Answers

		Marks
1 (a) (i)	**Company Y**	
(1)	The bonuses are allowable because they were actually paid in the year.	1
(2)	As the tax period only covers six months of the rental period, RMB 375,000 (18/24 x 500,000) is disallowable.	1·5
(3)	Subject to the maximum amount of 0·5% of the sales income of the year (90,000,000 x 0·5% = 450,000), 60% of the entertaining amount (900,000 x 60% = 540,000) is deductible. Thus, RMB 450,000 is deductible and RMB 450,000 (900,000 – 450,000) is non-deductible.	1·5
(4)	Advertising and promotion expenses are deductible up to 15% of the sales/business income of the year (90,000,000 x 15% = 13,500,000); thus the entire amount of RMB 3,000,000 is deductible.	1
(5)	Amortisation of a self-developed intangible asset is not allowable.	1
(6)	Unused assets are not eligible for tax depreciation.	1
(7)	Depreciation of assets purchased under a finance lease is allowable.	1
(8)	Depreciation of assets rented under an operating lease is not allowable.	1
(9)	A penalty imposed by the government is not allowable.	1
(10)	A penalty arising from the business's operations is allowable.	1
(11)	A general provision is not allowable.	1
(12)	Interest income from a national debenture is exempt from tax.	1
(13)	A gain on the disposal of a national debenture is taxable.	1
(14)	A loss on the trading of listed shares is allowable.	1
(15)	The share of a loss of an associated company under the equity accounting method is not allowable.	1
		16

(ii) Enterprise income tax for the year 2011

	RMB	RMB	Marks
Taxable profit before adjustment		22,270,000	
Add:			
(2) Office rental expense	375,000		0·5
(3) Entertaining expense	450,000		0·5
(5) Intangible asset amortisation	150,000		0·5
(6) Unused asset depreciation	100,000		0·5
(8) Depreciation on rented assets	25,000		0·5
(9) Penalty for late filing	50,000		0·5
(11) Stock provision	100,000		0·5
(15) Share of loss of associated company	200,000		0·5
Less:			
(12) National debenture interest	(20,000)		0·5
Total adjustment		1,430,000	
Adjusted profits		23,700,000	
Tax rate		25%	
Tax payable		5,925,000	0·5
			5

		Marks
(b) (1)	The general provision is not tax allowable and RMB 15,000 should be added back to the accounting profit of year one.	1
(2)	A specific stock write off is allowable if the loss is incurred in the course of business.	1
(3)	Given that the provision of RMB 15,000 was added back in calculating the taxable profit in year one, the write back of RMB 2,500 should not be treated as taxable income in year two.	2
		4

Marks

(c) **(i)** The interest is not deductible and should be added to the original value of the assets and depreciated over the expected life of the assets. 1

1

(ii) Interest paid between operating units of a non-financial enterprise is non-deductible. 1

1

(iii) Interest expenses will normally be non-deductible if: (1) the interest rate is not at an arm's length commercial rate; or (2) to the extent that they relate to a related party debt that exceeds a special debt to equity investment ratio. The ratio for a financial enterprise is 5:1 and for other kinds of enterprise is 2:1. 1

1

2

(d) Intangible assets refer to non-monetary long-term assets with no physical form used for the purpose of the manufacturing of products, provision of labour services, leasing, or business operations, including patents, trademarks, copyrights, land-use rights, know-how and goodwill, etc. 1·5

Intangible assets obtained through purchase are valued at cost plus any related taxes and charges paid. 0·5

Intangible assets obtained through capital contribution, donation, exchange of non-monetary assets and debt reconstruction, etc, are valued at fair value plus any related taxes and charges paid. 0·5

Self-developed intangible assets are valued at the cost of the development from the date when the conditions for capitalisation are satisfied until the time that the conditions for their intended use are achieved. 1

Intangible assets should be amortised according to the straight-line method over a period of not less than ten years, if there is no other specification under the assignment contract or the related laws. 1

Where a shorter beneficial period is specified in the contract or under the relevant laws, e.g. patent law, the intangible asset should be amortised over that shorter period. 0·5

Where the expenses incurred in the development of a self-developed intangible asset have been deducted for enterprise income tax, amortisation is not deductible. 0·5

The cost of acquired goodwill is an allowed deduction at the time when the entire enterprise is transferred (sold) or liquidated. 0·5

6

35

2 **(a)** **Mr Chang – individual income tax (IIT) for the month of January 2012**

(1) IIT for monthly employment income: (16,000 – 3,500) x 25% – 1,005 = RMB 2,120 1

IIT for the yearly bonus:

The applicable tax rate and the quick deduction factor for the bonus is determined by dividing the bonus by 12 (36,000/12 = 3,000); i.e. 10% and RM 105.

