

Fundamentals Level – Skills Module

Taxation (China)

Tuesday 3 June 2014



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 to 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

Before tax income (RMB)	Rate %	Quick deduction factor (RMB)
Up to and including 20,000	20	0
Over 20,000 to 50,000	30	2,000
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:

Manuscripts, 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%

VAT pilot programme for transportation and modern services

Industries	Rate
Transportation services	11%
R&D and technical services, IT services, cultural and innovation services, logistics auxiliary services, attestation and consulting services, and broadcasting, film and television services	6%
Tangible movable property leasing services	17%

Note: The above rates are based on the pilot rules effective from 1 August 2013. The new rules effective from 1 January 2014 are not examinable in the 2014 exams.

Business tax

Industries	Rate
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 6

ALL FIVE questions are compulsory and MUST be attempted

1 (a) Company B is a limited liability company set up on 1 January 2013. Company B is engaged in the provision of information technology and data processing services. The company’s accountant has prepared the following tax computation for the year ended 31 December 2013:

	Note	RMB
Service income		11,780,000
Cost of services	1	(4,285,000)
Gross profit		<u>7,495,000</u>
Sales expenses	2	(1,387,000)
Financial expenses	3	(875,000)
Administrative expenses	4	(5,280,000)
Research and development expenses	5	(760,000)
Other income and expenses	6	50,000
Loss		<u><u>(757,000)</u></u>

Notes:

(1) The cost of services includes wages and salaries of RMB 2,900,000, of which RMB 500,000 relates to the accrued portion of a bonus due and payable to a member of senior management on the termination of his contract in 2017.

(2) Sales expenses include:

	RMB
(i) Entertainment expenses	113,200
(ii) Advertising and promotion expenses	810,300
The excess amount of advertising and promotion expenses not deducted in 2012 is RMB 100,000.	

(3) Financial expenses include RMB 40,000 of interest paid on a shareholder’s loan. The interest rate on this loan is 5% p.a. which is the same as the market interest rate on loans on similar terms from banks.

(4) Administrative expenses include:

	RMB
(i) Staff welfare and benefits	400,000
(ii) Labour union fees	40,000
(iii) Penalty for the late registration with a government authority	100
(iv) Amortisation of goodwill on the acquisition of a business	515,000
This expenditure is being amortised over a period of five years.	
(v) Depreciation on computers acquired in 2012	200,000
These assets are being depreciated over a period of four years after taking into account a scrap value of 10%.	
(vi) Sponsorship fee to a local school	10,000

(5) Research and development (R&D) expenses include RMB 320,000 which has been registered with the tax bureau and agreed as qualifying for the tax incentives on R&D expenses.

(6) Other income and expenses comprise:

	RMB
(i) Non-specific purpose financial subsidy received from the local government	100,000
(ii) Write-off of furniture destroyed in a fire The furniture had cost RMB 150,000 and insurance compensation of RMB 120,000 was received. A report was submitted to the tax bureau.	(30,000)
(iii) US income tax paid in relation to services provided in the USA The profit on this specific service project was RMB 500,000.	(20,000)
	<hr/> 50,000 <hr/>

Required:

- (i) **Briefly explain the enterprise income tax (EIT) treatment of each of the 14 items referred to in notes (1) to (6).** (17 marks)
- (ii) **Calculate the correct amount of EIT payable by Company B for the year 2013, starting with the loss of RMB 757,000 and clearly identifying those items which do not require any adjustment.** (8 marks)
- (b) Company H is a Hong Kong company which has set up a representative office (RO) in China. The RO provides liaison services in China for Company H. The China tax authorities have assessed the tax position of the RO and concluded that the RO should pay tax on a cost-plus basis at a deemed profit rate of 15%. In 2013 the taxable costs of the RO are RMB 160,000.

