

Fundamentals Level – Skills Module

# Taxation (China)

Tuesday 2 December 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 A is a foreign investment enterprise set up in China, which manufactures and sells solar power equipment. The only shareholder of Company A is Solar Ltd, a company incorporated in the British Virgin Islands (BVI). The following is a summary of Company A's income statement for 2013.

	Notes	RMB	RMB
Turnover	1		1,850,000
Cost of sales	2		(1,100,000)
Gross profit			750,000
Financial expenses	3	20,000	
Administrative expenses		85,000	
Sales expenses	4	130,000	
			(235,000)
Operating income			515,000
Other income	5		8,800
Dividend	6		(100,000)
Taxable profit			423,800
Tax rate		25%	
Tax payable			(105,950)
After-tax profit			317,850

**Notes:**

	RMB	Item
(1) Turnover includes: A down payment from a customer for equipment to be produced and sold in 2014	10,000	(1)
Goods were delivered and the invoice was issued to the customer in November 2013, but the amount was not settled until February 2014	5,500	(2)
(2) Cost of sales includes: Normal wastage during production	23,000	(3)
(3) Financial expenses include: Interest on a shareholder's loan of USD10,000 at the rate of 0.5% per annum which is lower than the market rate for a similar loan from the bank of 5% per annum	300	(4)
Unrealised foreign exchange loss on the shareholder's loan	2,000	(5)
(4) Sales expenses include: Compensation to a customer on a sale of poor quality goods	4,000	(6)
Entertainment expenses (the amount in excess of the deduction limit for 2012 was RMB 5,000)	10,000	(7)
Advertising and promotion expenses (the amount in excess of the deduction limit for 2012 was RMB 342,000)	60,000	(8)
(5) Other income comprises: Net-of-tax royalties received from overseas (the gross royalties were RMB 8,000 and foreign tax withheld by the overseas payer RMB 800)	7,200	(9)
Interest income from national bonds	1,600	(10)
(6) Dividend income comprises the dividend declared by the board of Company A to its shareholder Solar Ltd.	100,000	(11)

**Required:**

- (i) Briefly explain the enterprise income tax (EIT) treatment of each of the items identified as (1) to (11). State clearly the items for which no adjustment is required. (13 marks)
- (ii) Calculate the correct amount of EIT payable by Company A for the year 2013 starting with the taxable profit of RMB 423,800. (4 marks)
- (iii) Calculate the amount of tax to be withheld by Company A from the dividend payable to Solar Ltd.

Note: There is no treaty relief between China and the British Virgin Islands (BVI). (1 mark)

- (b) An overseas company, P Ltd, provided management services to a China customer for a gross service fee of RMB 100,000. P Ltd is considered as having a China permanent establishment by the tax bureau, which has assessed a deemed profit rate of 50% on the service fee earned by P Ltd.

**Required:**

- (i) Calculate the business tax and enterprise income tax (EIT) payable by P Ltd on the service fee. (3 marks)
  - (ii) State the circumstances in which the tax authorities can assess the taxable profit of a non-resident enterprise on a deemed basis. (2 marks)
- (c) (i) State the FOUR types of tax exempt income for enterprise income tax (EIT) purposes. (4 marks)
  - (ii) Briefly explain the tax treatment of expenses incurred to earn non-taxable income and tax exempt income. (2 marks)
- (d) Company Cap demolished its old factory building and constructed a new one in 2013. The following information relates to these transactions in 2013:
    - (1) The cost of the old factory building was RMB 400,000 and its net book value as at 1 January 2013 (for both accounting and taxation purposes) was RMB 60,000. The old factory was demolished on 1 January 2013.
    - (2) Materials were transferred from inventory for the construction of the new factory. The cost of these materials was RMB 90,000 and their selling price was RMB 100,000.
    - (3) To finance the construction of the new factory, a loan of RMB 500,000 was borrowed from 1 January 2013 at an interest rate of 8% per annum. The loan was repaid on 31 December 2013.
    - (4) A construction company was engaged to build the new factory with a contract sum of RMB 700,000.
    - (5) The new factory building was completed on 15 November 2013 and started operations from 16 November 2013.
    - (6) Company Cap adopted an economic life for the new factory building of 20 years and a residual value of 10%, for both tax and accounting purposes.

**Required:**

- (i) Calculate the cost base of the new factory building for depreciation purposes. (4 marks)
- (ii) Calculate the amount of depreciation on the new factory building for 2013. (2 marks)

**(35 marks)**

- 2 (a) Mr Chen, a Chinese national, was hired by an IT company in 2012. His employer has proposed the following two alternative remuneration packages both with a total of RMB 300,000 to him for 2013:

**Plan 1:** A salary of RMB 17,500 each month for 12 months and an annual bonus of RMB 90,000.

**Plan 2:** A salary of RMB 5,000 each month for 12 months, a special award in June of RMB 120,000 and an annual bonus in December of RMB 120,000.