The IIT payable is therefore: 36,000 x 10% – 105 = RMB 3,495 1·5

(2) IIT on the dividend from an unlisted company: 10,000 x 20% = RMB 2,000 1

(3) IIT on the translation income: 5,000 x (1 – 20%) x 20% = RMB 800 1

(4) Interest income from Government bonds is exempt from IIT. 1

(5) IIT on patent income : 80,000 x (1 – 20%) x 20% – 7,000 = RMB 5,800 1·5

The full amount of the foreign tax is deductible since 80,000 x (1 – 20%) x 20% > 7,000

(6) IIT on authorship (book): 60,000 x (1 – 20%) x 20% x (1 – 30%) = RMB 6,720 1

IIT on authorship (newspaper): (4,000 – 800) x 20% x (1 – 30%) = RMB 448 1

(7) Income from the sale of listed shares is exempt. 1

(8) IIT on proof reading: 30,000 x (1 – 20%) x 30% – 2,000 = RMB 5,200 1

(9) Taxable income from property sale: (700,000 – 400,000) – (700,000 x 5%) – 8,000 = RMB 257,000 2

IIT on the profit from the property sale: 257,000 x 20% = RMB 51,400 1

14

Marks

(b) **(i)** The benefit to the shareholder Mr A is deemed to be a profit distribution. 1

IIT is payable at 20%: 300,000 x 20% = RMB 60,000 1

2

(ii) The loan to the shareholder Mr B is deemed to be a profit distribution. 1

IIT is payable at 20%: 300,000 x 20% = RMB 60,000 1

2

(iii) The benefit to the sole owner Mr C is deemed to be income received by an entrepreneur from a private enterprise. 1

IIT is payable under the schedule with the quick deduction factor: 300,000 x 35% – 14,750 = RMB 90,250 1

2

20

3 **(a)** **Company P – value added tax (VAT) for the month of May 2012**

(i) A sales discount is a price favour given to a buyer for the bulk purchase of goods. The sales discount can be netted off the turnover for the purpose of the VAT calculation. 1

A cash discount is a price favour given to a buyer if he settles payment earlier than he is supposed to.

Since it is basically a financial arrangement, the discount cannot be deducted from turnover for the purposes of the VAT calculation. 1

Output VAT: RMB 760,000 x 17% = RMB 129,200 0·5

(ii) The value of sales of goods by trade-in is based on the sales price of the new products; the consideration for the old goods is not subtracted from the sales value. 1

Normal selling price per new fan: RMB 80
Output VAT: 100 x RMB 80 x 17% = RMB 1,360 1

There is no input VAT as the use of a staff benefit is not tax deductible. 1

(iii) Selling goods, by later repayment of capital, is a kind of financial arrangement to the benefit of the vendor. Therefore the whole amount should be calculated for VAT, immediately, rather than over four years. 1

Output VAT payable: RMB 800,000 x 17% = RMB 136,000 0·5

(iv) Both parties to a barter trade should calculate the output VAT based on the amount of goods delivered and input VAT based on the amount of goods received. 1

Input VAT: RMB 68,000 x 17% = RMB 11,560 0·5
Output VAT: RMB 80,000 x 17% = RMB 13,600 0·5

9

(b) **Company W – customs duty and value added tax (VAT) on importation**

Customs taxable value: (2,000,000 + 40,000 + 4,000 + 2,000) = USD 2,046,000 1·5

Customs duty payable: 2,046,000 x 6 x 30% = RMB 3,682,800 0·5

VAT payable: (2,046,000 x 6 + 3,682,800) x 17% = RMB 2,712,996 1

Import duty and VAT are collected by Customs and the taxpayer should pay the tax within 15 days after the issue of the demand notice. 1

4

(c) **(i)** A small-scale value added tax (VAT) payer is:

– any taxpayer who cannot maintain a good accounting system to provide accurate tax information for the output tax, input tax and tax payable; 0·5
– an individual, non-corporate business or enterprise with infrequent taxable activities; 0·5
– a taxpayer with an annual turnover for production of goods or provision of services less than RMB 500,000; or 0·5

