

Fundamentals Level – Skills Module

# Taxation (China)

Thursday 8 December 2016



**Time allowed:** 3 hours 15 minutes

This question paper is divided into two sections:

Section A – ALL 15 questions are compulsory and MUST be attempted

Section B – ALL SIX questions are compulsory and MUST be attempted

Tax rates and allowances are on pages 2–4.

**Do NOT open this question paper until instructed by the supervisor.**

**Do NOT record any of your answers on the question paper.**

**This question paper must not be removed from the examination hall.**

Think Ahead

**ACCA**

**Paper F6 (CHN)**

The Association of  
Chartered Certified  
Accountants

**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 in Section B.

**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 operations income derived from private industrial or commercial operations

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

Allowance per annum RMB42,000

**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	RMB3,500
Additional allowance for expatriate employees	RMB1,300

### 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**

RMB4,000 and below	RMB800
Over RMB4,000	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 and simplified method	3%
For general taxpayers for the sale of itemised goods, processing, and repairing	17%
for the sale or import of itemised goods	13%
for the sale of certain agricultural products	exempt
input tax credit for agricultural products	13%

### VAT pilot programme

Industries	Rate
Transportation, postal and certain telecom 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 and certain telecom services	6%
Tangible movable property leasing services	17%

**Note: The above rates are based on the pilot rules published by 30 September 2015. The new rules issued from 1 October 2015 onwards are not examinable in the 2016 exams.**

### Business tax

Industries	Rate
Construction, 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 = RMB6

**Section B – ALL SIX questions are compulsory and MUST be attempted**

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

- 1 (a) Mr Chen is an employee of Cupod Ltd.

During a recent tax audit, Cupod Ltd was found not withholding any individual income tax (IIT) for Mr Chen and Mr Chen has not paid any IIT himself.

**Required:**

**State the tax consequences for each of Mr Chen and Cupod Ltd based on the Tax Collection and Administrative Law.** (2 marks)

- (b) Biz Ltd is a property developer selling villas in Yunnan. All Biz Ltd's accounting books and records were destroyed during an earthquake. Based on the land bureau's records, the turnover of Biz Ltd was RMB523,420,803 in 2015.

**Required:**

**State the most appropriate method by which the tax bureau can assess Biz Ltd's enterprise income tax for 2015.**

**Note: No mark will be given for stating 'other method'.** (1 mark)

- (c) HHold Ltd, which sells household products, is a value added tax (VAT) general taxpayer. In November 2016, the tax bureau discovered that HHold Ltd had not reported sales of RMB380,750 for 2014. The district tax bureau required HHold Ltd to pay VAT and enterprise income tax on these unreported sales plus a late payment surcharge on 15 December 2016.

**Required:**

**State the actions HHold Ltd can take if it disagrees with the decision of the district tax bureau.** (3 marks)

- (d) Hit-Tech Ltd submitted an application for classification as a high and advanced technology company for 2008. In the application, Hit-Tech Ltd overstated the number of university graduates it employed in order to obtain the tax incentive of paying enterprise income tax (EIT) at the rate of 15% for 2008.

Soft Ltd, a quality inspection company set up in Chongqing, submitted an application for the Central and Western tax incentive. All the information submitted in the application was genuine. Soft Ltd obtained the tax incentive of paying EIT at the rate of 15% for 2008.

In 2015, the tax authorities discovered that the tax incentives given to Hit-Tech Ltd and Soft Ltd were both wrongly granted.

**Required:**

(i) **State the tax consequences for Hit-Tech Ltd of the tax authorities' discovery.** (2 marks)

(ii) **State, with reasons, whether Soft Ltd will need to pay back the wrongly granted tax incentive.** (2 marks)

**(10 marks)**

2 (a) Golden Ltd, an investment company in Shanghai, is considering three alternative investment options:

- (1) Option A: Setting up a subsidiary in Vietnam. The profit before enterprise income tax (EIT) in Vietnam will be USD100,000 in 2016. The equivalent EIT rate in Vietnam is 15% and the dividend withholding tax rate in Vietnam is 10%.
- (2) Option B: Setting up a subsidiary in Chengdu, China. The profit before EIT will be RMB400,000 in 2016. The applicable EIT rate is 15% since the Chengdu company can enjoy tax incentives.
- (3) Option C: Setting up a subsidiary in Suzhou, China. The profit before EIT will be RMB500,000 in 2016. The applicable EIT rate for the Suzhou company is 25%.

