Professional Level – Options Module

# Advanced Taxation (China)

Monday 7 June 2010

**Time allowed**
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to 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 P6 (CHN)

ACCA

## SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings need only be made to the nearest RMB, unless the law and prevailing practice require otherwise.
3. All apportionments need only be made to the nearest month.
4. 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 domestic and foreign enterprises | 25% |

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 | 5,000 or below | 5% | 0 |
| 2 | 5,001– 10,000 | 10% | 250 |
| 3 | 10,001 – 30,000 | 20% | 1,250 |
| 4 | 30,001 – 50,000 | 30% | 4,250 |
| 5 | Over 50,000 | 35% | 6,750 |

### Individual income tax

Employment income

| Grade | Taxable income on which employee bears the tax/employer bears the tax (RMB) | Rate % | Quick deduction factor (RMB) |
|---|---|---|---|
| 1 | 500/475 or below | 5 | 0 |
| 2 | 501 – 2,000/476 – 1,825 | 10 | 25 |
| 3 | 2,001 – 5,000/1,826 – 4,375 | 15 | 125 |
| 4 | 5,001 – 20,000/4,376 – 16,375 | 20 | 375 |
| 5 | 20,001 – 40,000/16,376 – 31,375 | 25 | 1,375 |
| 6 | 40,001 – 60,000/31,376 – 45,375 | 30 | 3,375 |
| 7 | 60,001 – 80,000/45,376 – 58,375 | 35 | 6,375 |
| 8 | 80,001 – 100,000/58,376 – 70,375 | 40 | 10,375 |
| 9 | Over 100,000/70,375 | 45 | 15,375 |

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 or 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 and insurance | 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)

| | |
|---|---|
| For small size taxpayers | 6% (4% for commercial enterprises) |
| For ordinary taxpayers | 17% for the sale or import of itemised goods, processing and repairing |
| | 13% for the sale or import of itemised goods |
| | 7% for transportation charges |

### Stamp duty

| | | |
|---|---|---|
| Loan contracts with banks and other financial institutions | | 0·005% |
| Contracts for: | purchase and sale | |
| | construction and installation projects | |
| | Technology | 0·03% |
| Contracts for: | Processing | |
| | engineering projects and design | |
| | Transportation | 0·05% |
| Contracts for: | property leasing | |
| | storage and custody | |
| | property insurance | 0·1% |
| Documents of transfer of property rights | | 0·05% |
| Business books of account | | 0·05% |
| Documents of rights and licences | | RMB 5 |

**Section A – BOTH questions are compulsory and MUST be attempted**

**1** Company J, a company registered in Shenzhen, has an idle production plant. The original cost of the production plant was RMB 1,000,000 (including VAT); and total depreciation allowances of RMB 800,000 have been claimed. The current open market value of the production plant is RMB 500,000; and its estimated remaining useful life is five years.

Company J is considering the following options for utilising the idle capacity:

(1) Selling the production plant to Company K for RMB 500,000.

(2) Leasing out the production plant to Company K for five years for an annual rental of RMB 50,000. At the end of the lease, the production plant will be returned to Company J.

(3) Leasing out the production plant to Company K for five years for an annual rental of RMB 60,000. At the end of the lease, the production plant will become the property of Company K.

(4) Leasing out the production plant for an annual rental of RMB 55,000 to five different users under short leases of one year each.

(5) Contributing the production plant as capital into an associated company (Company X) to be formed with Company K. Company J will receive RMB 52,000 from Company X in each of the following five years but will not share the company's business risk.

(6) Contributing the production plant as capital into an associated company (Company Y) to be formed with Company K. Company J will share the business risk of Company Y.

In addition, in order to raise funds, the finance manager of Company J is suggesting selling some machinery to Company L and then leasing it back afterwards for its continued use. Company L is an associated company of Company J.

As the tax advisor to Company J, Mr Cheng, the Director of Company J, has sought your advice on the China tax implications of the above proposals.

**Required:**

**Assuming today's date is 7 June 2010, prepare a report for Mr Cheng setting out your advice on the following China tax issues:**

**(a) The enterprise income tax, business tax, value added tax and stamp duty implications for Company J of each of the six options for utilising the idle production plant.** (27 marks)

**(b) The nature of a 'sale and lease-back' arrangement and the way in which such an arrangement should be structured in order to minimise the China tax liabilities of Company J and Company L.** (7 marks)

**Professional marks will be awarded in question 1 for the appropriateness of the format and presentation of the report and the effectiveness with which the information is communicated.** (2 marks)

**(36 marks)**

**2** Lingbao Property Development (LPD) is a foreign joint venture engaged in the development and sale of properties in China. One of its residential property projects in Shanghai will be completed in September 2010. With the permission of the relevant Chinese tax authorities, LPD is allowed to enter into advance sale agreements for this residential property project.

In order to promote sales, LPD is considering offering four different payment terms to the buyers of the residential properties as follows:

(1) One-off payment of the full purchase price.
(2) Payment by instalments.
(3) Payments through housing loans.
(4) Sales by means of entrustment.