**Required:**

**Calculate the total individual income tax (IIT) payable by Mr Chen for the year 2013 in respect of each of the two plans.** (6 marks)

- (b) Ms Li, a Chinese national, earned the following income in 2013.

- (1) Coupons for RMB 200 which were given as a result of her bulk buying when she bought groceries from a supermarket for RMB 1,500. She used the coupons to purchase groceries in the next month.
- (2) Won a lottery prize of a smart phone with a value of RMB 3,000 from a supermarket. The supermarket has agreed to bear the individual income tax (IIT) payable by the winners.
- (3) Received bank deposit interest of RMB 2,000.
- (4) Lent Company W RMB 100,000 for a year at an interest rate of 15% per annum.
- (5) Wrote a long article for the newspaper, PP Daily, which was published on three days from 1 to 3 February and received a fee of RMB 1,500 for each day.
- (6) As the independent non-executive director of a listed company, received a director's fee of RMB 10,000 each month, i.e. a total of RMB 120,000 for the year.
- (7) Received employment income from two separate employments as follows:
  - from a retail shop for the period 1 to 15 April, a salary of RMB 2,800; and
  - from a restaurant for the period 16 April to 30 April, a salary of RMB 2,500.

Neither the retail shop nor the restaurant withheld any IIT for her.

**Required:**

**Calculate the individual income tax (IIT) payable by Ms Li for 2013 in respect of each of the items of income (1) to (7). State clearly any item(s) which are 'exempt from IIT' or 'not subject to IIT'.** (8 marks)

- (c) (i) Mr Zhang has a China domicile. In 2013, he was seconded to Hong Kong to work and earned a salary from this Hong Kong employment. After his secondment, he will return to China.

**Required:**

**State, giving reasons, whether Mr Zhang will be taxable in China on the salary from his Hong Kong secondment.** (2 marks)

- (ii) Ms Robin is a model working in the Hong Kong Special Administrative Region. Her Hong Kong employer sent her to China for a fashion show for five days in 2013. She earned a salary from her work at the fashion show. Except for this fashion show, Ms Robin did not spend any time in China in 2013.

**Required:**

**State, giving reasons, whether Ms Robin will be taxable in China in 2013.** (2 marks)

- (d)** Mr Wang is a China tax resident. In 2013, Mr Wang's only income was employment income of RMB150,000 and his employer withheld the correct amount of individual income tax for him.

**Required:**

- (i) State whether Mr Wang is required to submit an annual individual income tax (IIT) return.** (1 mark)
- (ii) State the tax filing deadline for the annual IIT return for the year 2013.** (1 mark)

**(20 marks)**

3 (a) Electronic Ltd is a newly set up retail company selling computer accessories. Electronic Ltd's finance manager prepared the following budget for 2013:

- (1) Sales of goods to individual customers at a value added tax (VAT) inclusive price of RMB 780,000.
- (2) Purchases of goods from a VAT general taxpayer at a VAT exclusive price of RMB 600,000.

**Required:**

- (i) Calculate the value added tax (VAT) payable by and the gross profit of Electronic Ltd for 2013, if it is a VAT general taxpayer. (3 marks)
- (ii) Calculate the VAT payable by and the gross profit of Electronic Ltd for 2013 if it is a small-scale taxpayer. (3 marks)

(b) Clothly Ltd is a factory producing garments for export, it does not have any domestic sales in China. The costs of production of the garments sold by Clothly Ltd in 2013 comprised:

- (1) Raw materials of RMB 200,000 purchased for which special value added tax (VAT) invoices were received.
- (2) Wages and salaries of RMB 50,000.
- (3) Overhead costs for water, electricity, transportation, etc with a total input VAT of RMB 10,000, all of which are supported by valid VAT invoices.

Clothly Ltd had two options for the export of all of the garments produced in 2013:

- (i) To export them itself, directly to an overseas customer for a price of RMB 400,000; or
- (ii) To sell the garments to a Chinese trading company for a price of RMB 360,000 and the trading company will then export the garments to the overseas customer at a price of RMB 400,000.

The VAT refund rate for garments is 16%.

**Required:**

- (i) Calculate the export value added tax (VAT) refundable to Clothly Ltd for the direct export of the garments. (2 marks)
- (ii) Calculate the export VAT refundable to the trading company for the export of the garments purchased from Clothly Ltd. (1 mark)

(c) Toyly Ltd had the following transactions in 2013:

- (1) Sold goods for cash-on-delivery in August and the customer paid in September.
- (2) Sold goods on credit terms of 30 days after delivery. The goods were delivered in February.
- (3) Sent goods on consignment to the consignee in March. The consignee sold the goods in May and passed a statement of the sale to Toyly Ltd also in May.
- (4) Sent goods to a branch in another province for sale in November. The branch sold the goods in December.
- (5) Received money from Customer X and issued a VAT invoice for the goods in June, but did not deliver the goods until July.

