

Applied Skills

Taxation – China (TX – CHN)

Tuesday 4 December 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.

TX – CHN

Think Ahead

ACCA

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%
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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	17%
for itemised goods (except for agricultural products)	11%
for agricultural products	11%
For small-scale taxpayers and simplified method	3%
For general taxpayers	17%
for the sale of itemised goods, provision of processing, and repairing services	11%
for the sale of agricultural products	13%/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 A – ALL 15 questions are compulsory and MUST be attempted

Please use the grid provided on page two of the Candidate Answer Booklet to record your answers to each multiple choice question. Do not write the answers to the MCQs on the lined pages of the answer booklet.

Each question is worth 2 marks.

- 1 Judy Chen received RMB200 cash (net of tax) in a lottery from Supermarket X and received RMB450 WeChat Red-pocket money from her friends.

What is the amount of individual income tax (IIT) which should have been withheld by Supermarket X on the cash lottery, and, how much IIT is payable by Judy on the WeChat Red-pocket money?

	Lottery (RMB200 cash)	WeChat Red-pocket (RMB450)
A	RMB40	RMB90
B	RMB40	RMB0
C	RMB50	RMB90
D	RMB50	RMB0

- 2 Big-Mart Store (BMS) offered a promotion whereby each walk-in customer received a packet of tissue paper free of charge. The cost and usual selling price of each packet is RMB0.5 and RMB1 respectively. In February 2018, BMS gave 10,000 packets of tissue paper to walk-in customers.

What are the deemed sales, and deemed promotional expenses of BMS for enterprise income tax (EIT) purposes, in February 2018?

You should ignore value added tax (VAT) and surtaxes.

	Deemed sales	Deemed promotional expenses
A	RMB10,000	RMB10,000
B	RMB10,000	RMB5,000
C	RMB5,000	RMB5,000
D	RMB0	RMB10,000

- 3 SS Express (SSE) is a logistics company. It acquired warehouse premises in March 2018 for RMB5,000,000. The value added tax (VAT) special invoice shows input VAT of RMB550,000. SSE also purchased forklifts for which the VAT special invoice showed input VAT of RMB170,000 in March 2018. Output VAT for March 2018 amounted to RMB10,000.

What is the value added tax (VAT) position of SSE for March 2018?

- A Input VAT carried forward RMB710,000
- B Input VAT refundable RMB710,000
- C Input VAT carried forward RMB422,000
- D Input VAT carried forward RMB490,000

- 4 Weke Ltd acquired land use rights for RMB100 million from the local government on 1 January 2000 and from this date, the land was idle. Weke Ltd incurred bank loan interest of RMB20 million relating to the acquisition of this land. Unfortunately, the company declared bankruptcy and the land use rights were sold at an auction on 31 December 2017 for RMB300 million excluding value added tax (VAT). The valuation of the land use rights on that date was RMB250 million. The following taxes were paid on auction:

VAT	RMB15 million
Surtaxes on VAT	RMB1.8 million

What is the amount of land appreciation tax, payable by Weke Ltd, on the auction of the land use rights?

- A RMB83.83 million
 B RMB74.08 million
 C RMB70.83 million
 D RMB14.46 million
- 5 **What is the statute of limitation on the collection of taxes underpaid concerning tax evasion and transfer pricing adjustments respectively?**

	Tax evasion	Transfer pricing
A	Unlimited	Unlimited
B	10 years	10 years
C	5 years	5 years
D	Unlimited	10 years

- 6 Win Ltd imports smart phones for resale. In March 2018, it imported 1,000 smart phones and received the following pro-forma invoice:

	RMB
Free on board (FOB) price for 1,000 smart phones	1,500,000
Insurance	10,000
Freight charges	4,000

After the smart phones arrived at the Shanghai port, Win Ltd paid a delivery charge of RMB1,000 for transporting the smart phones to a warehouse. The customs duty rate is 10%.

What is the amount of customs duty payable by Win Ltd?

