

Fundamentals Level – Skills Module

Taxation (China)

Thursday 7 June 2018



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

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% |
|---|-----|

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 | 17% |
| for itemised goods (except for agricultural products) | 17% |
| for agricultural products | 11% |
| For small-scale taxpayers and simplified method | 3% |
| For general taxpayers | |
| for the sale of itemised goods, provision of processing, and repairing services | 17% |
| for the sale of agricultural products | 11% |
| input tax credit for agricultural products | 13%/11% |
| For primary producers of agricultural products | exempt |

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 2017. The new rules issued from 1 October 2017 onwards are not examinable in the 2018 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) GKL Ltd engages in simple processing in Shenzhen and exports the finished goods to its overseas affiliates for further sale on to the ultimate customers. GKL Ltd made a loss in 2017. The tax bureau has challenged GKL Ltd's transfer pricing policy.

Required:

State ANY TWO transfer pricing methodologies which the tax bureau can use to assess the profit of GKL Ltd.

Note: No marks will be given for stating 'other method'. (2 marks)

- (b) CD Ltd qualifies for a reduced enterprise income tax rate of 15%. CD Ltd holds overseas investments in two subsidiary companies, T Ltd, its Turkmenistan subsidiary and U Ltd, its United States subsidiary. In 2017, CD Ltd received the following income from these overseas subsidiaries:

| | T Ltd RMB | U Ltd RMB |
|--|--------------|--------------|
| Profit of subsidiary | 2,500,000 | 1,000,000 |
| Overseas corporate tax paid on these profits | (500,000) | (300,000) |
| After-tax profit | 2,000,000 | 700,000 |
| Dividend paid to CD Ltd | 1,000,000 | 700,000 |
| Dividend withholding tax paid overseas | (50,000) | (70,000) |
| Net of tax dividend received by CD Ltd | 950,000 | 630,000 |

Required:

Calculate the amount of enterprise income tax (EIT) payable by CD Ltd in respect of the dividend income received from T Ltd and U Ltd in 2017. Clearly show the amount of the foreign tax credit utilised in 2017 and the foreign tax credit (if any) to be carried forward.

Note: CD Ltd did not opt for the combined basis to calculate the foreign tax credit. (5 marks)

- (c) STuv Ltd is a value added tax (VAT) general taxpayer. In 2017, it paid a royalty of RMB1,000,000 (net of all China taxes) to its Singapore parent company (a non-China tax resident without an establishment in China).

Required:

- (i) **Calculate the value added tax (VAT) and enterprise income tax (EIT) (withholding tax) to be withheld and paid by STuv Ltd in respect of the royalty.**

Note: Under the VAT pilot programme, a royalty is a type of cultural and innovation service. (2 marks)

- (ii) **Calculate the cost of the royalty to STuv Ltd for the purposes of its EIT accounting and EIT liability.**

Note: You should ignore surtaxes on VAT and any treaty incentive available on royalty income. (1 mark)

(10 marks)

- 2 (a) Ten-day Hotel is a value added tax (VAT) general taxpayer. Susan received the following bill in respect of her stay at Ten-day Hotel:

| Nature of item | Description | RMB |
|--------------------------------------|---------------------------------|--------------|
| Hotel accommodation | Two nights at RMB800 per night | 1,600 |
| Free breakfast | Valued at RMB200 | 0 |
| Soft drink from mini bar | Four cans of cola at RMB10 each | 40 |
| Total amount payable (VAT inclusive) | | <u>1,640</u> |

Required:

- (i) Briefly explain the meanings of a 'mixed sale' and a 'composite sale'. State whether the sale of the soft drink from the mini bar is a 'mixed sale' or a 'composite sale'. (3 marks)
- (ii) State, by referring to the definition of a deemed sale of services, whether the free breakfast is a deemed sale of services for value added tax (VAT). (2 marks)
- (iii) Calculate the output VAT payable by Ten-day Hotel on Susan's bill.

