

Fundamentals Level – Skills Module

Taxation (China)

Thursday 7 December 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

The Association of
Chartered Certified
Accountants

Paper F6 (CHN)

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%
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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 taxed 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 = RMB 6

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) Lizz Ltd borrowed RMB8,000,000 for a period of one year from 1 May 2016 to 30 April 2017, from a foreign bank with headquarters in the United Kingdom. Interest is charged at the rate of 12% per annum net of China withholding tax (enterprise income tax (EIT)) and value added tax (VAT).

Required:

Calculate the value added tax (VAT) and withholding tax (enterprise income tax (EIT)) to be withheld from the interest payable to the foreign bank and the total gross interest cost for Lizz Ltd.

Note: There is no tax treaty reduced rate available for interest income. (4 marks)

- (b) Wawa Ltd is a Chinese tax resident enterprise. The foreign incomes and foreign taxes paid by Wawa Ltd in 2016 are summarised below:

	From Country A RMB	From Country B RMB	Total RMB
Profit on investment	100,000	150,000	250,000
Foreign tax paid	(20,000)	(40,000)	(60,000)
Net of tax amount	80,000	110,000	190,000
Service income	50,000	40,000	90,000
Foreign tax paid	(30,000)	0	(30,000)
Net of tax amount	20,000	40,000	60,000

Required:

Calculate the foreign tax credit, the unused foreign tax credit carried forward and the China enterprise income tax (EIT) payable by Wawa Ltd on its foreign income for 2016. (4 marks)

- (c) FFF Insurance Co Ltd is an insurance company registered in the United States, which has registered a branch in Shanghai.

Required:

State and briefly explain whether FFF Insurance Co Ltd is a China tax resident enterprise or a non-resident enterprise. (2 marks)

(10 marks)

- 2 (a) Chen joined U-Chat Ltd as their chief financial officer on 1 May 2016. U-Chat Ltd is the subsidiary of U-Connect which is a company listed on the New York Stock Exchange. The following information relates to Chen's entitlements and transactions in relation to his employee's stock option scheme:

		Market price per share
1 October 2016	Chen was granted 10,000 options on the stock of U-Connect at an exercise price of USD0.5 per option	USD1.5
1 November 2016	Chen exercised 7,000 options	USD1.8
2 November 2016	Chen sold 3,000 shares at their market price	USD1.9
1 January 2017	Chen sold 2,000 shares at their market price	USD1.7

Required:

Calculate the individual income tax (IIT) payable by Chen on the above transactions.

Note: You should list all of the items referred to in the question in your computation, indicating by the use of zero (0) any item(s) which is tax exempt/not taxable. (5 marks)

- (b) Ms Huang, a Chinese citizen, is employed by Egg Ltd. For the year from 1 January 2016 to 31 December 2016, she was seconded to the Hong Kong Special Administrative Region (HK). All of her payroll costs during this secondment were borne by Egg Ltd. Details of Ms Huang's payroll for the month of December 2016 are as follows:

	RMB
Basic salary	40,000
Overseas working allowance	10,000
Reimbursement of air ticket to return to China	2,000
Employer's contribution to social insurance in China	3,000
Employee's contribution to social insurance in China	800

In addition to her secondment employment, Ms Huang also had a part-time employment as a teacher at a night school in HK, for which she received a salary of RMB3,000 in December 2016.

Required:

- (i) **Calculate the individual income tax (IIT) to be withheld by Egg Ltd for Ms Huang for December 2016.**

Note: You should list all of the items referred to in the question, indicating by the use of zero (0) any item(s) which is tax exempt/not taxable. (4 marks)

- (ii) **Calculate the additional individual income tax (IIT) which Ms Huang should pay herself on the salary from her employment as a part-time teacher.** (1 mark)

(10 marks)

- 3 (a) Wee Ltd is considering the following two business models for the production of kitchen utensils for export.

