Answers

Marks

1 (a) Company L

(i)

		Marks
(1)	Refurnishing expenses cannot be fully written off immediately for tax purposes, but should be amortised over five years.	1
(2)	A penalty for the late payment of business tax is not deductible.	1
(3)	60% of entertaining expenses are allowable subject to the maximum amount of 0·5% of the sales/business income of the year, i.e. RMB 375,000 (0·5% of RMB 75,000,000). Therefore, RMB 300,000 (60% of RMB 500,000) is deductible.	1
(4)	Qualifying advertising and promotion expenses are deductible up to 15% of the sales/business income of the year, i.e. RMB 11,250,000 (15% of RMB 75,000,000). Therefore, the full amount is deductible.	1
(5)	Donations to an unrelated scientific research centre are tax deductible, therefore, the treatment is correct.	1
(6)	Staff and worker benefits cannot exceed 14% of total salaries and wages, i.e. RMB 350,000 (14% of RMB 2,500,000).	1
(7)	Staff and workers union expenses cannot exceed 2% of total salaries and wages, i.e. RMB 50,000 (2% of RMB 2,500,000).	1
(8)	Staff and workers education expenses cannot exceed 2·5% of total salaries and wages, i.e. RMB 62,500 (2·5% of RMB 2,500,000).	1
(9)	A loss on listed shares is allowable, therefore, the treatment is correct.	1
(10)	Interest income from a national debenture is tax exempt.	1
(11)	The disposal of a national debenture is taxable, therefore, the treatment is correct.	1
(12)	Interest paid on a loan to provide an investor's capital contribution is not allowable.	1
(13)	Abnormal losses from the fire cannot be deductible as they are covered by the insurance.	1
(14)	Insurance compensation is not taxable.	1
(15)	The writing off of a liability is taxable, therefore, the treatment is correct.	1
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(ii) Enterprise income tax (EIT) for 2011

	RMB	RMB	
Taxable profit before adjustment		6,212,500	
Add:			
(1) Refurnishing of the office (125,000 – 25,000)	100,000		0·5
(2) Late payment penalty	3,750		0·5
(3) Entertainment disallowable portion (40% of RMB 500,000)	200,000		0·5
(4) No adjustment	0		0·5
(5) No adjustment	0		0·5
(6) Staff benefit over limit (1,250,000 – 350,000)	900,000		0·5
(7) Staff and workers union fee over limit (250,000 – 50,000)	200,000		0·5
(8) Staff and workers education over limit (125,000 – 62,500)	62,500		0·5
(11) No adjustment	0		0·5
(12) Interest expense for the loan borrowed by the investor	500,000		0·5
(13) Abnormal loss in the fire	300,000		0·5
(15) No adjustment	0	2,266,250	0·5
		8,478,750	
Less:			
(9) No adjustment	0		0·5
(10) National debenture interest (exempt)	30,000		0·5
(14) Compensation from insurance company	200,000	(230,000)	0·5
Adjusted taxable amount		8,248,750	
Tax rate		25%	
Tax payable		2,062,187	0·5
			8

Marks

(b) According to Cai Shui [2011] No. 50, a company is not required to withhold individual income tax (IIT) in the following circumstances when giving gifts to individuals during the process of selling products:

(i) the company sells products through discount or concession; 1

(ii) the company makes the gift simultaneously when it sells the product to the individuals; 1

(iii) the company rewards the individuals with gifts based on a points system where the accumulated purchases made by an individual has reached a certain magnitude. 1

According to Cai Shui [2011] No. 50, the individual recipients are subject to IIT at the rate of 20% and the company is required to withhold the IIT in the following circumstances when giving gifts to individuals: 1

(i) As part of activities such as business promotions or advertising, the company randomly picks individuals (other than the company's own staff) for the gifts. 1

(ii) On occasions such as annual conferences, seminars, ceremonies and other occasions, the company makes gifts to individuals (other than the company's own staff). 1

(iii) A gain is obtained by an individual when a company gives the extra opportunity to take part in a lottery based on a points system where the accumulated purchases made by that individual has reached a certain magnitude. 1

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(c) **(i)** EIT on the deemed sale = (100 – 80) x 25% = RMB 5 1

There is no IIT liability arising. 1

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(ii) The IIT is paid by Company L, therefore if the tax paid equals 't' 2

(200 + t) x 20% = t.

Solving the equation the IIT payable (t) equals RMB 50.

