

Fundamentals Level – Skills Module

# Taxation (China)

Thursday 8 June 2017



**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 2–3.

**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
For small-scale taxpayers of real estate and immovable property leasing services, grandfathered old projects taxing by the simplified method and certain special industries taxed by the simplified method	5%
Small-scale taxpayers and certain industries taxed by the simplified method except for real estate and immovable property leasing services	3%
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, financial services, consumer services	6%
Transportation, postal and certain telecom services, real estate and construction, immovable property leasing services	11%
Tangible movable property leasing services	17%

**Note:** The above rates are based on the pilot rules published by 30 September 2016. The new rules issued from 1 October 2016 onwards are not examinable in the 2017 exams.

### 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) Belle Ltd is a company incorporated in the United Kingdom. Belle Ltd has a representative office (RO) in Shanghai. The tax authorities deem the RO to be providing consultancy services to its head office. The RO is taxed on a cost-plus basis using a deemed profit rate of 15%. The total costs incurred by the RO from 1 May to 31 December 2016 amounted to RMB6,000,000. The RO is a value added tax (VAT) general taxpayer.

**Required:**

**Calculate the amount of value added tax (VAT) and enterprise income tax (EIT) payable by the representative office (RO) of Belle Ltd for the period from 1 May to 31 December 2016.**

**Note: Ignore local tax and surcharges.** (3 marks)

- (b) Cathie Ltd was set up in Shanghai to provide information technology (IT) services to customers in China and overseas. Cathie Ltd is a value added tax (VAT) general taxpayer. Its results for 2016 are summarised below:

	China customers	Overseas customers	Overseas customers	Total
		VAT zero rated	VAT exempt	
	RMB	RMB	RMB	RMB
Service fees (see note)	3,000,000	4,000,000	2,000,000	9,000,000
Identifiable input VAT	25,000	35,000	10,000	70,000
Commonly shared input VAT				45,000
Input VAT on new computers and mainframes commonly used				60,000

**Note:** The service fees from overseas customers qualify as exported services and are taxed under either the VAT zero rated or VAT exemption policies, as appropriate.

**Required:**

**Calculate the value added tax (VAT) payable by Cathie Ltd in 2016.** (4 marks)

- (c) The total receipts of Dodi Canteen in December 2016 amounted to RMB180,000. Also in December 2016, Dodi Canteen purchased fixed assets for RMB200,000 (exclusive of value added tax (VAT)) and obtained a VAT special invoice at 17%.

**Required:**

**Calculate the value added tax (VAT) payable or input VAT to be carried forward by Dodi Canteen in December 2016 if it is:**

- (i) a small-scale taxpayer; and  
 (ii) a VAT general taxpayer. (3 marks)

**(10 marks)**

2 (a) OBOR Ltd, a company with a head office in Shenzhen, has the following overseas investments:

- a subsidiary, SG Ltd, in Singapore;
- a subsidiary, INA Ltd, in Indonesia; and
- a branch in South Africa.

OBOR Ltd's transactions relating to these investments in 2016 were as follows:

- (1) Sold its shares in SG Ltd for USD950,000. The cost of this investment was USD150,000. Singaporean income tax at the rate of 10% was paid on the capital gain.
- (2) INA Ltd had a profit of USD120,000 in 2016, on which Indonesian corporate income tax at the rate of 18% was paid. INA Ltd declared a dividend of USD80,000 to OBOR Ltd. Indonesian withholding tax of 5% was imposed on the dividend.
- (3) The South African branch earned a taxable profit of USD740,000 in 2016, on which South African corporate income tax at the rate of 33% was paid.

**Required:**

**Calculate the foreign tax credit and enterprise income tax (EIT) payable by OBOR Ltd on each of the transactions (1) to (3) in 2016.** (7 marks)

(b) Forry Ltd is a law firm in the Hong Kong Special Administrative Region. It had income from the following three China sources in 2016:

- (1) Provided legal advisory services to a Suzhou client and charged a service fee of RMB200,000. Forry Ltd is considered to have a permanent establishment in China. The Suzhou tax authorities assessed a deemed profit rate of 30% on the service fee.
- (2) Lent RMB1,000,000 to a Chinese company on 1 January 2016 at an interest rate of 6% per annum.
- (3) Sold the equity investment in its Guangzhou subsidiary realising a profit of RMB5,000,000.

**Required:**

**Calculate the Chinese enterprise income tax (EIT) payable by Forry Ltd on each of its China sources of income (1) to (3) in 2016.**

**Notes:**

1. All amounts are stated inclusive of any China taxes.
2. Ignore value added tax (business tax) and surcharges.
3. No treaty incentives are available.

(3 marks)

**(10 marks)**

**3** Elema Group has two companies in China:

- A Beijing subsidiary, BJ Co, which produces and sells furniture in China. Its enterprise income tax (EIT) rate is 25%.
- A Chengdu subsidiary, CD Co, which designs, researches and develops new products. It qualifies as a hi-tech company and has an EIT rate of 15%.

