (5) 50% of the goods in (1) and (4) were used in production during the month of January 2012.
 - (6) Sold 20,000 cases of cigarettes for RMB 40 million (excluding VAT).
 - (7) Distributed four cases of cigarettes for staff welfare.

Required:

- (a) Calculate the value added tax (VAT) liability of Company M for the month of January 2012. (7 marks)
- (b) Calculate the consumption tax (CT) liability of Company M for the month of January 2012. (7 marks)
- (c) Calculate the consumption tax (CT) liability of Company N, if any, for the month of January 2012. (1 mark)

Note: The CT rate for tobacco is 30% and for cigarettes is RMB 160 per case plus 45% of turnover.

(15 marks)

- 5 (a) Define the term 'controlled foreign subsidiary' and briefly explain the tax treatment of the profits of such an enterprise in the context of the special tax adjustment pursuant to the enterprise income tax law and rules. (5 marks)
- (b) (i) Briefly explain when the tax authority can make a special tax adjustment in respect of transactions between related parties; (2 marks)
 - (ii) Briefly explain the interest levy applicable in the case of a special tax adjustment. (3 marks)

(10 marks)

End of Question Paper