	Marks
– a taxpayer with an annual turnover for any other kind of enterprise, e.g. retailing/wholesaling of less than RMB 800,000	0·5
The tax rate for small-scale VAT payers is 3% and no input tax can be deducted to determine the VAT payable.	1
Small-scale VAT payers are not allowed to issue VAT invoices and so they can only issue general invoices, which include the sales consideration and VAT. Therefore, in general, unless otherwise stated, the sales amount involved in a transaction with a small-scale VAT payer should be treated as the sales consideration plus VAT.	2
	5
(ii) VAT payable for goods: 20,600/(1 + 3%) x 3% = RMB 600	1
VAT payable for used car: 46,350/(1 + 3%) x 2% = RMB 900	1
	2
	20

4 Company M

(a) Value added tax (VAT) for the month of January 2012

1	Input VAT for the tobacco purchased from a general VAT payer: 250,000 x 17%/(1 + 17%) = RMB 36,325	1
2	Input VAT for the tobacco purchased from a local farmer: 40,000 x 13% = RMB 5,200	1
3	Input VAT for the transportation fee: 20,000 x 7% = RMB 1,400	1
4	Input VAT on the subcontracting fee: 90,000 x 17%/(1 + 17%) = RMB 13,077	1
5	Output VAT on sales: 40,000,000 x 17% = RMB 6,800,000	0·5
6	Output VAT on deemed sales for staff welfare: (40,000,000 x 4/20,000) x 17% = 8,000 x 17% = RMB 1,360	1·5
	VAT liability: (6,800,000 + 1,360) – (36,325 + 5,200 + 1,400 + 13,077) = RMB 6,745,358	1
		7

(b) Consumption tax (CT) for the month of January 2012

1	Since the contractor has not paid the CT on Company M's behalf, Company M will need to pay the CT based on the composite value of:	1
	– The cost of goods from the farmer without VAT: 40,000 – 5,200 = RMB 34,800	0·5
	– The transportation cost without VAT: 20,000 – 1,400 = RMB 18,600	0·5
	– The subcontracting fee without VAT: 90,000 – 13,077 = RMB 76,923	0·5
	The composite value for CT is (34,800 + 18,600 + 76,923)/(1 – 30%) = RMB 186,176; and	1
	the related CT: 186,176 x 30% = RMB 55,853	0·5
2	To avoid the double taxation of continuous production:	
	the deductible CT is 50% of RMB 55,853 = RMB 27,926	1·5
3	The CT on the turnover is (20,000 + 4) x 160 + (40,000,000 + 8,000) x 45% = RMB 21,204,240	1
	The total CT for the month is (21,204,240 – 27,926 + 55,853) = RMB 21,232,167	0·5
		7

(c)	There is no consumption tax liability for Company N as the fee for processing work is not subject to consumption tax.	1
		15

Marks

5 **(a)** A controlled foreign subsidiary is an enterprise established in a country (region) where the effective tax burden is distinctly (i.e. 50%) lower than that of the PRC tax rate (i.e. less than 12·5%), which is controlled by a PRC resident enterprise, by itself or together with other China residents. 1·5

Control means a tax resident directly or indirectly owning more than 10% of the foreign subsidiary's voting shares, individually, and jointly owning more than 50% of the foreign subsidiary's voting shares. 1·5

Even if the above requirements are not met, control may still exist if effective control is exercised over the foreign subsidiary by venture of shares, capital, business operation, purchases and sales, etc. 0·5

Where such a controlled foreign enterprise does not distribute its profits or reduces the distribution of its profits not on account of any reasonable operational needs, the portion of the profits attributable to the resident enterprise must be included in the revenue of the resident enterprise in the current period and the tax authorities may make a special tax adjustment where this is not the case. 1·5

5

(b) **(i)** Where a transaction of an enterprise with its related party does not comply with the arm's length principle or the enterprise implements an arrangement without a reasonable commercial purpose, the tax authorities have the right to make a tax adjustment within ten years, starting from the tax year during which such a transaction takes place. 2

(ii) Where the tax authorities make a special tax adjustment according to the relevant tax laws and administrative rules and regulations, the underpaid tax is subject to an interest levy on a daily basis, starting from 1 June of the tax year following the year to which the tax payment is related until the day the underpaid tax is settled. 1·5

The interest levy mentioned is not deductible in calculating taxable income. 0·5

The interest levy is determined based on the Renminbi loan base rate applicable to the relevant period of tax delinquency as published by the People's Bank of China in the tax year to which the tax payment is related, plus an additional 5%. 1

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10