Under all three options, all of the after-tax profits will be declared and paid to Golden Ltd as a dividend. Golden Ltd pays EIT at 25%.

**Required:**

**Calculate Golden Ltd's net of enterprise income tax income from the dividend receivable under each of the three options.** (5 marks)

- (b) HKT Ltd is a trading company set up in the Hong Kong Special Administrative Region by a Beijing company, BJT Ltd. BJT Ltd exports goods from China to HKT Ltd for resale to customers in Europe. The purchase and sale contracts between HKT Ltd and the European customers are negotiated and concluded by staff of BJT Ltd in Beijing by using the letterhead of HKT Ltd.

**Required:**

(i) **State, with reasons, whether HKT Ltd has an establishment in China.** (2 marks)

(ii) **State ANY THREE criteria which will be used to decide whether HKT Ltd is a China tax resident.** (3 marks)

**(10 marks)**

3 Huanglong Ltd sold two shopping malls in Guangzhou on 1 January 2016, Plaza 111 and Plaza 77.

**Plaza 111:**

Huanglong Ltd started the development of Plaza 111 on 1 July 2014 and completed the development in December 2015. The costs and expenses incurred are summarised below:

	RMB million
Land use right and deed tax	206
Relocation and construction costs	350
Interest on loan and administration expenses	228

Plaza 111 was sold for RMB1,200 million on 1 January 2016.

**Plaza 77:**

Plaza 77 was first put into use on 1 January 2000. Huanglong Ltd acquired Plaza 77 as an existing shopping mall from another property developer on 1 January 2013. The costs and expenses incurred are summarised below:

	RMB million
Acquisition cost of Plaza 77	800
Interest on loan	125

Plaza 77 was sold for RMB1,050 million on 1 January 2016.

Huanglong Ltd did not appoint any valuation company to value the malls on their sale.

**Required:**

**(a) Calculate the land appreciation tax (LAT) on the sale of each of Plaza 111 and Plaza 77. Show clearly all of the steps in your calculations.**

**Notes:**

1. Business tax, city maintenance and construction tax, education levy and local education levy total 5·6%.
2. Ignore stamp duty. (7 marks)

**(b) Calculate Huanglong Ltd's profit before enterprise income tax (EIT) from the sale of the two malls.**

Note: Ignore all costs and taxes other than those referred to in the question. (3 marks)

**(10 marks)**

- 4 (a) Wat Ltd sells three types of watch in China. The company's results for 2015 are summarised below:
- (1) Watch-LX: Imported 1,000 watches at a total cost of USD3,000,000 from overseas. 900 watches were sold to consumers at RMB50,000 each. Wat Ltd's shareholder took two watches for his personal use. 98 watches remained as inventory on 31 December 2015.
  - (2) Watch-Nor: Produced and sold 40,000 watches to a wholesaler at RMB3,000 each.
  - (3) Watch-XT: Sold a total of 5,500 watches at RMB18,000 each to consumers via e-commerce, of which 3,500 were self-produced watches and 2,000 were purchased from a third party factory.

All of the above prices are exclusive of value added tax (VAT).

**Required:**

- (i) Calculate the customs duty, consumption tax and value added tax (VAT) on the import of Watch-LX.

Notes:

1. The customs duty rate for watches is 5%.
2. A watch with an imported price or selling price over RMB10,000 is considered as a luxury watch for consumption tax purposes. The consumption tax rate on luxury watches is 20%. (2 marks)

- (ii) Calculate the consumption tax and the output VAT payable by Wat Ltd on the sale (including deemed sale) of watches for 2015. (3 marks)

- (b) Kool Ltd is a value added tax (VAT) general taxpayer which buys and sells stationery. Kool Ltd has received the following quotes from suppliers for the purchase of 1,000 ball-pens.