- A RMB151,500
 B RMB151,400
 C RMB150,000
 D RMB151,100
- 7 Smell Fast Food (SFF) is a small-scale taxpayer for value added tax (VAT) purposes. SFF pays VAT on a quarterly basis. In the first quarter of 2018, SFF generated the following amounts of sales of fast food:

	RMB
January 2018	28,000
February 2018	35,000
March 2018	22,000

What is the amount of value added tax (VAT) payable by SFF in the first quarter of 2018?

- A RMB2,476
 B RMB2,550
 C RMB0
 D RMB1,019

- 8 Bur Ltd qualified as a small-profit enterprise in 2017. Its enterprise income tax (EIT) status is as follows:

	RMB
Tax loss brought forward from 2016	38,000
Taxation profit for 2017	220,000

What is Bur Ltd's enterprise income tax (EIT) payable for 2017?

- A** RMB0
B RMB18,200
C RMB22,000
D RMB36,400
- 9 Which of the following are treated as taxable income for the purposes of individual income tax?
- (1) Cash of RMB100,000 from grandfather's estate
(2) Insurance compensation of RMB25,000 from a traffic accident
(3) Moon-cake coupon worth RMB100 received from an employer
(4) Company car, valued at RMB50,000, and transferred to an employee free of charge
- A** 1, 3 and 4
B 3 and 4 only
C 1 and 2
D 4 only
- 10 Tee Ltd is an export trading company. It purchased toys in December 2017 for RMB500,000, excluding value added tax (VAT). The VAT special invoice shows input VAT of RMB85,000. In January 2018, it exported 50% of the toys for RMB320,000. The export VAT refund rate for toys is 15%.
- What is the export value added tax (VAT) refund due to Tee Ltd?**
- A** RMB37,500
B RMB78,600
C RMB36,100
D RMB12,750
- 11 Arthur Ltd is a monthly taxpayer for value added tax (VAT) and the withholding agent in respect of individual income tax (IIT) for its employees.

What is Arthur Ltd's monthly tax filing deadlines for value added tax (VAT) and individual income tax (IIT) respectively?

	VAT monthly filing deadline (days after the month end)	IIT monthly filing deadline (days after the month end)
A	10th	15th
B	10th	7th
C	15th	15th
D	7th	10th

- 12** Mr Wu and Ms Yu are partners in a partnership business providing consultancy services sharing profits equally. In 2017, the partnership generated profit of RMB500,000 (assuming that there is no tax adjustment). They agreed Mr Wu would not draw any profits from the partnership in 2017.

What is the amount of individual income tax (IIT) payable by Mr Wu in 2017?

- A** RMB58,050
- B** RMB0
- C** RMB50,000
- D** RMB72,750

- 13** Rust Ltd lost some inventory during a snowstorm in January 2018. The inventory cost RMB200,000, with associated input value added tax (VAT) credited in December 2017 of RMB34,000. The normal selling price for these goods is RMB300,000. The insurance company agreed to compensate RMB120,000 to the company for the lost inventory. Where relevant, all amounts are exclusive of VAT.

What is the amount of irrecoverable input value added tax (VAT) on the inventory lost in January 2018?

- A** RMB34,000
- B** RMB30,600
- C** RMB0
- D** RMB13,600

- 14** Tett Ltd is a qualified software enterprise set up in Chengdu. Hence, it also enjoys the tax incentive of the Central and Western Region. It started benefiting from the enterprise income tax (EIT) incentive on software enterprise from 2015. Tett Ltd's taxable profit in 2017 is RMB1,200,000.

What is the minimum amount of enterprise income tax (EIT) payable by Tett Ltd?

- A** RMB180,000
- B** RMB0
- C** RMB90,000
- D** RMB150,000

- 15** FE Ltd is a UK engineering company. In February 2018, it entered into a service agreement with a Shanghai customer. The agreement specifies the service is to be completed by December 2018. FE Ltd sent its staff to China to provide services and created a permanent establishment in China.

When should FE Ltd register with the China tax bureau?

