

Research on Accounting Treatment and Tax Planning of Telecommunications Bundling Business

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Abstract—Along with the rapid increase of 4g internet and telecommunications since the tax reform of "Business Tax (BT) to Value Added Tax (VAT)" in 2014, how to reasonable layout the business model of telecom operators for the tax planning is especially important. Based on the analysis the telecom bundling sales, this paper identify the accounting treatment and tax planning for the telecom sector, in order to provide some strategies and suggestions for the telecommunications industry.

Keywords—Telecom Industry; Bundle; Accounting; Tax planning

I. INTRODUCTION

Since November 2011, the Ministry of Finance and National Tax Administration has implemented the pilot program, which is transferring business tax into value added tax (here in after referred to as "BT to VAT"). On August 1, 2013, to promote the further reform of China's tax system, "BT to VAT" this reform is carried out in the whole country. With the issue of No. 43 Finance and Tax Rule [2014]--"combination of telecommunications transfer from business tax into VAT pilot notice", as one of the "hardest chew bones" – telecommunications start to take "BT to VAT" reform as the official pilot since June 1, 2014. After the "BT to VAT", accounting and tax accounting of bundling sales is also different for telecommunications enterprises.

II. BACKGROUND

Accompanied by the ministry issued 3g licenses to the three carriers in 2009, all-round telecom operators developed the 3g net business and the ministry issued 4g licenses on 4th December 2013 dated. There is no denying that with the rapid development of China economic, the telecom industry also has entered a rapid development era under the new economic system transition. "BT to VAT" tax reform meet with national economic development strategy needs, which is conducive to the rational allocation of resources. The previous tax reform is aimed at relatively independent areas, whereas the telecommunications have the characteristics of the both communications industry and service industry. After its "BT to VAT", it is beneficial in VAT deduction chain and the upstream and downstream of the supply chain management,

and it promotes the transformation and upgrading of industry and eliminates duplicate tax problem. Although after the "BT to VAT" announced, the China Unicom, China Mobile, China Telecom these three major telecom operators pointed out that the short-term profits of the company would decline without exception. Admittedly, it is possible that tax for telecom operators may increase in a short period, and business profits may decline, but in the long run, due to the characteristics of the telecom industry which updates so fast, it cannot be ignored that a lot of equipment will upgrade in the future. Then telecom enterprises can deduct the input tax after the "BT to VAT" reform. Therefore, it will reduce the tax for telecom enterprises; at the same time, this can standardize the upstream and downstream of the supply chain for telecom market. The deputy director of Ministry of Finance division -- Liu Shangxi pointed out that by selecting telecoms as a "BT to VAT" pilot area in 2004, is advantageous to the rational allocation of the investment in the construction of 4g network base station equipment for three carriers, and in the same way, the input tax can be deducted^[1]. To some extent, it can relief the short-term negative impact of "BT to VAT" on operators. This also provides realistic significance for us to do research on the difference between accounting and tax accounting of telecom companies' bundling business after the "BT to VAT".

III. THE THEORY OF INTERPRETATION OF TELECOMMUNICATIONS BUNDLING SALES AFTER "BT TO VAT"

We are familiar with bundled sales; as a result of the fierce competition of market economy, bundling sales has become an important promotion activity to attract consumer attention. With the advent of the era of Internet, the telecommunications companies have launched 3g and 4g and this has affected people's lives. Over the past few years, the business model of telecom service providers has also changed, not only providing the initial pure telecom business, but also including mobile phone terminal bundling mode.

On the one hand, in order to grab market and customer resources, China's telecom operators are working with multiple vendors, agents, which has launched the phone, broadband combined mobile terminal sales model, implementation of "1 + 1 > 2" win-win model. A few years ago, China Unicom, this is the first one who launches 3g business and cooperates with

Apple, shacked the leader position of China mobile in the telecommunications industry and occupied a big domestic market share. By the bundle model of the mobile phone and telecommunication service, can encourage the customer to stay with the network and improve the adhesion reading of the user. On the other hand, from the perspective of a reasonable tax planning, the telecom industry plays great importance role on the accounting of bundling sales. Because of the laggard of the current accounting standards and tax system, lead to telecom enterprise stayed in the situation of low profits tax payable.