The tax manager of the Beijing subsidiary proposed the following tax schemes and these were adopted in 2008:

- (1) CD Co to lend RMB10 million to BJ Co and charge an interest rate of 36% per annum. The interest rate on similar loans from financial institutions is 7% per annum.
- (2) Overstating the expenses of BJ Co by RMB2 million.

The Beijing City Chaoyang District tax authority discovered these two tax schemes in 2016.

**Required:**

- (a) **Briefly state the definition of tax avoidance under the enterprise income tax law.** (2 marks)
- (b) **State which of the two tax schemes is tax avoidance.** (1 mark)
- (c) **State the consequences for BJ Co of the discovery of the two tax schemes by the tax authority in 2016.**  
Note: ignore the effect of the thin capitalisation rules. (5 marks)
- (d) **State the statute of limitation for the collection of taxes in the case of:**
  - (i) **tax evasion; and**
  - (ii) **tax avoidance.** (2 marks)

**(10 marks)**

- 4 (a) Batty Ltd produces batteries. In June 2016, Batty Ltd sold batteries to two customers as follows:
- to Chinese customer A for RMB2,000,000 (exclusive of value added tax (VAT)); and
  - to overseas customer B for RMB1,500,000 (exclusive of VAT).

The input VAT incurred for production in June 2016 was RMB455,000.

**Required:**

**Calculate the consumption tax (CT) payable on Batty Ltd's sales and the value added tax (VAT) refundable on exports in June 2016.**

**Notes:**

1. The CT rate on batteries is 4%.
2. The VAT refund rate for batteries is 13%. (3 marks)

- (b) Cosi Ltd imports skin care products and cosmetics and sells them via e-commerce to individual customers in China. Cosi Ltd is a value added tax (VAT) general taxpayer. Its transactions in July 2016 are summarised below:

	RMB	Remarks
Imported 2,000 bottles of lotion	200,000	At free on board (FOB) price
Insurance and freight charges incurred for the imported lotion	5,000	
Imported 1,000 boxes of eyeliners	150,000	At cost, insurance and freight (CIF) price
Insurance and freight charges incurred for the imported eyeliners	4,000	
Sold 1,500 bottles of lotion at RMB250 each		At VAT inclusive price
500 bottles of lotion were given to customers via a lottery		
Sold 500 boxes of eyeliners at RMB380 each		At VAT inclusive price
500 boxes of eyeliners were destroyed due to a thunderstorm		

**Required:**

- (i) **Calculate the customs duty payable by Cosi Ltd on the importation of the lotion and eyeliners in July 2016.**

**Notes:**

1. The customs duty rate on lotion is 7%.
2. The customs duty rate on eyeliner is 12%. (2 marks)

- (ii) **Calculate the consumption tax (CT) payable by Cosi Ltd on the importation of eyeliners in July 2016.**

Note: The CT rate on eyeliner is 30%. (1 mark)

- (iii) **State whether the cost of the eyeliners destroyed is an abnormal loss based on the value added tax (VAT) rules.** (1 mark)

- (iv) **Calculate the output VAT and input VAT of Cosi Ltd for July 2016.** (3 marks)

**(10 marks)**

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Question 5 begins on page 14.**



- 5 (a) Wang and Chen are both Chinese citizens. They plan to set up a coffee shop and are considering whether a partnership or a limited company will be the better option from a tax perspective.

The forecast results of the coffee shop in its first year of operation are as follows:

	RMB
Sales	2,000,000
Tax deductible expenses	(1,400,000)
Profit before any remuneration for Wang and Chen	<u>600,000</u>

If the coffee shop is set up in the form of a partnership, both Wang and Chen will be general partners, they will not charge any salaries for themselves and they will share profits in the ratio 4:1.

If the coffee shop is set up in the form of a company, Wang and Chen will be paid monthly salaries of RMB40,000 and RMB10,000 respectively. The company will not distribute any dividend in the first year of operation.

**Required:**

**Calculate the individual income tax (IIT) payable by Wang in the coffee shop's first year, if the coffee shop is operated:**

**(i) in the form of a partnership; and**

**(ii) in the form of a company.**

(2 marks)

- (b) Ms Xi is a UK citizen working for Olympic Ltd in Beijing. Her pay slip for December 2016 shows the following:

	RMB
Basic salary	80,000
Meal allowances paid on a cash basis	35,000
Reimbursement of car maintenance costs	1,000
Reimbursement of children's education allowances for studying in China	20,000
Reimbursement of the first round-trip air-tickets for home leave in the year	12,800
Reimbursement of medical expenses	3,000
Reimbursement of rent for her service apartment	<u>35,000</u>
Total before tax and contribution to social insurance	<u>186,800</u>
Employer's contribution to social insurance	10,500
Employee's contribution to social insurance	5,500
Annual bonus paid in December each year	400,000

All the reimbursements were supported by invoices.