- A** No need to register
- B** Register within seven days on conclusion of the service agreement
- C** Register within 30 days on conclusion of the service agreement
- D** Register within 30 days on completion of the service agreement

(30 marks)

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)** (i) Ms Zheng has citizenship and family in China. She was seconded to work in Singapore and has not returned to China since 2012. She receives her salary in Singapore.
- (ii) Mr Liu is a UK citizen and is employed by a UK employer. He was seconded to China from 1 January 2017. He stayed in China for 60 days in 2017. His salary was paid in the UK.
- (iii) Miss Xu is a UK citizen and is not domiciled in China. She started working in China from 1 January 2012 and has not left China since. She receives interest income from a bank in the UK in 2017.

Required:

State, with reasons, whether the income mentioned for each of the above persons is taxable in China in the year 2017. (4 marks)

- (b)** Mr Ou is a Chinese citizen who retired in 2016. During a sight-seeing visit to Malaysia in August 2017, he received winnings from a Malaysian lottery of USD200. He paid Malaysian tax of USD30 on his winnings. He filed an annual individual income tax (IIT) return, for the tax year 2017, in China, and paid the tax due before the deadline in 2018.

Required:

- (i) State the FOUR circumstances in which individual income tax (IIT) annual self-filing is required.**

Note: No marks will be given for stating 'other'. (4 marks)

- (ii) State the date by which Mr Ou would have been required to submit an annual IIT return for the year 2017.** (1 mark)

- (iii) Calculate the IIT payable by Mr Ou for the year 2017.** (1 mark)

(10 marks)

- 2 (a)** During a tax audit in October 2017, Horse Ltd was challenged by the district tax bureau on the following issues:
- Under-withholding of individual income tax (IIT) on employees' salaries of RMB100,000 for the year 2015; and
 - Underpaying enterprise income tax (EIT) of RMB150,000 for the year 2016 through using fraudulent invoices.

The tax notice required Horse Ltd to settle the above amounts by 31 October 2017.

Required:

- (i) Calculate the penalty range on the under-withholding of individual income tax (IIT).**
- (ii) Calculate the penalty range on underpayment of enterprise income tax (EIT).**
- (iii) Calculate the late payment surcharge on EIT if Horse Ltd settled the EIT on 31 October 2017.**

(4 marks)

- (b)** Horse Ltd paid the taxes, penalty and late payment surcharge on 31 October 2017. Due to other non-compliance issues, the company was downgraded to Grade D by the district state tax bureau in July 2018 and ceased to receive export value added tax (VAT) refunds from July 2018. In August 2018, Horse Ltd decided to appeal against the tax audit results, referred to in part (a) above, and the downgrading.

Required:

- (i) State, with reasons, whether in August 2018, Horse Ltd can appeal against the tax audit results referred to in part (a) above.**
- (ii) State, with reasons, whether Horse Ltd can appeal against its downgrading by the tax bureau in August 2018 and explain which bureau the appeal should be submitted to.**

(3 marks)

- (c) State any THREE circumstances in which the tax authorities can assess the enterprise income tax (EIT) of a resident taxpayer on the deemed basis.**

(3 marks)

(10 marks)

- 3 (a)** GH Ltd is a construction company set up in Shanghai and pays enterprise income tax (EIT) at 25%. XY Ltd is its holding company and is based in the Cayman Islands. The average amount of net equity of GH Ltd was RMB4,000,000 in 2017. The manager of GH Ltd proposes that XY Ltd provides a loan of RMB10,000,000 to GH Ltd, on which GH Ltd pays interest to XY Ltd at a rate of 20% per annum (inclusive of all China taxes). Hence, the interest will reduce the taxable profit of GH Ltd.

Required:

- (i) Calculate the value added tax (VAT) and enterprise income tax (EIT) (withholding tax) on the annual interest income payable to XY Ltd.**

Note: You should ignore surtaxes on VAT.