Supplier	Price quoted	VAT inclusive OR exclusive	Other information
A	RMB10,000	VAT inclusive	Supplier A is a VAT general taxpayer and can issue a VAT special invoice to Kool Ltd
B	RMB9,800	VAT inclusive	Supplier B is a small-scale taxpayer. It can get the tax bureau to issue a VAT special invoice to Kool Ltd
C	RMB9,300	VAT inclusive	Supplier C is a small-scale taxpayer. It can only give a VAT general invoice to Kool Ltd
D	RMB9,000	VAT exclusive	Supplier D is a VAT general taxpayer. It can issue a VAT special invoice to Kool Ltd

**Required:**

- (i) Calculate the cost to Kool Ltd of purchasing 1,000 ball-pens from each of the four suppliers for both accounting and enterprise income tax (EIT) purposes. (3 marks)
- (ii) Calculate the input value added tax (VAT) credit available to Kool Ltd on the purchase of 1,000 ball-pens from each of the four suppliers. (2 marks)

**(10 marks)**



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Question 5 begins on page 14.**

- 5 (a) Ms Liu joined a US listed company, Pancake Group, on 1 January 2005. She was granted 100,000 stock options to buy the shares of Pancake at RMB1·50 each on 1 January 2014. She exercised 40,000 of these options on 30 June 2015.

The market prices of Pancake Group shares were USD0·80 each on 1 January 2014 and USD1·40 each on 30 June 2015.

Ms Liu sold 30,000 shares on 31 December 2015 at USD4·70 each.

**Required:**

**Calculate the individual income tax (IIT) payable by Ms Liu in relation to the share incentive scheme options/shares of the Pancake Group on the grant date, the exercise date and the disposal of the shares. State 'not taxable' or 'tax exempt' where appropriate.** (4 marks)

- (b) Mr Jiang is employed by AF Ltd. He was seconded to work for AF Ltd in Africa for one year from 1 January to 31 December 2015. His remuneration package for 2015 is summarised below:

	RMB
Monthly basic salary	30,000
Monthly hardship allowance	10,000
Monthly employer's contribution to China social insurances	4,000
Monthly employee's contribution to China social insurances	2,800
Total African tax paid in 2015	60,500

**Required:**

**Calculate the individual income tax (IIT) payable by Mr Jiang for 2015.** (3 marks)

- (c) Mr Waki is a UK citizen. He has been working for a company in Beijing since 1 January 2008, but his family members are still in the UK, hence, not China domiciled. The number of days Mr Waki spent outside China in each of the years 2008 to 2014 are summarised below:

2008	2009	2010	2011	2012	2013	2014
35 days	108 days	85 days	35 days	29 days	31 days	90 days
one-off	cumulative	cumulative	cumulative	one-off	cumulative	cumulative

**Required:**

**State, with reasons, whether Mr Waki will be considered a China tax resident for individual income tax (IIT) purposes in each of the years 2008, 2012 and 2014.**

**Note: No mark will be given for stating 'yes' or 'no' without a reason.** (2 marks)

- (d) Mr Wu is a China citizen. He is one of the shareholders of WK Ltd and also the chairman of the board of directors and the general manager of WK Ltd. In 2015, Mr Wu received the following income from WK Ltd:

- a salary of RMB20,000 each month;
- a director's fee of RMB20,000 each month; and
- an annual bonus of RMB100,000 paid in May 2015.

Mr Wu borrowed RMB500,000 from WK Ltd in 2012 and has not repaid the loan since then.

Ms Xie is a foreigner and an independent non-executive director of WK Ltd. She receives a director's fee of RMB30,000 each month from WK Ltd. She invented a robot and sold the technology to WK Ltd for RMB100,000 in 2015.