**Required:**

**Calculate the taxable income of and individual income tax (IIT) payable by Ms Xi for December 2016.**

**Note:** You should list all of the items referred to in the question in your computation, indicating by the use of '0' any item(s) which is tax exempt/not taxable. (6 marks)

(c) Ms Wu, a Chinese citizen, had the following incomes before tax in 2016:

	<b>RMB</b>
Salary from employer Alpha Ltd (RMB2,000 x 12 months)	24,000
Salary from employer Beta Ltd (RMB3,800 x 12 months)	45,600
Consultancy fee from Delta Ltd (RMB5,000 x 12 months)	60,000
Interest income from a bank deposit	8,000
Interest income from a loan made to Beta Ltd	9,000
Dividend income from an overseas listed company (invested for over five years)	7,500
Dividend income from an A-share listed company (invested for over five years)	6,300
Profit on the disposal of A-shares (acquired in 2013)	100,500
Income from the China Daily News on the publication of an article in January 2016	3,000
Income from republishing the same article again in the China Daily News in February 2016	1,500
A smartphone valued at RMB8,000 won in a lottery, which she sold to a friend for RMB3,000	3,000
Compensation from an insurance company for a flight delay of RMB3,800; the premium paid for the insurance policy was RMB100	3,800

**Required:**

**Calculate the individual income tax (IIT) payable by Ms Wu in 2016.**

**Notes:**

1. You should list all of the items referred to in the question in your computation, indicating by the use of '0' any item(s) which is tax exempt/not taxable.
2. Ignore value added tax (business tax). (7 marks)

**(15 marks)**

6 Alitech Ltd, which was set up in Xi'an, produces and sells tablet computers and provides software services. It qualifies as a high and new technology enterprise.

Alitech Ltd's accounting profit for the year ended 31 December 2016 was RMB4,860,000. The following items were booked in the accounts before arriving at the accounting profit:

- (1) A donation of RMB600,000 to the China Red Cross.
- (2) Interest on a loan of RMB2,000,000 borrowed from a non-bank financial institution, LoanShark Ltd, from 1 January 2016. The interest rate on the loan is 24% per annum. The prime rate of the People's Bank of China is 6%.
- (3) Lost a legal case for the infringement of copyright and paid compensation of RMB1,500,000 to the copyright owner and a penalty of RMB500,000 to the State Administration for Industry and Commerce.
- (4) A warehouse was destroyed during a rainstorm. The cost of goods destroyed amounted to RMB540,000 and the compensation received from the insurance company was RMB521,000.
- (5) Out-of-fashion tablets costing RMB376,000 were scrapped during the year.
- (6) Qualifying research and development expenses incurred in the year of RMB460,000.
- (7) A customer went into bankruptcy in 2016 and the amount due of RMB230,000 was treated as a bad debt. In addition, a special provision for doubtful debts of RMB100,000 was made in the accounts. All necessary documents have been filed with the tax bureau.
- (8) Equipment bought in December 2014 for RMB6,000,000 is being depreciated for accounting purposes using the straight line method, with an economic life of five years and no residual value. For tax purposes, the company qualifies for the accelerated depreciation incentive and used the sum-of-the-years'-digits method in 2015.
- (9) Received royalties from its Shanghai distributors of RMB170,000 and from its Singapore distributors of RMB180,000. The Singapore distributors deducted Singaporean withholding tax of 10% before remitting the royalties to Alitech Ltd.
- (10) Salaries of qualified disabled employees employed in the year totalled RMB425,000.
- (11) Used computers with a net book value of RMB50,000 (for both accounting and tax purposes) were donated to a school. The disposal was treated as an administrative expense.
- (12) Ten new tablets were taken for their personal use by the shareholders of Alitech Ltd and recorded in the accounts by reducing the cost of sales. The cost of each tablet is RMB1,000 and the selling price is RMB4,000.
- (13) Expenses of RMB201,000 were accrued as at 31 December 2016. Invoices were obtained for all of these expenses before settlement of the enterprise income tax (EIT).
- (14) Interest income received included government treasury bond interest of RMB80,000 and bank interest of RMB91,500.
- (15) A specific government subsidy of RMB214,000 was received from the Xi'an government in respect of a new project, Adda. The expenses incurred for project Adda in 2016 amounted to RMB123,000.
- (16) Commercial insurances for employees of RMB128,000 and employer's social insurance contributions of RMB285,000 were paid.
- (17) Goodwill of RMB5,340,000 arising on the acquisition of a subsidiary in Hangzhou in 2015 is being amortised over a ten-year period for accounting purposes.

**Required:**

**Calculate the enterprise income tax (EIT) payable by Alitech Ltd for the year 2016, assuming that Alitech Ltd has made all relevant applications and/or reports to the tax authorities.**

**Notes:**

1. You should start your computation with the net profit figure of RMB4,860,000 and list all of the items referred to in notes (1) to (17) identifying any item(s) which do not require adjustment by the use of zero (0).
2. Ignore value added tax on any deemed sales or abnormal losses.
3. Ignore adjustments to the accounting profit.

**(15 marks)**

**End of Question Paper**