

Fundamentals Level – Skills Module

Taxation (China)

Tuesday 3 December 2013



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

	Rate
Income tax for resident enterprises and non-resident enterprises with an establishment in China	25%
Income tax for specific China sourced income of non-resident enterprises	10%

Deduction limits on certain expenses

Employment welfare expenses	14% of total wages
Labour union expenses	2% of total wages
Employee training expenses	2.5% of total wages*
Donations	12% of the accounting profits
Entertainment expenses	60% of the amount subject to a maximum of 0.5% of the sales/business income of the year.
Advertising and promotion expenses	15% of the sales/business income of the year*

*except for certain special industries

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	Up to and including 15,000	5%	0
2	Over 15,000 to 30,000	10%	750
3	Over 30,000 to 60,000	20%	3,750
4	Over 60,000 to 100,000	30%	9,750
5	Over 100,000	35%	14,750

Employment income

Level	Taxable income on which employee bears the tax/employer bears the tax (RMB)	Rate %	Quick deduction factor (RMB)
1	Up to and including 1,500/1,455	3	0
2	Over 1,500 to 4,500/1,455 to 4,155	10	105
3	Over 4,500 to 9,000/4,155 – 7,755	20	555
4	Over 9,000 to 35,000/7,755 to 27,255	25	1,005
5	Over 35,000 to 55,000/27,255 to 41,255	30	2,755
6	Over 55,000 to 80,000/41,255 to 57,505	35	5,505
7	Over 80,000/57,505	45	13,505

Monthly personal allowance for a China local	RMB 3,500
Additional allowance for expatriate employees	RMB 1,300

Individual service income

Net of tax income (RMB)	Before tax income (RMB)	Rate %	Quick deduction factor (RMB)
Up to and including 21,000	Up to and including 20,000	20	0
Over 21,000 to 49,500	Over 20,000 to 50,000	30	2,000
Over 49,500	Over 50,000	40	7,000

Allowance each time for individual service income, income from manuscripts, royalties and rental of property:

RMB 4,000 and below	RMB 800
Over RMB 4,000	20%

Income from:

	Rate
Royalties, interest, dividends, rental of property, transfer of property, incidental income and other income	20%

Donations of individuals

Limited to: 30% of the taxable income; or
100% if the donation is made to certain funds approved by the government

Value added tax (VAT)

	Rate
For importation of goods depending on the itemised goods	17%/13%
For small-scale taxpayers	3%
For ordinary taxpayers for the sale of itemised goods, processing, and repairing	17%
for the sale or import of itemised goods	13%
input tax credit for agricultural products	13%
input tax credit for transportation charges	7%

Note: VAT reforms in China since 1 August 2013 need not be considered.

Business tax

Industries	Rate
Transportation, construction, postal and telecommunication, culture and sports	3%
Finance and insurance, services, transfer of intangible property, sale of immovable property	5%
Entertainment	5%~20%

Land appreciation tax

Level	The ratio of increased value against the value of deductible items	Rate %	Quick deduction ratio (%)
1	No more than 50%	30	0
2	Over 50% to 100%	40	5
3	Over 100% to 200%	50	15
4	Over 200%	60	35

Exchange rate

USD1 = RMB 7

ALL FIVE questions are compulsory and MUST be attempted

1 (a) Company Y is a manufacturing company. The accounting clerk has prepared the following statement of enterprise income tax (EIT) payable for the year 2012 as follows:

	Note	RMB
Turnover		12,500,000
Cost of goods sold	1	(7,300,000)
Gross profit		5,200,000
Sales expenses	2	(2,580,000)
Financial expenses	3	(420,000)
Administrative expenses	4	(1,210,000)
Other income	5	220,000
Taxable profit		1,210,000
Tax rate		25%
Tax payable		302,500

Notes:

1. Cost of goods sold includes a batch of goods at a cost of RMB 98,000, which was sold at RMB 35,000 due to the poor market situation.
2. Sales expenses include the following:

	RMB
(i) Entertainment expenses	80,000
(ii) Advertising and promotion (the amount in excess of the deduction limit for 2011 was RMB 580,000)	1,200,000
(iii) Provision for doubtful debts	200,000
(iv) Bad debt written off (this amount was due from Customer B, who has not been in contact with Company Y since 2007; Company Y has not taken any action to recover the debt)	135,000
(v) Compensation paid to a customer for breach of contract	240,000

