Answers

		Marks
1 (a)	Company P	
(i) (1)	Refurbishing expenses cannot be fully written off immediately for tax purposes, but should be amortised over five years, i.e. RMB 15,000 per year.	1·5
(2)	Although business tax is deductible, a penalty for the late payment of business tax is not tax deductible.	1·5
(3)	The cost of entertaining expenses cannot be deducted in full, but is limited to the lower of 60% of the expenses and 0·5% of turnover: [0·5% x 45,000,000 > 60% x 300,000], thus RMB 180,000 is deductible.	1·5
(4)	The treatment is correct because donations to an unrelated scientific research centre are tax deductible.	1
(5)	Staff and worker benefits cannot exceed 14% of total salaries and wages, i.e. 14% of (3,000,000 + 1,500,000) = 4,500,000 = RMB 630,000.	1·5
(6)	The provision for union expenses cannot be tax deductible as the union is not set up.	1
(7)	Staff and workers education expenses cannot exceed 2·5% of total salaries and wages, i.e. 2·5% of 4,500,000 = RMB 112,500.	1
(8)	The gross amount of the overseas dividend, inclusive of the overseas tax paid is taxable, but a credit is available for that overseas tax limited to the Chinese tax payable.	1
	Actual tax paid is [40,500/(1 – 10%)] x 10% = RMB 4,500	
	Limit of the tax = [40,500/(1 – 10%)] x 25% = RMB 11,250	
	Therefore, the whole amount of RMB 4,500 can be set off against the income tax liability.	2
(9)	Interest paid on a loan to provide an investor's capital contribution is not allowable.	1
(10)	Only the tax written down value of RMB 30,000 (150,000 – 120,000) is allowable, not the net book value of RMB 45,000.	1
(11)	The treatment is correct because any non-payable liability over two years old is taxable.	1·5
(12)	Since the whole amount of the debtors provision was disallowed last year, the write back will be non-taxable.	1·5
		17

(ii) **Foreign enterprise income tax computation:**

		RMB	RMB	
Taxable profit before adjustment			9,895,500	
Add:				
(1)	Refurbishing of the office (75,000 – 15,000)	60,000		0·5
(2)	Late payment penalty	2,250		0·5
(3)	Entertainment over limit (300,000 – 180,000)	120,000		0·5
(5)	Staff benefit over limit (750,000 – 630,000)	120,000		0·5
(6)	Union expenses	150,000		0·5
(7)	Tax withheld from overseas dividend (gross up)	4,500		0·5
(8)	Interest expense for the loan borrowed by the investor	300,000		0·5
(9)	Tax written down value over limit (45,000 – 30,000)	15,000		0·5
(10)	Write back of debtors provision – non-taxable	(150,000)		0·5
			621,750	
Adjusted taxable amount			10,517,250	
Income tax at 25%			2,629,313	0·5
Less: foreign tax credit			(4,500)	1
Income tax payable			2,624,813	
				6

(b) The terms of a business transaction between associated enterprises should be the same as the transaction terms between independent enterprises in accordance with the fair trading process and normal business practice. 1

Marks

If a business transaction between an enterprise and its related parties does not comply with the arm's length principle, thus reducing the taxable income or revenue of the enterprise or the related parties, the tax authorities shall be empowered to make adjustments using reasonable methods in the following order:

(1) Comparable uncontrolled price method:
Refers to the price that is used by the comparable non-related parties in the identical or similar transaction.

(2) Resale price method:
Refers to the price of the goods as sold to non-related parties after purchasing from the related party.

(3) Cost plus method:
Refers to the cost plus a reasonable amount of expenses and gross profits margin.

(4) Transaction net margin method:
Refers to the net profits earned by non-related parties in the identical or similar transactions.

(5) Profit split method:
Refers to the allocation of profits/losses out of consolidated profits/losses earned by all the related parties involved.

(6) Based on other reasonable methods.