**Required:**

**In the case of each of the transactions (1) to (5), state the month in which Toyly Ltd's value added tax (VAT) liability will crystallise.** (5 marks)



- (d) Softko Ltd, a software development company, is a value added tax (VAT) general taxpayer. Softko Ltd had the following transactions in October 2013. All amounts are exclusive of VAT unless stated otherwise.
- (1) Paid a software fee of USD2,000 to an overseas supplier. VAT was withheld and paid to the tax bureau.
  - (2) Purchased ten computers as fixed assets for RMB 100,000. A special VAT invoice was obtained. The computers are used for both taxable and tax exempt services and are used around 20% of the time to provide VAT exempt services.
  - (3) Paid a software house, which is a small-scale taxpayer, a gross amount of RMB 30,000 inclusive of VAT. A special VAT invoice issued via the tax bureau was obtained.
  - (4) Hired a coach for transporting its staff from the metro-station to the office for RMB 50,000. A special VAT invoice was obtained.
  - (5) Acquired a mainframe computer for RMB 40,000, specifically for the development of some software for an overseas customer. A special VAT invoice was obtained. Softko Ltd has applied for VAT exemption on the export of the software overseas.

**Required:**

**Calculate the input value added tax (VAT) of Softko Ltd for the month of October 2013. Clearly identify any item(s) for which input VAT is not creditable and state the reason.** (6 marks)

**(20 marks)**

- 4 (a) The following transactions were undertaken by the persons indicated in 2013:
- (1) A university set up by the local government received tuition fees of RMB 170,000 from students studying for bachelor degrees.
  - (2) A property developer sold used computers for RMB 20,000.
  - (3) A factory received rent of RMB 48,000 from sub-leasing an unused area.
  - (4) A trading company received bank interest income of RMB 10,000.
  - (5) A trading company received interest income of RMB 38,000 from lending to another company.
  - (6) A construction company provided construction services for RMB 500,000.
  - (7) The government transferred a land use right to a property developer for RMB 26,000,000.
  - (8) A company used a trademark valued at RMB 320,000 as a capital contribution to another company.
  - (9) A hotel charged a customer a total fee of RMB 1,300, of which RMB 100 was for the soft drinks from the refrigerator.
  - (10) A son received a villa valued at RMB 2,000,000 from his father's estate.
  - (11) A property management company received a total of RMB 24,000 from tenants, of which RMB 12,000 was for the allocation of electricity and water costs to the tenants and RMB 8,000 was for the salaries of the guards.

**Required:**

**In each of the cases (1) to (11), calculate the business tax payable where relevant, and where not relevant, state clearly whether the transaction is 'subject to VAT instead of business tax' or 'exempt from business tax' or 'not subject to business tax'.**

**Note:** Marks will not be given for stating 'not taxable'. (11 marks)

- (b) Cosmet Ltd, produces and sells cosmetics. Currently, Cosmet Ltd makes three standard types of goods with selling prices and costs as follows. All amounts are stated exclusive of value added tax (VAT).

	Selling price RMB	Cost RMB	Comments
Rouge	80	25	Consumption tax at 30%
Lipstick	40	10	Consumption tax at 30%
Hand cream	10	3	Not subject to consumption tax

In December 2013, Cosmet Ltd had the following transactions:

- (1) Sold 4,200 sets of a pack containing rouge with a lipstick at a price of RMB 100 for each set.
- (2) Sold 1,000 sets of hand cream with a lipstick at a price of RMB 50 for each set.
- (3) Gave 100 pieces of lipstick to participants during the company's annual dinner.
- (4) Purchased 3,000 pieces of rouge from another factory at RMB 30 each and sold 2,500 of these purchased pieces at the same selling price as for its own rouge of RMB 80 each.

**Required:**

**For each of the transactions (1) to (4), calculate the consumption tax payable by Cosmet Ltd or state clearly if the transaction is 'not subject to consumption tax'.** (4 marks)

**(15 marks)**

- 5 (a) **State the FIVE methods which the tax authorities can use to carry out a special tax adjustment (transfer pricing adjustment) where a transaction is not conducted at arm's length.** (5 marks)
- (b) Company D underpaid its enterprise income tax (EIT) for the year 2012 by RMB 230,000 because it overstated its deductible expenses by using fraudulent invoices for its annual tax filing. The tax bureau discovered the overstatement of expenses and considered it as an act of tax evasion and imposed a penalty on Company D. Company D settled the underpaid tax on 31 July 2013.

**Required:**

- (i) **Calculate the amount of late payment surcharge which Company D would have had to pay when it settled the underpaid tax on 31 July 2013.** (2 marks)
- (ii) **State the range of penalties which the tax bureau could have imposed on Company D.** (1 mark)
- (c) The accountant of Company E wrongly typed income of RMB 10,000 as RMB 100,000 in the company's tax return for February 2008 and as a result Company E overpaid its business tax by RMB 4,500.

**Required:**

**State, giving reasons, whether Company E can obtain a refund of the business tax overpaid from the tax bureau in 2014.** (2 marks)

**(10 marks)**

**End of Question Paper**