Note: Under the VAT pilot programme, hotel accommodation is a type of consumer service. (2 marks)

- (b) O-source Ltd, which provides information technology outsourcing services to customers, is a value added tax (VAT) general taxpayer. The following information relates to O-source Ltd's VAT position in 2017:

| | RMB |
|--|-------------------|
| Service income from overseas customers (VAT exempt) | 4,000,000 |
| Service income from domestic Chinese customers (taxable) (VAT exclusive) | 6,000,000 |
| | <u>10,000,000</u> |

| | VAT exclusive RMB | VAT RMB | Gross amount RMB |
|--|----------------------|------------|---------------------|
| For services provided to both types of customer: | | | |
| Total periodic costs and expenses | 4,000,000 | 185,000 | 4,185,000 |
| Cost of equipment purchased | 1,000,000 | 170,000 | 1,170,000 |

Required:

- (i) Calculate the output value added tax (VAT) on O-source Ltd's service income in 2017. State zero (0) for any item of income which is not subject to VAT. (1 mark)
- (ii) Assuming all the above transactions have a VAT impact, calculate the amount of input VAT credit available to O-source Ltd in 2017. (2 marks)

(10 marks)

- 3 (a) Elsa Chen set up a proprietorship business selling handcrafts via an e-commerce platform. The transactions of her business in 2017 were as below:

| | RMB | RMB |
|---|---------|--------------------|
| Sales (exempt from value added tax) | | 300,000 |
| Costs and expenses | | |
| Cost of sales (all tax deductible) | 100,000 | |
| Salary of Elsa (RMB10,000 x 12 months + one month's bonus of RMB10,000) | 130,000 | |
| Entertainment expenses | 1,600 | |
| Other costs and expenses (all tax deductible) | 49,400 | |
| | <hr/> | |
| Total costs and expenses | | (281,000) |
| Net profit | | <hr/> 19,000 <hr/> |

Required:

Calculate the individual income tax (IIT) payable by Elsa Chen for 2017 and her after-tax income. (4 marks)

- (b) Elsa Chen converted her business into a limited company, EC Hand Ltd, on 1 January 2018. EC Hand Ltd qualifies for the small profit enterprise income tax (EIT) incentive. Elsa will distribute all of the profits of EC Hand Ltd as a dividend.

Required:

Assuming that the transactions of EC Hand Ltd in 2018 are the same as those of Elsa's proprietorship business in 2017:

- (i) **Calculate the enterprise income tax (EIT) payable by EC Hand Ltd and the amount of the dividend payable to Elsa Chen in 2018.** (2 marks)
- (ii) **Calculate the individual income tax (IIT) payable by Elsa Chen in 2018.** (3 marks)
- (iii) **Calculate the total after-tax income receivable by Elsa Chen in 2018.** (1 mark)

Note: You should assume that the 2017 tax rates will continue to apply in 2018.

(10 marks)

- 4 (a) Uanke Ltd is a property developer which developed a shopping mall and sold it to JD-Mart in April 2017. Details of the sale and the related costs are summarised below:

| | RMB | RMB |
|---|------------|-------------|
| Sales proceeds (exclusive of value added tax (VAT)) | | 150,000,000 |
| Acquisition of land use right | 30,000,000 | |
| Construction costs | 20,000,000 | |
| Administrative expenses | 4,000,000 | |
| Bank loan interest | 4,500,000 | |
| Total costs excluding taxes | 58,500,000 | |
| Taxes paid: | | |
| Deed tax at 3% on the acquisition of the land use right | 900,000 | |
| VAT | 8,000,000 | |
| Surtaxes on VAT | 960,000 | |

Required:

Calculate the land appreciation tax (LAT) payable by Uanke Ltd on the sale of the shopping mall to JD-Mart.