The main mode of telecom operators' service is bundling mobile terminal and subsequent communication service together, and also each bundling contract contains different types of contractual arrangements. The telecom industry has hundreds of millions of individual users and it provides a wide variety of personalized and diversified products and services for each customer. Therefore, the revenue recognition for different contract is a complex tedious work, which affecting the tax accounting of the telecommunications industry. The most typical selling strategy is the "mobile fees and phone" bundling selling model. Long before this development mode, the three telecom operators send gifts when users deposit money, but now send mobile phone instead. Through accurate definition of "deposit mobile fees to send mobile phone", it is advantageous to the enterprise accounting system and further would affect the enterprise tax payable. Namely, this mode requires the user to prepare some money to buy the telecom service in accordance with saving the money to buy mobile phones (even could be zero RMB). At the same time, the user needs to meet monthly minimum consumption, and contract plans usually last for one year, two years or three years. Therefore, this can encourage users to increase consumption and stay on the net, so as to achieve the goal of increment income. In general, telecom operators require customers use specific mobile to match the SIM card until the end of the contract period in order to get the money back monthly, and after the contract expired, SIM card can be given on another phone to use^[2]. This approach can maintain stability and loyalty of customers. And another kind of mode is more intuitive, which is "buy mobile phones give fees". Namely, the first payment of the price the users paid is the main mobile phone retail and only a small amount of money deposited to the telecom service. The contract includes communications services and mobile terminal sales agreement. Usually, the fee for the first time is about one point two times of the terminal retail price with a high threshold.

IV. ACCOUNTING AND TAX TREATMENT OF BUNDLING SALES MODE

Under the business tax system, the provision of telecom operators' bundling sales for telecommunications services with mobile phone belongs to the category of the business tax, rather than the category of value added tax. According to the "Provisional regulations on business tax regulation" stipulates this mode of selling does not belong to business tax. After "BT to VAT", according to the No. 43 of "Finance and Taxation Regulation" [2014], for telecom operate taxpayers who provide telecommunication services with the user identification card (SIM card), goods or other telecommunications services such

as telecommunications terminal (the so-called "bundling" sales), the bundling sales should be accounted separately which obtain full price and other charges to pay VAT value-added tax with their respective applicable tax rate calculation. In accordance with the chapter4 of "Regulations on value-added tax rules", stipulated that for telecom operators who provide telecom services with other physical sales (not a telecommunications terminal), this mode should be regarded as bundling sales. In the form of other physical sales as well as giving gifts to electronic securities such as supermarket card, gas card, etc., it should be regarded as sales and the calculation of VAT payable should base on the cost price. The new income criterion issued by the IASB and FASB in May 2014 also requires enterprises to divide the transaction price in a clear distinction between the businesses; therefore the telecom enterprise should provide a clear division of network services and terminal sales.

Take the iPhone7 (32 GB) as an example, the 4g internet and the package machine contracts - the contract price is 5499 RMB. Assume that the user's contract is 296RMB each month, the pre-existing contract costs 5499 RMB, including advance deposit for telecom service is 3300 RMB and preferential price for the mobile phone is 2199 RMB. Therefore, customers spend the preferential price 2199 RMB to buy Iphone7 which the original price is 5288, and the cost for this mobile phone is 4699 RMB. In the contract, the monthly return amount for users is 137.5 RMB, and it would be 3300 RMB for 24 months. (Note: suppose basic telecom services accounts for 40% in the package fee for every month, and value-added telecommunication services accounts for 60%. Then the net current mobile phone would be paid for tax by its cost temporarily at the beginning, and telecom service revenue would be amortized according to the fair value of each contract period. The follow table shows the relevant accounting treatment method, and it help us to understand the related tax policy, even it may not represent in enterprise practice)

On the one hand, for telecommunications services, the applicable tax rate from previous 3% into two benchmark rates after "BT to VAT". One basic telecom service is 11%, and the other rate for value-added telecom services is 6%^[3]. Therefore, no matter which rate the operators choose, tax rate is higher than before. On the other hand, for telecom operators which provide donation telecom services or physical business ought to pay VAT after "BT to VAT". Starting from these two points simply, we can see that "BT to VAT" reform will result in an increase in taxes.

In this case, it is not hard to find, after the tax reform, "save fees to send machine" tax actually decreased. In this case, the telecommunications industry revenue is 4604 RMB ($5499 - 4699 + 158.5 * 24$), and terminal cost is: 1879.49 ($2199 / 1.17$), pre-tax profit is: 2724.51 ($4604 - 1879.49$), the actual tax burden is: $159.48 / 2724.51 = 5.85\%$. But due to the mobile phone cost as the input tax deduction, makes overall tax cut. Of course, the premise is the telecom operators need to obtain special VAT invoice in order to be deductible. It is not hard to find in this case, the mobile phone cost is 4699 RMB, can reach to 50.5% of total revenue of 9303 RMB ($5499 + 158.5 * 24$).