(2 marks)

- (ii) Calculate the interest deductible by GH Ltd in 2017 according to the thin capitalisation rules if the market interest rate is 7% per annum.**

(2 marks)

- (b)** Lont Pte Ltd is a Singapore company which carried out the following transactions in 2017:

- (1) Sold goods to its Chinese customers for RMB5,500,000 and earned a profit of RMB520,000.
- (2) Received a royalty from a Chinese company, Tstar Ltd, of RMB700,000.
- (3) Sold shares held in a Beijing company for RMB8,000,000 and made a gain of RMB4,800,000.
- (4) Received a fee of RMB260,000 (tax inclusive) on the provision of services in China. Lont Pte Ltd has created a permanent establishment in China for the provision of these services. The China tax authorities assessed a deemed profit rate of 30% on the service fee.
- (5) Leased an aircraft, without a crew, to an airlines company in China at a rent of RMB3,300,000. The depreciation of the aircraft amounts to RMB2,700,000.

Note: Each of the above items is an isolated transaction.

Required:

Calculate the enterprise income tax (EIT) for each of the above items of income (1) to (5) received by Lont Pte Ltd in 2017. Indicate by the use of a zero (0) any item which is not subject to EIT.

Note: You should ignore value added tax (VAT) and ignore tax treaty reduction.

(6 marks)

(10 marks)

4 (a) KT Ltd manufactures and sells gadgets via the internet. KT Ltd is a value added tax (VAT) general taxpayer. It carried out the following transactions in March 2018.

- (1) Purchased raw materials for RMB600,000, excluding VAT of RMB102,000, as shown on the VAT special invoice. 70% of the materials were used in production and 30% remained in stock in the warehouse.
- (2) Paid a transportation fee of RMB10,000, excluding VAT of RMB1,100, as shown on the VAT special invoice.
- (3) Paid rent to the landlord of RMB25,000, excluding VAT of RMB1,250 as shown on the VAT ordinary invoice issued by the landlord.
- (4) Purchased canned food and soft drinks for the staff canteen for RMB8,000, excluding VAT of RMB1,360, as shown on the VAT special invoice.
- (5) Purchased new machinery for RMB800,000, excluding VAT of RMB136,000, as shown on the VAT special invoice. It is expected the machinery can be used for a period of five years.
- (6) The normal price of gadgets is RMB44 for each piece. KT Ltd offered a promotion campaign where customers can receive a coupon worth RMB5 which can be used against the purchase of each gadget. The coupon cannot be exchanged for cash. In addition, customers who register as KT Club members can receive one gadget free of charge. The above prices are VAT inclusive.

The following table shows the number of gadgets sold to or received free of charge by customers in March 2018:

	No. of gadgets
Sold to customers at normal selling price	20,000
Sold to customers with coupons	8,000
Received free of charge by new KT Club members	2,000

- (7) Sold old machinery and received RMB2,000. No invoice was issued. The machinery was acquired in November 2015 for RMB40,000, with input VAT of RMB6,800 credited in the month of purchase.

Note: You should assume the above are the only transactions with VAT implications.

Required:

- (i) Calculate the input value added tax (VAT) credit on items (1) to (5) above. State 'no VAT credit' for items which are not eligible for input tax credit. (3 marks)
 - (ii) Calculate the output VAT on items (6) and (7) above. (4 marks)
- (b) Explain the differences in VAT treatment between 'exempt' and 'zero rated' supplies. (3 marks)

(10 marks)

5 (a) Wonder Ltd is the subsidiary of a group with its parent company listed on the New York Stock Exchange. The human resources manager is not sure how to calculate the individual income tax (IIT) liability for each of the following persons:

- (1) Mr Wang is an independent non-executive director who received a director's fee of RMB40,000 in January 2018. He donated RMB1,800 of this to the China Red Cross.
- (2) Ms Xie is the managing director and general manager of Wonder Ltd. She received salary of RMB80,000 and a director's fee of RMB50,000 in January 2018.
- (3) Mr Yao, the head of the marketing department, received a salary of RMB70,000 in January 2018 and an annual bonus of RMB1,000,000 due to his excellent work performance.
- (4) Ms Zhang is the chief financial officer who joined the company in 2015. She was granted 10,000 share options in the company on 2 January 2018 when the market price was USD20 per share. The share option agreement allows Ms Zhang to exercise these options at USD1 per share. She exercised 3,000 share options on 28 January 2018 when the market price was USD19 per share. She sold 2,000 shares on 31 January 2018 when the market price was USD28 per share.