Note: You should ignore stamp duty. (5 marks)

- (b) JD Mart plans to sell the shopping mall for RMB250 million in October 2018. Details of the sale and the related costs are forecast to be as below:

| | RMB | RMB |
|--|-------------|-------------|
| Sales proceeds (exclusive of value added tax (VAT)) | | 250,000,000 |
| Acquisition of shopping mall | 150,000,000 | |
| Administrative expenses | 4,000,000 | |
| Bank loan interest | 8,500,000 | |
| Total costs excluding taxes | 162,500,000 | |
| Taxes paid: | | |
| Deed tax at 3% on the acquisition of the shopping mall | 4,500,000 | |
| VAT | 11,000,000 | |
| Surtaxes on VAT | 1,320,000 | |

The shopping mall will qualify as a used property and the value of construction of a new building at the time of sale is forecast as RMB220 million. The wear and tear of the shopping mall is 10%.

Required:

- (i) **Calculate the estimated land appreciation tax (LAT) payable by JD-Mart on the sale of the shopping mall.**

Note: You should ignore stamp duty. (3 marks)

- (ii) **Calculate the estimated profit before enterprise income tax (EIT) of JD-Mart on the sale of the shopping mall.**

Note: You should ignore stamp duty. (2 marks)

(10 marks)

- 5 (a) Mr Zhang has a household and family in China. He was seconded to work in Zambia for a six-year period from 1 January 2012 and has not returned to China since his secondment. Mr Zhang's remuneration for December 2017 is summarised below:

| | RMB equivalent |
|---|----------------|
| Gross salary for December | 30,000 |
| Less: Zambian tax paid | (2,000) |
| Less: Employee's social security contribution paid in China | (2,400) |
| | 25,600 |
| Employer's social security contribution paid in China | 7,500 |
| Total payroll costs for Mr Zhang | 37,500 |

In December 2017, Mr Zhang won USD1,000 in a lottery in Zambia. The Zambian tax paid was USD500.

Required:

- (i) **State why Mr Zhang will be considered as a China tax resident during the period of his secondment in Zambia.** (2 marks)
- (ii) **Calculate the individual income tax (IIT) payable by Mr Zhang for the month of December 2017.** (4 marks)
- (b) Ms Yang, a US citizen, has been working in Shanghai for SX Express, which is listed on the China Stock Exchange, since January 2016. Her income slip for July 2017 shows the following:

| | RMB |
|--|--------|
| (1) Monthly salary | 60,000 |
| (2) Reimbursement of the cost of leasing a serviced apartment | 25,000 |
| (3) Meal allowances paid on a cash basis | 10,000 |
| (4) Reimbursement of her children's education fees for studying in the United States | 31,500 |
| (5) Reimbursement of the cost of learning Putonghua in Shanghai | 4,800 |
| (6) Reimbursement of the air-ticket charges for her third home leave in 2017 | 6,200 |
| (7) Reimbursement of her hotel charges on business trips | 2,950 |

In addition to the salary items (as listed above), Ms Yang had the following transactions in July 2017:

- (8) Received a director's fee from the subsidiary of SX Express of RMB30,000.
- (9) Exercised 150,000 stock options of SX Express at RMB1 per option on 6 July 2017, when the market price of the stock was RMB50 per share.
- (10) Sold 50,000 of the shares of SX Express which she had received from exercising the options (as in (9) above), for RMB52 per share.
- (11) Received fees of RMB1,000 from the China Daily and RMB1,000 from the Xin Huang News Agency on the publication and re-publication of an article she had written in July 2017.

Required:

Calculate the individual income tax (IIT) payable by Ms Yang on each of the items (1) to (11) in July 2017. Indicate by the use of zero (0) any item which is tax exempt or not taxable. (9 marks)

(15 marks)

- 6 Sun Ltd is a solar energy equipment manufacturer operating from Ningxia, which qualifies for both the Central and Western Region and high and advanced technology enterprise income tax (EIT) incentives.

