

## THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2017

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### PAPER 2.02 – CHINA OPTION

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#### ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

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TIME ALLOWED – 3¼ HOURS

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This paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **The** question in **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

#### Further instructions

- All workings should be made to the nearest month and in Renminbi (RMB) yuan, unless otherwise stated.
- Start each answer on a new page and clearly indicate which question you are answering. 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.
- Marks may be allocated for presentation.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering Parts B and C.
- The first 15 minutes of the exam consists of reading time. You will be allowed to annotate the question paper during this time; however, you will **not** be permitted to start writing or typing your answer, or use a calculator. The Presiding Officer will inform you when you can start answering the questions.

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, which distributes medicines to customers in the UK.

In 2016, ACO set up a wholly owned company, BCO, in China. Under the business plan, BCO produces medicinal products in China and supplies them to ACO at an arm's length price. ACO then resells the products to customers in mainland China. For the purpose of the business plan, BCO has been appointed as ACO's sole agent and authorised to accept orders on ACO's behalf.

For each order taken, ACO sends a corresponding purchase order to BCO which then arranges production and delivery of the goods. ACO has licenced its patented medicinal products and rented a set of equipment to BCO, and has seconded its product manager, a UK resident, to work at BCO's office in order to monitor the quality of the products. The manager was in China for more than 304 days in 2016, and periodically reported to ACO's management. BCO paid a fee at cost plus 10% markup to ACO, in return for the services provided by the manager. It is expected that BCO will earn a profit in 2017, and will distribute the profit to ACO.

**What are the tax implications of the above activities in mainland China for ACO, BCO and the product manager?** (25)

2. **You are required to describe the GAAR under the Chinese Income Tax Law.**

**Your description should address the following aspects of the GAAR:**

- **the legal framework;**
- **the content of basic rules (excluding procedural issues);**
- **the applied scope;**
- **any special tax adjustments which may potentially be made by tax authorities; and**
- **its relationship with other domestic anti-avoidance regimes and tax treaties.**

(25)

**PART B**

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

3. CCO is a car manufacturer resident in the United Kingdom. In January 2015, CCO acted in joint partnership with a Chinese domestic company to establish a new car manufacturing company in China, DCO.

For the purposes of management, CCO concluded an agreement with DCO under which three directors and two technical consultants were appointed by CCO to DCO for three years. The directors are members of DCO's governing board, but only visit China in order to attending board meetings. The technical consultants are based in China throughout the three year period, and are responsible for the design, production, installation and testing of equipment in which CCO has invested, as well as providing technical training services to staff in relation to the maintenance of equipment.

Before the appointment, the three directors and two technical consultants were resident in the UK. Under the agreement, DCO is required to pay an annual management fee of RMB 10 million to CCO.

**You are required to explain the Chinese Income Tax implications of the arrangements described.** (20)

**PART C**

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

4. **You are required to provide a brief answer to the following questions, in relation to the Individual Income Tax:**

1) **How does the double taxation agreement (DTA) between China and the United Kingdom identify “the individual taxpayer as a resident of a contracting state”?** (5)

2) **Will a Chinese citizen who lives in the UK as a doctoral candidate at a UK university be taxed on his/her worldwide income? If so, explain how the tax will be applied.** (5)

3) **Bryn is a UK citizen who is employed by a Hong Kong-based company, for which he has worked since 2004. Bryn also purchased an apartment in Hong Kong. The company’s activities required Bryn to work in Shenzhen, China, for five months in 2016.**

**Which DTA will be applied in determining the taxation of Bryn’s income from his work in mainland China, and why?** (5)

Total (15)

5. **A United Kingdom company has carried on business activities in China through a representative office (RO) in Guangzhou, since 2015. The RO has two employees, one of whom is resident in China and the other resident in the UK.**

**The annual salary of the Chinese resident employee totals RMB 500,000, and is paid by the RO. The UK resident employee’s RMB 1 million annual salary is paid by the company’s head office.**

**In 2016, in support of the company’s sales activities in China, expenses totalling RMB 2 million were spent by the RO; the expenditure included the provision of liaison and marketing services in China, but excluded the two employees’ salaries. However, the RO is unable to provide any evidence in support of its earnings.**

**You are required to explain the Chinese Income Tax implications of these transactions in 2016.** (15)

6. Andrew is a United Kingdom citizen and was employed by a representative office (RO) in Guangzhou, China, in 2014; the RO was set up by a UK company (ECO) in London. In January 2016, the RO was restructured as a Chinese resident company, FCO, and Andrew was appointed as the legal representative of the new company.

Andrew was not domiciled in China and returned to London in December 2016. During his time in China, Andrew was also employed by a UK company, GCO, based in London. GCO is an affiliated enterprise of ECO and FCO.

Andrew visited the UK each year between 2014 and 2016, but for less than 30 days on each occasion. Andrew spent 181 days in China in 2014, 243 days in 2015, and 304 days in 2016.

For his work at the RO, ECO paid Andrew RMB 600,000 in 2014 and RMB 800,000 in 2015. FCO paid Andrew a total of RMB 1 million in 2016. Andrew also received income from GCO, for work which he conducted for ECO during his time outside China, totalling RMB 600,000 in 2014, RMB 400,000 in 2015 and RMB 200,000 in 2016.

**You are required to explain the Chinese Income Tax implications of the transactions described, for Andrew.** (15)

7. XCO is a Chinese controlled company registered in Xiamen, China, which produces medicinal supplies. XCO has a wholly owned subsidiary company, ZCO, in the United Kingdom.

In 2015, XCO and ZCO set up a sale company (HKCO) in Hong Kong, which sells products supplied by XCO to customers in Hong Kong. 24% of HKCO's capital is owned by XCO, and the remainder by ZCO.

HKCO is managed by a board of five directors, three of whom are domiciled in Hong Kong and the remaining two in mainland China. Board meetings are normally held via video conference. A senior manager is also domiciled in Hong Kong, and is responsible for HKCO's day-to-day management.

In 2016, HKCO generated a large profit. For Chinese taxation purposes, HKCO applied to the tax authority's office in Xiamen for the identification of residence under Chinese Income Tax law. HKCO argued that its place of effective management is in mainland China. However, the tax authority argued that a substantial proportion of HKCO consists of a CFC of XCO, that HKCO is resident in Hong Kong and that it is controlled by XCO.

**You are required to:**

- 1) **Explain the tax benefits to which XCO and HKCO will be entitled if HKCO is determined to be resident in mainland China;** (7)
- 2) **Comment on the arguments presented by both parties regarding HKCO's tax residence.** (8)

Total (15)