	Source of raw materials	Price
Model A	China domestically sourced raw materials	RMB800,000
Model B	Imported raw materials under an import processing agreement	RMB900,000

In addition to any input value added tax (VAT) on the raw materials (as above), Wee Ltd will have other input VAT relating to the production process of RMB130,000.

All of the finished goods will be exported overseas for RMB1,500,000.

Except where stated otherwise, all amounts are exclusive of any applicable VAT.

Required:

Calculate the export value added tax (VAT) refundable to and the amount of the actual export VAT refund receivable by Wee Ltd under each of the two models (A and B).

Note: The export VAT refund rate of kitchen utensils is 5%. (5 marks)

- (b) Scarce Ltd purchases and exports copper alloys from China to Japan. It purchased copper alloys at a cost of RMB200,000 and obtained a value added tax (VAT) special invoice with input VAT of RMB34,000.

In September 2016, Scarce Ltd exported the copper alloys for the export price of USD60,000 on a cost including freight and insurance (CIF) basis. The insurance and freight costs paid by Scarce Ltd for the shipment of the alloys from China to Japan were USD3,000.

Required:

- (i) **Calculate the amount of export customs duty payable on the copper alloys.**

Note: The export customs duty rate of copper alloys is 30%. (1 mark)

- (ii) **Calculate the amount of export value added tax (VAT) refund due to Scarce Ltd on the export of the copper alloys.**

Note: The export VAT refund rate is 9%. (1 mark)

- (c) Koo Ltd had the following transactions in August 2016:

- (1) Imported 50 luxury watches at a cost of USD2,000 each, on a cost including freight and insurance (CIF) basis, from Switzerland.
- (2) Paid transportation costs totalling RMB3,000 to deliver the watches after landing at the port to its warehouse.
- (3) On arrival at the port, two watches were found to be damaged. The Swiss supplier replaced these with two new watches free of charge and sent the new watches to China by courier. Koo Ltd was allowed to keep the two damaged watches.

Required:

Calculate the amount of customs duty and consumption tax (CT) payable by Koo Ltd on each of the transactions of importation of the 50 watches and the two replacement watches.

Notes:

1. The customs duty rate on watches is 15%.
2. The consumption tax (CT) rate for luxury watches is 60%. (3 marks)

(10 marks)

- 4 (a) GY Ltd is a property developer. The information below relates to a residential property recently developed by GY Ltd. The development was started on 1 July 2016 and completely sold in January 2017.

	RMB
Cost of land use right	20,000,000
Construction costs	15,000,000
Administrative and management expenses	3,500,000
Interest on borrowing from financial institutions	2,100,000
Sale of residential property	95,000,000
Taxes paid	
– Deed tax on the land use right	600,000
– Value added tax (VAT)	6,000,000
– City maintenance and construction tax, education levy and local education levy (12% of VAT paid)	720,000

All amounts are exclusive of any applicable VAT.

Required:

Calculate the land appreciation tax (LAT) payable by GY Ltd on the sale of the development.

Note: Ignore stamp duty and other surtaxes.

(6 marks)

- (b) The following transactions relate to the transfer or alienation of real estate by various entities/persons:

- (1) The local government transferred a land use right to AK Ltd for RMB18 million in 2012.
- (2) AK Ltd contributed the land use right as registered capital of AGL Ltd in 2014, when the land use right was valued at RMB25 million.
- (3) AGL Ltd used the land to develop standard residential property units, which it sold in 2014. The land appreciation rate was 15%.
- (4) In December 2016, Mr Wu gave a unit of the property to his son as a marriage gift when the property was valued at RMB8 million. Mr Wu had bought the unit of property from the developer for RMB4 million in 2014.
- (5) Min Ltd acquired ten units of the property from the developer in 2014 as staff dormitories and pledged them to the bank to get a mortgage loan.
- (6) In 2016 Mrs Xie sold a unit of the property for RMB5 million. She had bought the property from the developer for RMB3 million in 2014 for use as accommodation for her family.
- (7) In 2020 Kur Ltd sold a unit of the property for RMB6 million, which it had bought from the developer for RMB3.3 million in 2014.
- (8) Lill Ltd acquired two units of the property from the developer in 2014. Lill Ltd was merged by absorption by Lar Ltd, a manufacturing company, in 2016 and hence, the title of the property was transferred to Lar Ltd.