As the IIT withheld is a part of the business expenses of Company L, the EIT on the deemed sale will be (200 – 100 – 50) x 25% = RMB 13. 1

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2 **(a)** **Mr Huang – Individual income tax (IIT)**

(1) IIT was paid by the enterprise, therefore if the tax paid equals 't'

(30,000 + t) x (1 – 20%) x 30% – 2,000 = t 2

Solving the equation the tax payable (t) equals RMB 6,842. 1

(2) IIT in relation to the income from the partnership: 300,000/4 x 30% – 9,750 = RMB 12,750 1

(3) The gain from trading in listed shares is exempt. 0·5

(4) IIT for the transfer of a patent in Country G: Euro 10,000 x 9·5 x (1 – 20%)) x 20% = RMB 15,200 1

So, RMB 200 (15,200 – 15,000) needed to be paid in China. 0·5

(5) IIT for giving a lecture in Country K: USD 1,500 x 7 x (1 – 20%) x 20% = RMB 1,680 1

So, no further IIT needed to be paid in China since the tax paid in Country K of RMB 1,800 exceeds this amount. 0·5

(6) The insurance compensation is exempt. 0·5

(7) RMB 9,000 (i.e. 30% of the prize) is deductible for the donation to the approved charity. 1

So, IIT for the lottery prize: (30,000 – 9,000) x 20% = RMB 4,200 1

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Marks

(b)	**(i)** According to the State Administration of Taxation [2011] (announcement 28) the portion of individual income tax (IIT) borne by an employer should itself be subject to IIT. The taxable income in either circumstance is:	
	(1) Where the employer bears a fixed amount of IIT for the employee: Taxable income = the annual non-gross up bonus + the fixed amount of IIT borne by employer – the amount by which the current monthly deduction exceeds the current monthly salary	1
	(2) Where the employer bears a certain percentage of IIT for the employee: Step 1: Determine the applicable tax rate (A) and quick deduction (A) by dividing the non-gross up bonus by 12.	1
	Step 2: Taxable income = (the annual non-gross up bonus – the amount by which the current monthly deduction exceeds the current month salary – the quick deduction x the portion of IIT borne by the employer)/(1 – the applicable tax rate x the portion of IIT borne by the employer)	1
	Step 3: Determine the applicable tax rate (B) and quick deduction (B) by dividing the taxable income by 12.	
	IIT payable = taxable income x tax rate (B) – quick deduction (B)	1
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	(ii) Company B	
	(1) Taxable income = 100,000 + 20,000 = 120,000	
	120,000/12 = 10,000, so the tax rate is 25% and the deduction factor	1
	RMB 1,005	0·5
	The IIT payable = (120,000 x 25% – 1,005) = RMB 28,995	1
	IIT borne by the employee = 28,995 – 20,000 = RMB 8,995	0·5
	(2) 100,000/12 = 8,333, so the tax rate is 20% and the deduction factor RMB 555	0·5
	Taxable income = (100,000 – (555 x 20%))/(1 – (20% x 20%)) = RMB 104,051	1
	104,051/12 = 8,671, so the tax rate is still 20% and the deduction factor	0·5
	RMB 555	0·5
	IIT payable = 104,051 x 20% – 555 = RMB 20,255	0·5
	IIT borne by the employee = 20,255 x 80% = RMB 16,204	
		6
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3	**(a)**	**Company M – Value added tax (VAT)**	
	(1)	Input VAT on purchasing excavator: 122,400 + 48,000 x 7% = RMB 125,760	1
	(2)	Input VAT on purchasing low-value consumption goods: RMB 6,720	0·5
	(3)	Input VAT on transportation freight: 72,000 x 7%: RMB 5,040	0·5
	(4)	VAT output for sales: 10,000 x 600 x 1/4 x 17%: RMB 255,000	1
	(5)	VAT for other sales/deemed sales: (250 + 600) x 600 x 17% = RMB 86,700	1
	(6)	VAT output for sales: 300,000 x 13% = RMB 39,000	1
		Total VAT output = 255,000 + 86,700 + 39,000 = RMB 380,700	0·5
		VAT liability = 380,700 – (125,760 + 6,720 + 5,040) = RMB 243,180	0·5
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Marks

(b) A small-scale taxpayer for value added tax (VAT) is:

- any taxpayer who cannot maintain a good accounting system to provide accurate tax information for VAT output tax, input tax and tax payable; and 1
- individuals, non-corporate business and enterprise with annual sales of less than the prescribed limit (i.e. less than RMB 500,000 for manufacturing/service providers and RMB 800,000 for other industries). 1