3. Financial expenses include interest of RMB 300,000 calculated at 30% per annum on a loan from one of Company Y's shareholders, Mr A. The market rate of interest on a similar type of loan from a bank is 5% per annum.
4. Administrative expenses include the following:

	RMB
(i) Staff welfare and benefits (the total amount of wages and salaries for 2012 were RMB 3,800,000)	650,000
(ii) Penalty for the late filing of a tax return	2,000
(iii) Donation to a school	10,000

5. Other income comprises:

	RMB
(i) Interest income on national bonds	30,000
(ii) Dividend received from a long-term investment in a subsidiary in China	120,000
(iii) Gain on the disposal of national bonds	70,000

Required:

- (i) Briefly explain the enterprise income tax (EIT) treatment of each of the 13 items referred to in notes 1 to 5. (15 marks)
- (ii) Calculate the correct amount of EIT payable by Company Y for the year 2012, starting with the taxable profit of RMB 1,210,000. (7 marks)

(b) Company A was set up in 2005. The table below shows its taxable profits/(losses) for the years 2005 to 2012.

	2005	2006	2007	2008	2009	2010	2011	2012
	RMB	RMB	RMB	RMB	RMB	RMB	RMB	RMB
Taxable profits/ (losses)	(820,000)	(600,000)	(400,000)	960,000	180,000	(800,000)	140,000	1,280,000

Required:

- (i) **Briefly explain the tax treatment of losses for enterprise income tax (EIT).** (2 marks)
- (ii) **Explain the treatment of Company A's losses, clearly identifying the total allowable loss available for offset in the year 2012.** (3 marks)

(c) Company H is considering borrowing RMB 10,000,000 from an overseas bank, Bank K. Bank K has proposed a net-of-tax interest rate of 4.25% per annum. Bank K does not have any branches, offices or agents in China and it is not entitled to a reduced withholding tax rate under a tax treaty.

As an alternative to borrowing from Bank K, Company H could borrow the RMB 10,000,000 from the Chinese branch of another overseas bank, Bank W.

Required:

- (i) **Calculate the amount of gross interest which Company H is paying on the loan from Bank K.**
Note: You should assume that there are no other local surtaxes and levies. (1 mark)
- (ii) **Calculate the business tax and enterprise income tax (EIT) liability of Bank K in respect of the interest income from Company H.** (1 mark)
- (iii) **Briefly explain the meaning of a non-resident enterprise for EIT purposes.** (3 marks)
- (iv) **For each of Bank K and Bank W, state why they are non-resident enterprises and the basis (if any) on which they will pay EIT.** (3 marks)

(35 marks)

- 2 (a) (i) Explain the term 'China tax resident' for the purposes of individual income tax (IIT). (2 marks)
- (ii) State the scope of IIT in the case of (1) a tax resident; and (2) a non-tax resident of China. (2 marks)

(b) Mr Li, a foreign national, is considered a China tax resident for individual income tax (IIT) purposes. Mr Li worked in China for the whole of 2012, except for his one-month's annual leave in July 2012, when he spent the whole month in the USA.

In the year 2012, Mr Li received the following income and benefits from his China employer:

- (1) He received a monthly salary of RMB 80,000 for each of the 12 months of 2012.
- (2) In December he received an annual bonus of RMB 120,000 for the year 2012.

Mr Li also earned the following income from other sources in the year 2012:

- (3) In September he taught two classes in a university in China and earned a lecture fee of RMB 15,000 for each class.
- (4) He won a lottery from a supermarket in China and received a computer valued at RMB 5,000.
- (5) He received insurance compensation of RMB 30,000 for a work-related injury in China.
- (6) He has written an article for publication and the remuneration was RMB 5,000
- (7) He set up a privately owned sole proprietorship on 1 January 2012. The income of this business for the year 2012 was RMB 400,000 after the deduction of tax deductible expenses and Mr Li's monthly remuneration of RMB 10,000, but before the deduction of the annual standard deduction of RMB 42,000.