Required:

State whether each of the above transactions is 'taxable', 'exempt' or 'not subject to' land appreciation tax (LAT).

Note: You are not required to give reasons for your answers.

(4 marks)

(10 marks)

- 5 (a) Lei started selling handicrafts via e-commerce on 1 January 2016. His sales are around RMB35,000 each month but to date he has not set up any formal structure for his handicrafts business and has not paid any taxes.

Required:

State, with reason, whether Lei should be tax registered.

(1 mark)

- (b) Lei is considering the following three options for running his business. The business's forecast results for 2017 under each option is as follows:

	RMB	RMB
Option 1: Sole proprietorship		
Sales income		1,500,000
Costs and expenses	800,000	
Salary of Lei (RMB30,000 x 12 months)	360,000	
		<u>(1,160,000)</u>
Net profit		<u>340,000</u>
Option 2: Partnership with Tommy		
Sales income		2,200,000
Costs and expenses		<u>(1,000,000)</u>
Net profit of partnership		1,200,000
Lei's share of the profit (60%)		<u>720,000</u>
Option 3: Limited company		
Sales income		1,500,000
Costs and expenses	800,000	
Salary of Lei (RMB30,000 x 12 months)	360,000	
		<u>(1,160,000)</u>
Net profit		340,000
Enterprise income tax at 25%		<u>(85,000)</u>
After-tax profit		<u>255,000</u>
Dividend to Lei		<u>255,000</u>

All costs and expenses are tax deductible under all three options.

Required:

- (i) Calculate the individual income tax (IIT) payable by Lei under each of the three options. (6 marks)
- (ii) Calculate the total after-tax income which Lei will receive under each of the three options. (3 marks)
- (c) Lei decided to operate his business in the form of a limited company, EE Ltd. EE Ltd is registered as a value added tax (VAT) general taxpayer and in 2017 made the following payments:
- (1) USD100,000 for the importation of smart phones, purchased from Alima Ltd, a US company.
 - (2) A royalty of RMB100,000 (net of all China taxes) for the use of a patent licensed to it by Cal plc, a UK company.

Required:

State, with reasons, whether EE Ltd will be a withholding agent in respect of the payments made to Alima Ltd and Cal plc, and if so, in respect of which taxes.

Note: Calculations of the taxes are not required.

(3 marks)

(d) Mr Liu, a Chinese citizen, earned the following gross director's fees in the year 2016:

	RMB
Fee as an independent non-executive director of NN Ltd, received in November 2016	40,000
Fee as the managing director of MM Ltd, received in December 2016	50,000

Except for the above fees, Mr Liu did not receive any other income from NN Ltd or MM Ltd in November and December 2016.

Required:

Calculate the individual income tax (IIT) payable by Mr Liu on the director's fees received from NN Ltd and MM Ltd.

Note: Ignore value added tax (VAT) and surtaxes. (2 marks)

(15 marks)

- 6 (a) Biocat Ltd is a high and new technology enterprise. The company's statement of profit or loss for the year ended 31 December 2016 is as follows:

	Notes	RMB	RMB
Sales			81,350,000
Cost of sales	1		(50,460,500)
Gross profit			30,889,500
Business operating expenses	2	(17,856,000)	
Management and administrative expenses	3	(8,396,000)	
Financial expenses	4	(1,002,150)	
			(27,254,150)
Operating profit			3,635,350
Investment income	5	242,000	
Government subsidies	6	424,000	
Dividend income	7	139,000	
Dividend expense	8	(200,000)	
Non-operating expenses	9	(7,000)	
			598,000
Net profit			4,233,350