Required:

- Calculate the business tax (BT) and enterprise income tax (EIT) of the representative office (RO) for the year 2013.** (3 marks)
- (c) **Briefly explain the principle of 'effective management' used to determine whether an enterprise registered outside China can be considered as a China tax resident.** (3 marks)
- (d) **State any FOUR circumstances in which the tax authorities can assess an enterprise's liability to enterprise income tax (EIT) using the deemed basis.** (4 marks)

(35 marks)

2 Ms Chen, a Chinese national, received the following income in 2013.

Income from her employment as a manager with Company X:

- (1) A salary of RMB 10,000 per month for each of the 12 months of 2013. In addition, she was entitled to the following subsidies and allowances in 2013:
 - (a) A meal allowance of RMB 500 per month.
 - (b) Overtime income of RMB 1,000 per month.
 - (c) Reimbursement of business trip expenses in January 2013. The amount incurred was RMB 1,200 and the whole amount was supported with invoices.
 - (d) Employer's mandatory contribution to social security of RMB 1,200.
- (2) A year-end bonus of RMB 40,000 in December 2013.

Other income:

- (3) She had an article published in a magazine in June and republished in July. The authorship fee was RMB 3,000 for each publication.
- (4) In June, a private limited company paid her a dividend from which it withheld individual income tax (IIT). The net-of-tax dividend she received was RMB 40,000.
- (5) In April 2013, she invested RMB 20,000 in A-shares and sold them for RMB 35,000 in August 2013.
- (6) She has provided consultancy services to a Canadian company and received a gross service fee of USD20,000. Canadian tax of USD2,000 was withheld and deducted at source from this fee.
- (7) Her uncle in France died in 2013 and she inherited an estate worth USD1,000,000.
- (8) An advertising company used Ms Chen's photo and image in an advertisement and paid her a fee of RMB 100,000. She decided to donate RMB 15,000 of this fee to an approved charitable organisation specifically for the earthquake in Sichuan. The donation was paid directly to the charity from the advertising company.
- (9) She received net-of-tax interest from a private company of RMB 4,800. Individual income tax and business tax were withheld and deducted by the company before paying this interest.

Required:

- (a) Calculate the individual income tax (IIT) payable by Ms Chen in respect of each of the items (1) to (9), clearly identifying any item(s) which are tax exempt.**

Note: You should ignore the effect of business tax and surtaxes on business tax in respect of items (6) and (8) and surtaxes on business tax in respect of item (9). (16 marks)

- (b) (i) State the penalty which will be levied on the publisher for not withholding IIT from the payment made to Ms Chen (item (3)). (1 mark)**
- (ii) Explain Ms Chen's responsibilities for filing and paying the IIT on this fee. (3 marks)**

(20 marks)

3 (a) Company T, an accountancy firm in Shanghai, is a value added tax (VAT) general taxpayer. Company T's transactions for the month of November 2013 included the following:

- (1) Provided book-keeping services to Client A and billed a fee of RMB 30,000 and outlays of RMB 1,000.
- (2) Billed Client B RMB 40,000 inclusive of VAT for audit services provided.
- (3) Sent a bill to Client Z on 1 November for RMB 100,000. As Client Z settled the bill before the end of November, Company T granted it an early payment discount of RMB 1,000.
- (4) Provided consultancy services to a German client for a fee of RMB 80,000. These services qualified as an export of services.
- (5) Engaged a law firm to provide legal advisory services and received a VAT invoice for fees of RMB 15,000.
- (6) Paid a trademark fee to a global firm in the USA of RMB 50,000. VAT was withheld and paid by Company T.
- (7) Bought computers for RMB 20,000 and obtained a VAT general invoice.
- (8) Paid RMB 5,000 for the repair of the computers. The repair company was a small-scale taxpayer and issued a general invoice to Company T.
- (9) Paid rent to its landlord of RMB 60,000. A business tax invoice was obtained.
- (10) Paid a transportation fee of RMB 2,000 for picking up its staff from the metro station and bringing them to its office. A VAT invoice at 11% was obtained.
- (11) Provided free-of-charge audit services to a charitable organisation. The market value of these services was RMB 35,000.
- (12) Paid leasing charges of RMB 6,000 for a photocopying machine. A VAT invoice was obtained.

Except where stated otherwise, all amounts are exclusive of VAT.