The following table describe the accounting and tax treatment of this case.

TABLE I. THE DIFFERENT BETWEEN ACCOUNTING AND TAX TREATMENT BEFORE/AFTER "BT TO VAT"

	Before "BT to VAT"	After "BT to VAT"
Accounting treatment	First stage	
	Debit: Bank Deposit 5499 Credit: Deferred revenue 3300 Other income 2199	Debit: Bank Deposit 5499 Credit: Deferred revenue 3300 Other income – Sales of goods 1879.49 Tax payable-VAT(output)319.51
	Debit: Other business cost 4699 Credit: Inventory(materials) 4699	Debit: Deferred revenue-deferred tax (VAT) 242.89 Credit: Tax payable-VAT(output) 242.89 Debit: Inventory(materials) 4016.24 Tax payable-VAT(input) 682.76 Credit: Bank Deposit 4699
	Debit: Business tax and additional65.97 Credit: Bank Deposit 65.97	Debit: Cost of goods sold 2136.75 Other Expenses--sales 1879.49 Credit: inventory(materials) 4016.24
Tax treatment	Second stage: In the contract	
	Debit: Deferred revenue 137.5 Other income 158.5 Credit: Sales incomes 296	Debit : Deferred revenue 137.5 Other income 158.5 Credit: Sales incomes 264.36 Deferred revenue-deferred tax (VAT)10.12 Tax payable-VAT(output) 11.66 (158.5*40%/1.11*0.11+158.5*60%/1.06*0.06)
	Debit: Business tax and additional 8.88 Credit: Bank Deposit 8.88	
Tax treatment	Business tax: 1. The first stage: 2199 * 3% = 65.97 2. In the contract: 296 * 3% = 8.88 The general business tax is: 65.97 + 8.88 * 24 = 279.09	VAT: 1. The first stage: output tax: 319.51 + 242.89 = 562.4 The input tax: 682.76 Pay tax = output tax - the input tax = 120.36 2. In the contract: 11.66 * 24 = 279.84 Total operating rate is: 120.36 + 279.84 = 159.48

V. TAX PLANNING OF TELECOM ENTERPRISES ATER "BT TO VAT"

"BT to VAT" tax reform has influenced to the telecommunications industry from tax cost, upstream and downstream supply chain or business model. Telecommunications companies need to explore and learn its effects actively, and pay more attention to the understanding of related tax and business in order to do tax planning. We believe that we can obtain from the following several aspects.

1. It is important to strengthen the management of special VAT invoices, according to the "Provisions on the Use of Special VAT invoices"^[4], for telecom operators who pay VAT only have to obtain special invoices for value-added tax in order to offset the input tax. Therefore, telecom enterprises should choose partners more carefully, and keep track of the input offset invoice. It is better should choose the general taxpayer enterprises who can issue special invoices of value-added tax when it comes to purchase all kinds of equipment.

2. Because there are many regional branches for telecom operators, it provides convenience to the consumers but also increases their management fee, and this part cannot be deducted as the input tax. In the long run, telecom operators should follow the development of modern Internet by relying on its own network features, and develop its online business hall and mobile business hall in order to reduce their operating costs. According to the layout of the site, telecom operators

should put more effort into telecom value-added service; reduce the tax burden of enterprise.

3. In general, there are three kinds of accounting treatment for "bundling" sales, which are sales discount, sales allowance, and trade discount. For the different bundling, tax payable will be different because of the differences between the accounting treatments^[5]. Therefore, telecom operators should choose the best marketing strategy, decrease the previous bounding with real products, and take the marketing strategy of product discounting, and construct tax control mechanism, such as, according to Tax Law, the listed discount in one receipt can be deductible.

VI. CONCLUSION

"BT to VAT" can bring certain impact to the telecommunications industry. The increase of tax will reduce the disposable wealth, from the industry development perspective, it is necessary for telecom enterprise to focus on tax policy of the tax department, such as how to allocate the supplementary goods turnover problems. Therefore, the telecoms enterprises should strengthen the communication with the competent financial and tax departments, and put forward the suggestions and comments in the actual problems to ensure high efficiency of reform.

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