Sun Ltd's accounting profit before tax for 2017 is RMB85,000. Except where stated otherwise, the following items have all been included when computing this accounting profit:

- (1) Goods costing RMB1,250,000, which were sold in December 2017 for RMB1,350,000, were returned by the customer in January 2018 due to defects. The return of these goods was not recorded in 2017.
- (2) Inventory was valued under the weighted average cost method. If the inventory had been valued under the last in, first out method, the profit would have been increased by RMB280,000.
- (3) In 2016, Sun Ltd borrowed RMB100,000,000 from its affiliates in Shanghai at an interest rate of 6% per annum. Except for this loan, Sun Ltd did not have any other loans from related companies. Sun Ltd has not prepared any transfer pricing documentation in relation to this loan. In 2017, the weighted average equity of Sun Ltd was RMB30,000,000. The market interest rate from financial institutions on similar loans is 6% per annum.
- (4) A receivable of RMB45,000 was written off as a bad debt because the debtor was bankrupt.
- (5) A specific provision of RMB360,000 was made in respect of a receivable due from Customer YY which announced its bankruptcy in January 2018.
- (6) A donation of solar energy equipment was made to a school. This equipment had a cost of RMB40,000 and its normal selling price is RMB75,000. The cost of the equipment was booked as part of cost of sales. No record was made of the donation.
- (7) In addition to the donation of solar energy equipment (as in (6) above), Sun Ltd donated cash of RMB18,000 to the China Red Cross.
- (8) New equipment, which qualified for the EIT energy and water saving equipment incentive, was acquired for RMB1,500,000. The equipment was put into use in October 2017, but no accounting depreciation was booked in the 2017 accounts. The equipment has an economic life of five years and no residual value. Sun Ltd has not applied to use accelerated depreciation for this new equipment.
- (9) Sun Ltd is an advanced-type small and medium size company which qualifies for the additional research and development incentive. In 2017, Sun Ltd incurred qualifying research and development expenses of RMB1,374,000.
- (10) Included in wages and salaries is a provision for a bonus of RMB300,000, which was paid in April 2018.
- (11) Also included in wages and salaries is a provision for employees' stock option incentives with a grant date in January 2017 of RMB680,000. None of these stock options were exercised in 2017.
- (12) Except for the new equipment (as in (8) above), Sun Ltd's fixed assets were all purchased in December 2015 for RMB6,000,000. Depreciation is calculated under the straight line method for accounting purposes using an economic life of five years and no residual value. Sun Ltd qualifies for the accelerated depreciation tax incentive in respect of these assets and can use the sum-of-years-digit depreciation method for tax purposes.
- (13) Sun Ltd received a specific financial subsidy of RMB500,000 for Project DD in 2010. The total amount spent on the completion of Project DD by the end of 2017 was RMB480,000.
- (14) Sun Ltd received another specific financial subsidy of RMB720,000 for Project SS starting in 2017. The expenses incurred for Project SS in 2017 amounted to RMB232,000.
- (15) Sun Ltd received a general purpose financial subsidy of RMB186,000 in 2017.
- (16) Sun Ltd incurred promotion and advertising expenses of RMB3,200,000 in 2017. Sun Ltd's sales for EIT purposes in 2017 totalled RMB25,000,000. The amount of excessive promotion expenses not deductible in 2016 were RMB400,000.
- (17) Dividend income of RMB50,000 was received from a subsidiary in Xinjiang. The Xinjiang subsidiary was exempt from EIT in 2017.
- (18) Interest received on government bonds was RMB30,000.
- (19) Interest received on corporate bonds was RMB11,500.

(20) In August 2017, a dividend of RMB21,000 was received from an A-shares investment made in May 2017.

Required:

Calculate the enterprise income tax (EIT) payable by Sun Ltd for the year 2017, assuming that Sun 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 RMB85,000 and list all of the items (1) to (20) as referred to in the question, identifying any item which does 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. You should ignore value added tax (VAT) on any deemed sales or abnormal losses.

(15 marks)

End of Question Paper