Any FIVE methods – 1 mark each, maximum 5

6

(c) Company C

The portion of the interest over the rate limit:

Loan A: 1,000,000 x (7% – 6%) = RMB 10,000; and 1
Loan B: 2,000,000 x (8% – 6%) = RMB 40,000 1
Sub-total = RMB 50,000

For a non-financial industry, the maximum gearing ratio is 2 for enterprise income tax (EIT) deductible purpose, so the portion over the capital ratio is:

(70,000 + 160,000) x (3,000,000 – 2,000,000)/3,000,000 = RMB 76,667 2

Total disallowable interest = 50,000 + 76,667 = RMB 126,667

The portion of disallowable interest absorbed as interest expense:

126,667 x 140,000/(140,000 + 90,000) = RMB 77,102 1

The portion of disallowable interest absorbed as construction in progress:

126,667 x 90,000/(140,000 + 90,000) = RMB 49,565 1

6

35

2 (a) Mr Y

(i) (1) According to the relevant rule, the income from the first and second editions of the book can be combined into one source:

Tax payable = (45,000 + 15,000) x (1 – 20%) x 20% x (1 – 30%) = RMB 6,720 2

The income from the newspaper:

Tax payable = 5,250 x (1 – 20%) x 20% x (1 – 30%) = RMB 588 1·5

(2) The income from the painting:

Tax payable = 5,400 x (1 – 20%) x 20% = RMB 864 1

(3) The income from the speech:

Tax payable = 28,500 x (1 – 20%) x 30% – 2,000 = RMB 4,840 1

(4) The income from the translation:

Tax payable = 60,000 x (1 – 20%) x 30% – 2,000 = RMB 12,400 1·5

(5) The income from the overseas speech:

Tax payable = 27,000 x (1 – 20%) x 30% – 2,000 = RMB 4,480 1

	Marks
But since the overseas tax paid of RMB 6,750 is higher than RMB 4,480, no more IIT is payable.	1
(6) The income from selling the painting overseas:	
Tax payable = 15,000 x (1 – 20%) x 20% = RMB 2,400	1
But since overseas tax of RMB 2,250 was deducted, only additional IIT of RMB 150 (2,400 – 2,250) is payable.	1
(7) The interest income on the loan:	
Tax payable = 7,500 x 20% = RMB 1,500	1
	12
(ii) Mr Y will be required to file an individual tax return in respect of his overseas (non China-sourced) income.	1
The return required will be an annual return and it must be submitted and the tax paid within 30 days after the end of the tax year.	2
	3
(b) (i) The tax withheld on a monthly basis must be paid by the withholding agent to the State Treasury within seven days of the following month together with the submitted tax returns.	1

(ii) An individual taxpayer needs to do self-reporting for individual income tax (IIT) purposes:

- where annual taxable income is more than RMB 120,000;
- where wages or salaries are received from two or more sources;
- where taxable income is received for which there is no withholding agent;
- where separate payments are received for one-off personal services, remuneration for manuscripts, royalties or property lease income;
- in any other case where the tax bureau requires it.

ANY FOUR items only – 1 mark each, maximum	4
	20

3 (a) Enterprise G

Output VAT = (400,000 + 20,000 + 10,000)/(1 + 17%) x 17% = RMB 62,479	1·5
Input VAT = (500,000 – 50,000)/(1 + 17%) x 17% + (200,000 – 20,000) x 13% + 100,000/(1 + 17%) x 17% = 65,385 + 23,400 + 14,530 = RMB 103,315	3
Non-deductible VAT = 103,315 x 350,000/(400,000 + 350,000) = RMB 48,214	2
VAT payable = 62,479 – (103,315 – 48,214) = RMB 7,378	0·5
	7

(b) Enterprise H

(1) VAT payable on sale = 20,000/(1 + 3%) x 3% = RMB 583	1
(2) Production materials are a non-creditable input VAT for small-scale VAT payers.	1
(3) The production machine is a non-creditable input VAT for small-scale VAT payers.	1
VAT payable on the sale of the used machine = 10,000/(1 + 3%) x 2% = RMB 194	1
	4

(c) Company X

(1) The donation of a building is a deemed sales activity.	0·5
BT payable = 500,000 x (1 + 10%)/ (1 – 5%) x 5% = RMB 28,947	1·5
(2) The contribution of immovable property is exempt from business tax.	1
(3) The subsequent disposal of an equity holding is exempt from business tax.	1