Required:

Calculate the individual income tax (IIT) payable by Mr Li in respect of each of the items (1) to (7), clearly identify any item(s) which are tax exempt or not subject to IIT. (11 marks)

- (c) List the circumstances in which an individual is subject to self-assessment for IIT. (5 marks)

(20 marks)

3 A newly set up company, Company Q, imports red wine from France for sale in China. Company Q had the following transactions in the year 2012:

- (1) Imported 3,000 bottles of red wine at a CIF (cost including insurance and freight) value of USD 30,000.
- (2) Sold 2,000 bottles of the wine at RMB 300 per bottle to wholesalers who are all VAT general taxpayers.
- (3) Gave 100 bottles of the wine to customers as Christmas gifts.
- (4) Due to a flood, 150 bottles of the wine in the warehouse were destroyed.
- (5) Due to poor management, the warehouse was broken into and 200 bottles of wine were lost through theft.
- (6) A customer returned 50 bottles of the wine, together with the Certificate of Returns and Discounts issued by the tax bureau. Company Q accepted the goods returned.
- (7) An early settlement discount of RMB 10,000 was granted to a regular customer.
- (8) Transportation expenses of RMB 20,000 were paid on the sales of the wine. Transportation invoices were obtained.
- (9) Bottle-openers were purchased from a small-scale taxpayer. Company Q paid a total of RMB 2,000 to this supplier and a VAT special invoice was obtained.

Required:

(a) (i) Calculate the import customs tariff, consumption tax (CT) and value added tax (VAT) payable by Company Q on the 3,000 bottles of wine imported under item (1).

Notes:

1 The customs tariff rate is 10%.

2 The consumption tax rate for red wine is 10%. (4 marks)

(ii) State when Company Q must make the customs import declaration. (1 mark)

(b) Calculate the amount of VAT payable by Company Q in 2012, clearly identifying any transactions for which no tax charge or adjustment is required. (8 marks)

(c) Explain the VAT and enterprise income tax (EIT) treatments of item (5). (3 marks)

(d) State any FOUR transactions which can be considered as deemed sales for VAT purposes. (4 marks)

(20 marks)

- 4 (a) Company D is a consultancy firm in Guangxi. The company had the following transactions in May 2012.
- (1) Signed an engagement letter with Client B with a service fee of RMB 100,000. A down payment of RMB 50,000 was due on the signing of the engagement letter and the balance was due on the completion of the project. Company D received the down payment of RMB 50,000 in May.
 - (2) Completed a consultancy project for Client E and received the service fee of RMB 40,000 plus outlays of RMB 1,200 which were to be borne by the client.
 - (3) Client F was declared bankrupt, owing Company D outstanding fees of RMB 20,000. Company D does not expect the outstanding amount to be recovered and has written it off as a bad debt.
 - (4) Received interest on a loan to an associated company of RMB 20,000.
 - (5) Received interest on a bank deposit of RMB 8,000.
 - (6) Sold office premises for RMB 10,000,000. The office premises had been acquired by Company D at a cost of RMB 6,000,000.
 - (7) Sold some used computers for RMB 20,000.

Required:

- (i) **State the business tax (BT) treatment of each of the items (1) to (7).** (7 marks)
- (ii) **Calculate the BT payable by Company D for May 2012.** (1 mark)

- (b) A property developer, Company P, sold a newly constructed office tower in March 2012 for RMB 20,000,000. Details of the costs of construction of the office tower are as follows:

- (1) Acquisition of the land use right from the government for RMB 5,000,000, on which deed tax of 3% was paid.
- (2) Costs of demolition of RMB 400,000.
- (3) Costs of construction of RMB 3,000,000.
- (4) Management, administrative expenses and interest of RMB 1,500,000.

The taxes payable on the sale of the property were: business tax (BT) of 5% and city maintenance and construction tax and education levy of 10% on the BT.

Required:

Calculate the land appreciation tax (LAT) payable by Company P, if the office tower was sold immediately after completion.

Note: You should ignore stamp duty when answering this question. (7 marks)

(15 marks)

- 5 (a) Briefly explain the following terms for the purposes of the enterprise income tax (EIT) law:
- (i) associated (or connected) parties; and (3 marks)
 - (ii) arm's length principle. (2 marks)
- (b) Company K is a foreign-invested enterprise set up by a Japanese company. Company K purchases materials domestically in China and exports the finished goods to its parent company in Japan. Company K calculates the selling price of the finished goods exported based on the cost of production plus a 0.5% mark-up. Since 2009, Company K has sold the material scraps from the processing in China, but has not paid any taxes on these sales.

Required:

In the case of each of the following, state what action will be taken by the tax authority, including any fines or other penalty which may be imposed:

- (i) The tax authority disagrees with the mark-up of 0.5% on the cost of production. (2 marks)
- (ii) The tax authority discovers the sale of the material scraps on which taxes have not been paid. (3 marks)

(10 marks)

End of Question Paper