



# THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2016

---

## PAPER 2.02 – CHINA OPTION

---

### ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

---

TIME ALLOWED – 3¼ HOURS

---

You should answer **FIVE** out of the seven questions: **BOTH** questions from Part A; the **ONE** question in Part B; and **TWO** questions from Part C.

Part A questions are worth 25 marks each. The Part B question is worth 20 marks. Part C questions are worth 15 marks each.

You should aim to spend approximately half of your exam time answering Part A, and the remaining half answering Parts B and C. The amount of time you spend answering each question should correspond broadly to the number of marks available for that question.

Start each answer on a new page. If you are using the on-screen method to complete your exam, you must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.

All workings should be made to the nearest month and Renminbi (RMB) yuan, unless the question requires otherwise.

Marks are specifically allocated for presentation.

For your information this paper is accompanied by:

**Agreement between China and the United Kingdom for the Avoidance of Double Taxation (including Protocol)**

## PART A

**You are required to answer BOTH questions from this Part.**

1. ACO is a company resident in the United Kingdom. It owns 100% of the shares in BCO, a company incorporated in Hong Kong but without any personnel or effective management in Hong Kong. ACO also owns 100% of the shares in DCO, a wholly foreign-owned enterprise operating in mainland China, which was established in January 2015 and has a registered, fully paid-up capital of RMB 10 million. DCO manufactures electronic products for sales both within and outside mainland China. For sales outside mainland China, DCO sells its products to BCO, which in turn sells the products to foreign clients.

For this business operation, ACO has issued a three year loan to DCO of RMB 25 million at a normal annual interest rate of 6%, and has licensed to DCO a key patent to be used in the production of the electronic products. DCO pays ACO royalties at the rate of 30% of its gross electronic product sales.

In addition, two ACO employees, both resident in the UK, have been working for DCO since January 2015. The two employees will work for DCO for a period of three years, and will be in charge of the management of the loan and the patent, as well as BCO's business operations in China. DCO accordingly paid ACO administrative fees of RMB 5 million in 2015.

**What are the tax implications of the circumstances described above, in mainland China?** (25)

2. Mr Zhang is a Hong Kong-resident individual who has lived in Hong Kong since 2009. In January 2015, Mr Zhang set up a partnership enterprise with Ms Wen; the partnership is registered in Shanghai. As a limited partner, Mr Zhang made a contribution of RMB 40 million to the partnership in return for an 80% interest in the partnership. As a general partner, Ms Wen contributed RMB 10 million in return for a 20% interest in the partnership.

The partnership's main activity is in providing clients in mainland China with technical and management services relating to venture capital investment. In May 2015, the partnership invested RMB 30 million in a manufacturing limited company established in Suzhou, China, in exchange for 10% of the company's shares.

In December 2015, the partnership received dividends from the manufacturing limited company of RMB 5 million. In addition, in 2015 the partnership received revenue of RMB 10 million from its business operations.

During 2015, the partnership recorded the following costs and expenses:

- 1) RMB 2 million in leasing expenses for a business office and other facilities, and for indirect taxes;
- 2) RMB 3 million in wages, salaries, and contributions to an affiliated employees' fund as required by Chinese law; and
- 3) RMB 1 million salary paid to Ms Wen for her management of the partnership.

**What are the tax implications of the circumstances and activities described above?** (25)

## **PART B**

**You are required to answer THIS question.**

3. N Ltd is a Chinese real estate holding company which plans to develop a luxury hotel in Shanghai. M Ltd is a corporation resident in the United Kingdom. In January 2015, N Ltd entered into a technical service and management supporting contract with M Ltd.

According to the terms of the contract, M Ltd's obligations include:

- 1) Providing technical documents relating to the development of the hotel, including technical standards, guidance on the hotel's design and a summary of the hotel standard;
- 2) Supervising (but not participating in) the design and construction of the hotel, in order to ensure that the design and construction follow established standards;
- 3) Managing and operating the hotel for five years after its construction; and
- 4) Providing some direct debt financing for the operation of the hotel.

According to the terms of the contract, N Ltd shall ensure that all technical documents provided by M Ltd are held confidentially throughout the period of use, return the technical documents to M Ltd after the hotel's construction, and pay all relevant fees to M Ltd.

**You are required to explain the Chinese income tax implications for M Ltd of these transactions.** (20)

## PART C

You are required to answer TWO questions from this Part.

4. You are required to provide a brief answer to each of the following questions related to the Individual Income Tax:

- 1) How does the Individual Income Tax determine residence in China for tax purposes? (5)
- 2) Is an individual taxpayer resident in China required to pay Individual Income Tax on his or her worldwide income? Explain the reason(s) for your answer. (5)
- 3) Ms Lin is a citizen of Singapore. In 2014, she was employed by a Chinese company in Shanghai for the full year. During that time, Ms Lin's family lived in her apartment in Singapore. In January 2015, Ms Lin began a ten year employment contract with the Chinese company, at which time she purchased an apartment in Shanghai and moved her family there. Is Ms Lin liable to Chinese Individual Income Tax in 2015? On what basis? You are required to explain the reason(s) for your answer. (5)

Total (15)

5. A Ltd is a Chinese manufacturing company registered in Shenzhen. B Ltd is a British company that designs and produces customised production equipment for its clients. On 16 January 2015, A Ltd entered into a contract with B Ltd, under which B Ltd agreed to sell a suite of customised production equipment to A Ltd for RMB 20 million.

B Ltd is responsible for the design, production, installation and testing of equipment which it sells, and provides technical training services to guide the maintenance of its equipment. For these purposes, B Ltd deployed UK-resident employees to Shenzhen, to work on the installation and testing of equipment, and the provision of training services, for a period of 12 months.

You are required to explain the Chinese income tax implications of these activities. (15)

6. You are required to provide a brief answer to the following questions related to the Enterprise Income Tax:

- 1) What is the tax implication of a 'business agent' of a non-resident enterprise under Chinese domestic tax law? (5)
- 2) Does the Agreement between China and the United Kingdom for the Avoidance of Double Taxation alter the tax implications of a 'business agent' of a non-resident enterprise? Explain the reason(s) for your answer. (5)
- 3) Mr Yang is an individual resident in China. ACO is a company resident in China, and BCO is a company resident in Virgin Islands. In October 2015, on behalf of BCO, Mr Yang entered into a consultancy contract with ACO.

In November 2015, under the terms of the contract, BCO introduced an investor resident in Hong Kong to ACO and received a RMB 2 million commission fee from ACO. Is BCO liable to pay Chinese Enterprise Income Tax in 2015? Explain the reason(s) for your answer. (5)

Total (15)

7. XCO is a company resident in the United Kingdom and Mr Sun is a resident of the United Kingdom. In 2012, XCO and Mr Sun jointly owned ZCO, a wholly foreign-owned enterprise in China, whose operations involve the extraction of mineral resources. XCO owned 90% of the equity shares in ZCO, and Mr Sun owned the remaining 10% of equity shares.

In January 2015, in order to adjust the structure of its business in China, XCO registered YCO, a wholly-owned subsidiary, in Guangzhou. XCO transferred its 90% equity holding in ZCO to YCO as its contribution to YCO, and Mr Sun sold his 10% holding in ZCO to YCO for RMB 10 million. Following this restructuring, XCO owns 100% of the equity in YCO and YCO owns 100% of the equity in ZCO.

**You are required to explain the Chinese income tax implications of these transactions for XCO and Mr Sun.** (15)