Required:

(i) In respect of Company T's transactions for November 2013, state, giving reasons, those transactions on which value added tax (VAT) will not be charged or for which a VAT credit will not be allowed.

(5 marks)

(ii) Calculate the VAT payable by Company T for the month of November 2013 as a result of transactions (1) to (12).

(9 marks)

(b) Company M is a production company manufacturing lighting products for exportation. The company's transactions for December 2013 are as follows:

- (1) Exported goods at a FOB (freight on board) price of RMB 200,000.
- (2) Sold goods domestically in China for RMB 180,000.
- (3) Imported materials at a CIF (cost including insurance and freight) value of RMB 12,000. The import customs duty rate was 10%.
- (4) Purchased raw materials for RMB 160,000. A bulk purchase discount of RMB 10,000 was deducted directly in the VAT invoice obtained.
- (5) Paid transportation costs of RMB 10,000. A VAT invoice at 11% was obtained.

Except where stated otherwise, all amounts are exclusive of VAT.

Required:

(i) Calculate the amount of irrecoverable input value added tax (VAT) on the exported goods.

Note: The export refund rate is 13%.

(1 mark)

(ii) Calculate the VAT payable by Company M for the month of December 2013.

(5 marks)

(20 marks)

4 (a) Company S sells cosmetics, its transactions in October 2013 were as follows:

- (1) Imported 300 sets of cosmetics packs at a CIF (cost including insurance and freight) value of USD100 per set. The import customs duty rate was 10%.
- (2) Purchased 1,000 pieces of lipstick at RMB 10 per piece from a manufacturing company, Company W.
- (3) Purchased chemicals for the production of cosmetics packs from Company L for RMB 123,000.
- (4) Sold 200 sets of the imported cosmetics packs at RMB 1,500 per set without further processing.
- (5) Sold 600 pieces of lipstick at RMB 50 per piece without further processing.
- (6) Sold 450 sets of self-produced cosmetics packs at RMB 1,000 per set.

All amounts are stated exclusive of VAT.

Required:

- (i) Calculate the consumption tax (CT) paid by Company S on the importation of the cosmetics sets (item (1)). (2 marks)
- (ii) State clearly whether the sales of goods in each of items (4), (5) and (6) are or are not subject to CT. (3 marks)
- (iii) Calculate the CT payable by Company S on its sales for the month of October 2013. (1 mark)

Note: The consumption tax rate on cosmetics is 30%.

(b) In July 1998, Company P acquired an office for self-use, comprising one floor in a multi-storey building, for RMB 3,000,000. In December 2013, Company P sold the office for RMB 20,000,000. The appraised value of the office was RMB 15,000,000.

The taxes payable on the sale of the property were: business tax (BT); city maintenance and construction tax and education levy of 10% on the BT; and stamp duty of 0.05% on the sales contract.

Required:

Calculate the land appreciation tax (LAT) payable by Company P on the sale of the office. (5 marks)

(c) A retail shop, Shop R, sells air-conditioners to customers for RMB 2,000 each; at the same time Shop R charges a RMB 100 installation fee.

Required:

State, giving reasons, whether Shop R should pay business tax (BT) or value added tax (VAT) on the installation fee. (4 marks)

(15 marks)

- 5 (a) (i) Define the term 'tax evasion' as provided for in the Tax Collection and Administration Law. (3 marks)
- (ii) State the statute of limitation on the recovery of taxes in the case of tax evasion. (1 mark)
- (b) During a tax audit of Company A, it was discovered that it had committed the following acts:
- (1) Deducted expenses of RMB 250,000 which were not related to its business operations.
- (2) Sold goods to a related company for RMB 500,000 when the open market selling price of the similar type of goods was RMB 2,000,000.

Required:

Explain whether either or both of the acts committed by Company A constitutes tax evasion, and if not, state how the issue will be classified. (2 marks)

- (c) State the actions which the taxpayer can take if there is a dispute on the amount of tax assessed by the tax authorities and by when such action should be taken. (4 marks)

(10 marks)

End of Question Paper