Apart from selling units in the residential property project, LPD is considering leasing out some of the units; but is concerned that some of the rentals may be uncollectible. The Board of Directors also proposes selling some of the units to LPD's senior management at a 20% discount on the fair market value of those units.

As the tax advisor to LPD, Mr Zhu, the Managing Director of LPD, has sought your advice on the China tax implications of the above issues for the company.

**Required:**

**Assuming today's date is 7 June 2010, write a letter to Mr Zhu which advises on:**

**(a) The enterprise income tax treatment of the receipts from the advance sale of the residential properties.** (7 marks)

**(b) When the income under each of the four payment methods will be recognised for enterprise income tax purposes.** (8 marks)

**(c) The China tax implications arising from the leasing of the units and the treatment of any uncollectible rental income.** (8 marks)

**(d) The China tax implications of the sale of the units at a discount for both the members of the senior management and the company, Lingbao Property Development.** (3 marks)

**Professional marks will be awarded in question 2 for the appropriateness of the format and presentation of the letter and the effectiveness with which the information is communicated.** (2 marks)

**(28 marks)**

**Section B – TWO questions ONLY to be attempted**

**3** Sam, a Chinese national, is a musician in a band. He works for two nightclubs operated by Entertainment Ltd. Sam's terms of remuneration are as follows:

(1) He has no fixed remuneration. He plays an agreed number of hours per month for which he is paid at a fixed hourly rate. The number of hours he is required each month are subject to change.
(2) There is no fixed period of engagement, nor is there any notice period for termination of the engagement.
(3) He is not entitled to sick leave, holidays or severance pay.
(4) Instruments are supplied by the nightclubs for the use of Sam.
(5) He practices at home, using his own guitar.

Sam has been advised that there are tax advantages of his remuneration being classified as 'individual service income'.

**Required:**

**(a) Briefly explain the tax treatment of 'employment income' and of 'individual service income' in the case of a Chinese national.** (4 marks)

**(b) Distinguish between employment income and individual service income, explain the criteria the tax authorities use to determine whether or not income is derived from individual service; and state, giving reasons, whether Sam's remuneration will be considered as income derived from individual service.** (8 marks)

**(c) Calculate Sam's taxable income and individual income tax (IIT) liability under each of the two alternative treatments (i) employment and (ii) individual service, based on the following:**

- **monthly after tax income of RMB 30,000;**
- **any IIT is borne by the employer; and**
- **no other fringe benefits are provided.** (6 marks)

**(18 marks)**

**4** Fast Food Ltd (FFL), a foreign invested fast food shop, set up its first store in Shanghai in June 2009. FFL's Shanghai store offers fried chicken as well as souvenirs printed with its logo. To celebrate its opening, FFL conducted the following promotional activities:

(1) All souvenirs were sold at a discount of 20%.
(2) For every purchase of souvenirs over RMB 50, a coupon for RMB 10 was given for every multiple of RMB 50. The holder could use the coupons in settlement of any further purchase within one month.
(3) A lucky draw was launched using souvenirs as free gifts to the winners.

FFL is assessed as a general value added taxpayer, and its applicable VAT rate is 17%.

**Required:**

**(a) Explain the turnover tax implications of the sale of fast food and souvenirs by Fast Food Ltd.** (4 marks)

**(b) Explain the value added tax, enterprise income tax and individual income tax implications of each of the three types of promotional activities.** (10 marks)

**(c) Explain the value added tax implications if some of the souvenirs become obsolete and are written off in full.** (4 marks)

**(18 marks)**

**5** Brian, a Singapore resident, is employed by Speed Ltd, a company incorporated in Singapore. From 1 May 2009, he has been seconded to Fast Ltd, a wholly foreign owned enterprise of Speed Ltd in China. The secondment period is four years, ending on 30 April 2013. With the exception of a two-month trip to Japan in 2010, Brian expects to spend all of his time in China during his four-year secondment.

The income derived by Brian during the four-year secondment will be as follows:

(1) Basic salary: RMB 80,000 per month.
(2) Cost of living allowance: RMB 10,000 per month.
(3) Housing allowance: RMB 20,000 per month, payable in arrears upon the production of official rental receipts issued by the landlord.
(4) Relocation allowance: a one-off lump sum of RMB 50,000.
(5) Home leave allowance: RMB 40,000 per year.
(6) Annual bonus: RMB 300,000 paid at each year end by Speed Ltd.
(7) Non-transferable stock options of 5,000 shares in Speed Ltd.
(8) Rental income: S$12,000 from the leasing out of his apartment in Singapore.

**Required:**

**(a) State the basis on which Brian will pay individual income tax (IIT) and explain the treatment of each of the above eight items of income.**

Notes:
**(1) You should ignore the specific provisions of the China–Singapore Tax Treaty.**
**(2) You are not required to calculate the IIT payable.** (13 marks)

**(b) State the general circumstances in which an individual taxpayer must perform IIT self reporting and determine whether or not Brian is liable to perform IIT self reporting for his annual income during his four year assignment period and, if so, when.** (5 marks)

**(18 marks)**

**End of Question Paper**