The tax rate for a small-scale taxpayer who engages in the trading of goods is 3% and no input tax can be deducted when determining the VAT payable. 1

Small-scale taxpayers are not allowed to issue VAT invoices and so can only issue general invoices, which include the sales consideration and the VAT. 1

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(c) **Company N – business tax (BT)**

(1) BT for factory construction: 9,600,000 x 15% x 3% = RMB 43,200 1

(2) BT for laying cables: (1,200,000 – 200,000) x 3% = RMB 30,000 1

(3) BT for mud engineering service: 2,000,000 x 3% = RMB 60,000 0·5

(4) BT for decoration: (450,000 + 50,000 + 200,000) x 3% = RMB 21,000 1

(5) BT for sale of house: 600,000 x (1 + 20%)/(1 – 3%) x 3% + (1,500,000 + 10,000) x 5% = 22,268 + 75,500 = RMB 97,768 2·5

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(d) The tax bureau may assess the business tax (BT) liability on a deemed income basis, with the income determined according to the following methods, applied in the order listed: 1

(1) The average price of similar services provided by the taxpayer in the same month.

(2) The average price of similar services recently provided by the taxpayer.

(3) The composite taxable value, calculated by the formula: A x (1 + B)/(1 – C)

where: A = the cost of the business operation;
B = the profits ratio (determined by the tax bureau); and
C = the applicable business tax rate 3

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4 **(a)** **Company S**

(i) Customs taxable value: (1,680,000 + 252,000 + 140,000 + 28,000) x 7·5 = RMB 15,750,000 1
Customs duty payable: 15,750,000 x 40% = RMB 6,300,000 1
Composite value: (15,750,000 + 6,300,000)/(1 – 30%) = RMB 31,500,000 1
Consumption tax = 31,500,000 x 30% = RMB 9,450,000 1
Value added tax = 31,500,000 x 17% = RMB 5,355,000 1

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(ii) VAT taxable value: (6,000,000 + 900,000) x 7·5 = RMB 51,750,000 1
Value added tax: [51,750,000/(1 + 17%)] x 17% – 5,355,000 = RMB 2,164,231 2
Consumption tax = [51,750,000/(1 + 17%)] x 30% – 9,450,000 = RMB 3,819,231 2

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Marks

(b) Customs may assess duty on the following bases, applied in the order listed:

- The transaction price of the same goods.
- The transaction price of similar goods.
- By working backwards from the sales price in the domestic market of the same/similar imported goods.
- The cost summation method.
- Any other appropriate method.

1 mark each method, maximum 5

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5 (a) The general tax treatment is that a taxpayer who derives income from sources outside China and has paid foreign tax on that income may deduct such foreign tax from the amount of income tax payable in China. The credit amount must not exceed the amount of China income tax payable on the taxpayer's foreign-sourced income. 1·5

The limitation of foreign tax credit is calculated as: the total tax payable for both domestic and foreign income multiplied by foreign income/world (foreign plus domestic) income. 0·5

The limitation of foreign tax credit is calculated separately for each country. 0·5

Any unused credit can be carried forward indefinitely. 0·5

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(b) Company C

For 2010:
Total taxable income: 1,000,000 – 1,000,000 = 0 0·5
The limit of credit is zero and the foreign tax credit carried forward RMB 300,000. 1·5

For 2011:
Total taxable income: 1,000,000 + 3,000,000 = RMB 4,000,000. 0·5
Available foreign tax credit = RMB 300,000
Foreign tax credit limit = 4,000,000 x 25% x (1,000,000/4,000,000) = RMB 250,000 1
Unused tax credit carried forward = 300,000 + 300,000 – 250,000 = RMB 350,000 0·5
EIT = 4,000,000 x 25% – 250,000 = RMB 750,000 1

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(c) When a domestic registered enterprise sets up branches registered in different regions in China that are not separate legal entities, the head office and the branches individually need to file monthly/quarterly provisional returns and pay the provisional tax on a local basis within 15 days after the end of each month/quarter. However, for the annual filing and settlement, only the head office should submit the annual return and pay the tax on a consolidated basis within five months after the end of tax year to the tax district relevant to the head office. 2

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Examiner's note: *According to Guanshuifa [2008]28, the enterprise should pay tax on the consolidated income by 50/50 among head office and branches. The apportionment among the branches is based on a ratio agreed by the tax authorities (determined in a formula taking into account the branch's asset/income/headcount).*