**Required:**

(i) Calculate the individual income tax (IIT) payable by Mr Wu for 2015.

(4 marks)

(ii) Calculate the individual income tax (IIT) payable by Ms Xie for 2015.

Note: Ignore value added tax and business tax.

(2 marks)

**(15 marks)**

- 6 (a) Beautiful Ltd was set up in 2008 in Suzhou. The company's statement of profit or loss for the year ended 31 December 2015 is as follows:

	<b>RMB</b>	<b>RMB</b>
Sales		112,541,600
Cost of sales		(106,572,365)
		<u>5,969,235</u>
Financial expenses	(2,348,567)	
Administrative expenses	(2,084,829)	
Marketing expenses	(1,063,812)	
Other costs and expenses	(193,610)	
		<u>(5,690,818)</u>
Net profit for 2015		<u>278,417</u>

The following information is relevant to the items charged/credited in the above statement of profit or loss:

- (1) Inventory costing RMB53,800 was thrown away in 2015 because it had been bitten by mice due to poor management of the warehouse. The cost of this inventory was included in the cost of sales.
- (2) Depreciation of the factory building of RMB480,000 was included in factory overheads. The cost of the factory building was RMB19,200,000 and the depreciation period of 40 years with a zero residual value was used to calculate the accounting depreciation.
- (3) Electricity charges of RMB102,210 for December 2015 were accrued in 2015. These charges were paid in February 2016.
- (4) Financial expenses included:
  - interest of RMB213,000 on a loan to pay an overseas supplier; and
  - interest of RMB1,234,000 on a loan to construct a new factory premises. The new factory will be put into use in June 2016.
- (5) Products costing RMB200,000 were taken from inventory as gifts to customers. The normal selling price of these products was RMB300,000. Value added tax (VAT) was properly accounted for on these gifts. No adjustments were made in the accounts for these gifts. In addition to these gifts, the other entertainment expenses incurred in 2015 were RMB230,200.
- (6) Marketing expenses included:
  - RMB650,000 paid to a television station for a promotion campaign for a new product; and
  - RMB32,000 paid to a newspaper for an announcement of the closure of the company's branch in Changzhou.
- (7) The total salaries paid in 2015 were RMB14,100,200. The salaries accrued for December 2015 and paid in January 2016 were RMB891,000. A staff special bonus of RMB200,000 also accrued in 2015 was paid in July 2016.
- (8) Staff union expenses of RMB399,200 were incurred in 2015 and supported by a tax invoice.
- (9) Beautiful Ltd acquired 150 chairs for its office in June 2015 at a cost of RMB600 each. For accounting purposes the chairs have an economic life of two years and no scrap value. Beautiful Ltd qualifies for the accelerated depreciation incentive for tax purposes for these chairs.
- (10) Other costs and expenses include:
  - an unrealised exchange loss of RMB96,000 due to devaluation of the Renminbi; and
  - a loss on the disposal of A-shares of RMB204,230.

Beautiful Ltd's tax profits/(losses) for previous years are as follows:

	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Tax profit/(loss) in RMB	(1,890,500)	210,421	521,400	410,800	200,821	(21,800)

**Required:**

**Calculate the enterprise income tax (EIT) payable by Beautiful Ltd for the year 2015, assuming that Beautiful Ltd has made all relevant applications and/or reports to the tax authorities.**

**Note:** You should start your computation with the net profit figure of RMB278,417 and list all of the items referred to in notes (1) to (10) identifying any items which do not require adjustment by the use of zero (0).  
(14 marks)

- (b)** Beautiful Ltd has paid a royalty of RMB3,800,000 each year since 2008 to its overseas associated company for the use of a trademark. In 2015, the tax authorities challenged this related party transaction and requested a retrospective tax adjustment for each of the years from 2008 onwards.

**Required:**

**State, with reasons, whether the retrospective transfer price adjustment proposed by the tax authorities is valid.**  
(1 mark)

**(15 marks)**

**End of Question Paper**