Except where stated otherwise, the following items are all included in the financial statement figures:

Note	Item
1	Cost of sales includes:
(1)	The inventory which is valued based on the first-in, first-out method. If the inventory was valued based on the weighted average cost method, the cost of sales would be increased by RMB108,000.
(2)	The factory building which is being depreciated over 40 years with no residual value. The depreciation charge in 2016 was RMB1,000,000. Under the tax law, the shortest depreciation period for the building is 20 years.
(3)	Energy saving equipment acquired in June 2016 for RMB934,000 and depreciated over a five-year period with no residual value. This equipment qualified for the tax incentive for environmental protection equipment.
(4)	Tools acquired in June 2016 with a total value of RMB70,000 and each piece costing less than RMB5,000, being depreciated over a two-year period from 1 July 2016. These tools qualified for the accelerated depreciation tax incentive.
(5)	Goods costing RMB4,000,000 taken as souvenirs for the marathon event (see Note 2 below). The normal selling price of these goods is RMB5,500,000. No other entry has been made in the books for these goods.
(6)	Salaries of qualified disabled employees of RMB380,000.
(7)	Salaries included annual bonuses of RMB304,000 accrued in December 2016 and payable in April 2017.
2	Business operating expenses include:
(8)	An advertising fee of RMB6,000,000 paid as the sole sponsor of a marathon held in Beijing.
3	Management and administrative expenses include:
(9)	A provision for labour union fees of RMB80,000, which is 1% of the total salaries. The labour union was not yet set up in 2016.
4	Financial expenses include:
(10)	Interest of 7% per annum on RMB8,000,000 borrowed on 1 July 2016 for the construction of a new factory building. The factory building will be completed in 2017.
(11)	A special provision for a bad debt of RMB45,000 owed by Customer D who has been out of contact since 1 June 2013.

- 5 Investment income comprises:
- (12) Interest income from government bonds of RMB74,000.
 - (13) The profit on the disposal of government bonds of RMB168,000.
- 6 (14) Government subsidies of RMB424,000 is the amount received from the local finance bureau for promising to employ over 1,000 workers.
- 7 Dividend income comprises:
- (15) Net of tax dividend income of RMB85,000 from Biocat Ltd's Chengdu subsidiary. The Chengdu subsidiary paid enterprise income tax (EIT) at the rate of 15%.
 - (16) Net of tax dividend income of USD9,000 from Biocat Ltd's investment in an associated company in the US. The US company withheld withholding tax at 10% on this dividend.
- 8 (17) The dividend expense of RMB200,000 is for the withholding tax paid on the dividend paid by Biocat Ltd to its overseas shareholder.
- 9 (18) Non-operating expenses comprise the cost of inventory destroyed by a fire of RMB267,000 less the compensation received from the insurance company of RMB260,000.

No entries have been made in the accounts for the following:

- (19) The lorry valued at RMB40,000 donated to Biocat Ltd by its shareholder on 15 June 2016. The shortest depreciation period for this lorry is four years.
- (20) A surplus of RMB14,200 identified during the stock take.

Required:

Calculate the enterprise income tax (EIT) payable by Biocat Ltd for the year 2016, assuming that Biocat 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 RMB4,233,350 and list all of the items (1) to (20) identifying any item(s) which do not require adjustment by the use of zero (0).
2. You are not required to make adjustments for any of the above items for accounting purposes.
3. Ignore value added tax (VAT) on any deemed sales or abnormal losses. (14 marks)

- (b) Biocat Ltd invested in a subsidiary, Silvercat Ltd, in 2016. Silvercat Ltd is expected to make a loss in 2017.

Required:

State, with reason, whether it will be possible to offset Silvercat Ltd's 2017 loss against Biocat Ltd's 2017 profit for enterprise income tax (EIT) purposes. (1 mark)

(15 marks)

End of Question Paper