			Marks
		(4) BT on the rental income = 2,000,000 x 6% x 6/12 x 5% = RMB 3,000	1
		BT on the transfer of property = (2,000,000 + 1,000,000) x 5% = RMB 150,000	1
			6
	(d)	The conditions for the exclusion of transportation fees for value added tax (VAT) are:	
		(1) The seller must pay the fee directly to the transportation company on behalf of the buyer.	1
		(2) The official invoice must be issued by the transportation company in the name of buyer.	1
		(3) The seller must pass on the official invoice to the buyer.	1
			3
			20
4	**(a)**	Company K	
		(1) For the importation of the vehicle:	
		Composite value for tariff = 300,000 + 10,000 x 6·6 = RMB 366,000	1
		Customs tariff = 366,000 x 20% = RMB 73,200	0·5
		Composite value for CT and VAT = (366,000 + 73,200)/(1 – 10%) = RMB 488,000	1
		CT = 488,000 x 10% = RMB 48,800	0·5
		VAT = 488,000 x 17% = RMB 82,960	0·5
		(2) For the repair of the machine:	
		Composite value for tariff = (10,000 + 30,000) x 6·6 = RMB 264,000	1
		Customs tariff = 264,000 x 20% = RMB 52,800	0·5
		Composite value for VAT = (264,000 + 52,800) = RMB 316,800	1
		VAT = 316,800 x 17% = RMB 53,856	0·5
		(3) For the subcontracting services:	
		Composite value for subcontracting services = (100,000 + 20,000) x 6·6 = RMB 792,000	1
		Customs tariff = 792,000 x 20% = RMB 158,400	0·5
		VAT = (792,000 + 158,400) x 17% = RMB 161,568	1
		(4) Since the quality problem goods are still in China, i.e. there is no return of goods overseas so the total amount of the original shipment will still be subject to customs tariff and VAT and the 20% replacement goods will also be subject to customs tariff and VAT on importation.	
		Composite value for tariff = (30,000,000 + 6·6 x 50,000) x 1·2 = RMB 36,396,000	2
		Customs tariff = 36,396,000 x 20% = RMB 7,279,200	0·5
		VAT = (36,396,000 + 7,279,200) x 17% = RMB 7,424,784	0·5
			12
	(b)	The taxpayer should make an import duty declaration at the place of importation within 14 days of the arrival declaration made by the transporter. The penalty for a delay in declaration is 0·05% of the dutiable value, on a daily basis.	1·5
		The Customs should assess the duty according to the tariff nomenclature and the dutiable value, then issue the duty payment notice. The taxpayer should pay the duty to the designated bank within 15 days of the assessment made by the Customs. The penalty for late payment is 0·05% of the duty payable, on a daily basis.	1·5
			3
			15

Marks

5 (a) Where a taxpayer fails to keep or maintain proper accounting records, the tax authority will impose a period for the taxpayer to remedy the situation. If the situation is not remedied within the set period a fine of up to RMB 2,000 may be imposed. If the case is serious, the tax authority may impose a fine greater than RMB 2,000 but not more than RMB 10,000. 2

(b) Where a tax payer or tax withholding agent fails to make a tax filing within the prescribed time limit, the tax authority will order the taxpayer to rectify within a prescribed time limit and impose a fine below RMB 2,000. If the case is serious, the tax authority may impose a fine of over RMB 2,000 but below RMB 10,000. 2

(c) Where a taxpayer fails to file a return and hence does not pay or pays less tax than is duly payable, the tax authority will pursue the tax with the surcharge on overdue tax owing due to the non-payment or underpayment and impose a fine of over 50% but below five times of the amount of tax underpaid. 1

(d) Where a taxpayer transfers or conceals his property and this results in a failure of tax recovery, the tax authority will pursue the tax together with the surcharge on overdue tax owing due to the non-payment or underpayment and impose a fine of over 50% but below five times the amount of the tax evasion. 1

Criminal penalties may also be imposed. If the avoidance of tax recovery involves an amount of RMB 10,000 or more but below RMB 100,000, a term of imprisonment of less than three years and/or a fine of more than 100% but below five times the amount of tax avoidance may be imposed. Where the amount involved is over RMB 100,000, a term of imprisonment of more than three years but less than seven years and a fine of more than 100% but below five times the amount of tax avoidance may be imposed. 2

3

(e) Where a taxpayer refuses to pay tax by using violence or threatening behaviour, the tax authority will pursue the payment of the tax together with the surcharge on tax overdue and impose a fine of 100% but below five times the tax payable. 1

Criminal penalties may also be imposed and the term of imprisonment will range from below three years or from three years to seven years with a fine of 100% but below five times the amount of the tax depending on the seriousness of the offence. 1

2

10