Required:

Calculate the individual income tax (IIT) liability for each of the above persons. Indicate by the use of zero (0) any transaction which is not taxable or tax exempt.

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

(9 marks)

(b) Ms Ma is a UK citizen. She started working in Beijing in January 2017. Her payslip for the month of December 2017 showed the following items:

	RMB
(1) Monthly salary	90,000
(2) Rental allowance in cash	10,000
(3) Reimbursement of air-tickets on business trips	6,000
(4) Reimbursement of air-tickets on the third home leave in 2017	4,100
(5) Reimbursement of costs for Ms Ma to learn Putonghua in China	5,500
(6) Reimbursement of piano tuition fees in China for Ms Ma's children	2,400
(7) Laundry allowance on reimbursement basis	480
(8) Reimbursement of car rental for private use	6,700
(9) Employer's contribution on social security	5,800
(10) Employee's contributions on social security	3,200

Required:

Calculate the individual income tax (IIT) payable by Ms Ma on the above items (1) to (10) for December 2017. Indicate by the use of zero (0) any item which is tax exempt or not taxable.

(6 marks)

(15 marks)

- 6 Moon Ltd's accounting profit before tax for the year 2017 is RMB620,000 and its turnover is RMB12,300,000. Except where stated otherwise, the following items have been included when computing the accounting profit before tax:
- (1) Entertainment expenses of RMB120,000 incurred in 2017.
 - (2) Marketing and promotion expenses of RMB1,000,000 incurred in 2017. Excess marketing expenses brought forward from 2016, and not deducted in arriving at the accounting profit for the year 2017, are RMB350,000.
 - (3) Research and development (R&D) expenses of RMB160,000. Moon Ltd qualified as a small-medium sized technology enterprise and can enjoy the additional tax incentive on R&D expenses.
 - (4) Handicapped employees' salaries of RMB200,000.
 - (5) Qualified work safety equipment at a cost of RMB150,000.
 - (6) A fine of RMB17,800 issued by the trademark bureau for infringement of a trademark.
 - (7) Staff welfare expenses of RMB461,000. Total salaries incurred were RMB4,000,000.
 - (8) The cost of lost inventory of RMB450,000, due to the warehouse being destroyed in a fire during the year, and insurance compensation received of RMB430,000.
 - (9) A special provision for doubtful debts of RMB121,000.
 - (10) A bad debt written off of RMB32,000 as the debtor declared bankruptcy.
 - (11) A specific purpose government subsidy received of RMB350,000 and related costs incurred of RMB310,000.
 - (12) A general purpose government subsidy received of RMB428,000.
 - (13) An amount owed by Moon Ltd of RMB4,000 written off to income as the creditor ceased trading.
 - (14) Interest income on treasury bonds of RMB8,000.
 - (15) Bank interest income of RMB16,500.
 - (16) A value added tax (VAT) refund on export of goods for RMB768,000.
 - (17) Dividend income from a Vietnam subsidiary of RMB90,000 (gross dividend of RMB100,000, Vietnam tax paid RMB10,000).
 - (18) Dividend income from a China subsidiary of RMB30,000 (profit before tax of the China subsidiary was RMB40,000 and enterprise income tax (EIT) paid of RMB10,000).
 - (19) Profit on the sale of A-shares of RMB60,500.
 - (20) A donation paid to the China Red Cross for RMB100,000.

Required:

Calculate the enterprise income tax (EIT) payable by Moon Ltd for the year 2017, assuming that Moon Ltd has made all relevant applications and reports to the tax authorities.

Notes:

1. You should start your computation with the profit before tax figure of RMB620,000 and list all of the items (1) to (20) as referred to in the question, identifying any item which does not require adjustment for tax purposes by the use of zero (0).
2. You are not required to make adjustments for any of the above items for accounting purposes.

(15 marks)

End of Question Paper