# Answers

Section B *Marks*

**1 Taip Ltd**

**(a)** In addition to the cost plus method, the following four methods can be used for transfer pricing adjustments:

| | |
|---|---|
| – Comparable uncontrolled price method | 1 |
| – Resale price method | 1 |
| – Transactional net profit method | 1 |
| – Profit split method | 1 |
| | 4 |

**(b) Additional enterprise income tax (EIT) payable for the years 2010 to 2014**

| Year | 2010<br>RMB '000 | 2011<br>RMB '000 | 2012<br>RMB '000 | 2013<br>RMB '000 | 2014<br>RMB '000 | |
|---|---|---|---|---|---|---|
| Total costs | 7,100 | 9,300 | 12,000 | 15,000 | 21,000 | |
| Adjusted profit (10%) | 710 | 930 | 1,200 | 1,500 | 2,100 | 1·5 |
| Tax rate | 0% | 0% | 12·5% | 12·5% | 12·5% | 1·5 |
| EIT payable | 0 | 0 | 150 | 187·5 | 262·5 | 1·5 |
| EIT paid already (1,350 x 12·5%) | | | | | (168·75) | 1 |
| Additional EIT payable | 0 | 0 | 150 | 187·5 | 93·75 | 0·5 |

Total EIT payable = RMB431,250

| | |
|---|---|
| | 6 |
| | **10** |

**2 Trinity Ltd**

**(a) Cosmetic packs**

| | |
|---|---|
| Customs duty = (USD100,000 x 6·5% x 6) = RMB39,000 | 0·5 |
| Composite value for consumption tax = ((100,000 x 6 + 39,000) ÷ (1 – 30%)) = RMB912,857 | 1 |
| Consumption tax on importation = (912,857 x 30%) = RMB273,857 | 0·5 |
| | 2 |

**(b) Lipsticks**

| | |
|---|---|
| VAT refundable on export = (400,000 x 13%) = RMB52,000 | 1 |

**(c) Face powder**

| | |
|---|---|
| Consumption tax on production and sale = (250,000 x 30%) = RMB75,000 | 1 |

*Marks*

**(d)** **Total output value added tax (VAT) and input/import VAT for 2015**

| | RMB | RMB | Marks |
|---|---|---|---|
| **Output VAT** | | | |
| Item (1) (2,350,000 x 17%) | 399,500 | | 0·5 |
| Item (2) (zero rated export) | 0 | | 0·5 |
| Item (3) (250,000 x 17%) | 42,500 | | 0·5 |
| Item (4) (1,000 x 30 ÷ (1 + 17%) x 17%) | 4,359 | | 1·5 |
| Total output VAT | | 446,359 | |
| **Input VAT** | | | |
| Item (1) (912,857 (from part (a) x 17%)) | 155,186 | | 1 |
| Item (2) (goods purchased for export) | 0 | | 1 |
| Item (3) (85,000 x 17%) | 14,450 | | 0·5 |
| Item (4) (10,000 x 17%) | 1,700 | | 0·5 |
| Total input VAT | | 171,336 | |
| | | | 6 |
| | | | **10** |

**Tutorial notes:**
– *VAT on goods purchased for export by a trading company are accounted for separately.*
– *Early settlement discounts do not affect the amount of customs duty or VAT.*
– *Unsold inventory does not affect input VAT.*

**3** **(a)** **Differences between direct and indirect taxes**

– A direct tax is usually levied on income or wealth of a person while an indirect tax is usually levied on the consumption of goods and services.

– The payer of a direct tax bears the tax directly and it is more difficult to shift the tax burden to another person.

– A direct tax is usually simpler to administer whereas an indirect tax is usually more complicated to administer.

– A direct tax is usually progressive whereas an indirect tax is usually regressive.

*ONLY TWO differences required, 1 mark each – maximum* 2

**(b)** **Direct taxes:**

– Individual income tax 0·5
– Enterprise income tax 0·5

**Indirect taxes (any TWO):**

– Value added tax 0·5
– Business tax 0·5
– Consumption tax 0·5

*Maximum* 2

**(c)** The tax bureau can recover the tax wrongly exempt in 2014.

The tax bureau can recover any taxes under-collected as a result of a wrong decision made within three years; and for under-collected amounts over RMB100,000 the time limit is extended to five years. 2

**(d)** **(i)** No. *[Imprisonment is a criminal penalty and can only be decided by a court]* 0·5

**(ii)** Yes. 0·5

**(iii)** Yes. 0·5

**(iv)** No. *[This is the authority of the State Administration for Industry and Commerce]* 0·5

2

*Marks*

**(e)** The tax bureau can assess the enterprise income tax on a deemed basis by reference to the tax burden of other taxpayers involved in the same or similar industries with a similar scale of operations and a similar level of revenue. 2

**10**

**4 (a) Design Ltd**

**(i) Value added tax (VAT) payable/refundable for the year 2016**

| | | RMB | RMB | Marks |
|---|---|---|---|---|
| **(1)** | **Taxable** | | | |
| | Output VAT (9,805,000 ÷ 1·06 x 6%) | | 555,000 | 1 |
| | Input VAT | | | |
| | Computers (3,500,000 ÷ 1·17 x 17%) | 508,547 | | 0·5 |
| | Other service expenses (210,000 ÷ 1·06 x 6%) | 11,887 | | 0·5 |
| | | | (520,434) | |
| | VAT payable | | 34,566 | |
| **(2)** | **Zero rated** | | | |
| | Output VAT | | 0 | 0·5 |
| | Input VAT (as in (1) above) | | | |
| | Computers | 508,547 | | |
| | Other service expenses | 11,887 | | |
| | | | (520,434) | |
| | VAT refundable | | (520,434) | 0·5 |
| **(3)** | **VAT exempt** | | | |
| | Output VAT | | 0 | 0·5 |
| | Input VAT | | 0 | 0·5 |
| | VAT payable/refundable | | 0 | |
| | | | | 4 |

**(ii) Gross profit for the year 2016**

| | | RMB | RMB | Marks |
|---|---|---|---|---|
| **(1)** | **Taxable** | | | |
| | Turnover (9,805,000÷1·06) | | 9,250,000 | 0·5 |
| | Expenses: | | | |
| | Depreciation on computers (3,500,000 ÷ 1·17 ÷ 3 x 11/12) | 914,055 | | 1 |
| | Other service expenses (210,000 ÷ 1·06) | 198,113 | | 0·5 |
| | | | (1,112,168) | |
| | Gross profit | | 8,137,832 | |
| **(2)** | **Zero rated** | | | |
| | Turnover | | 9,805,000 | 0·5 |
| | Expenses (as in (1)) | | (1,112,168) | 0·5 |
| | Gross profit | | 8,692,832 | |
| **(3)** | **VAT exempt** | | | |
| | Turnover | | 9,805,000 | 0·5 |
| | Depreciation on computers (3,500,000 ÷ 3 x 11/12) | 1,069,444 | | 1 |
| | Other service expenses | 210,000 | | 0·5 |
| | | | (1,279,444) | |
| | Gross profit | | 8,525,556 | |
| | | | | 5 |

*Marks*

**(b)** Major reasons for the merger of business tax and value added tax (VAT) are:

– Reduce the tax burden by eliminating double taxation,
– Encourage capital (fixed assets) investment by service industries.

*ANY ONE reason required* 1

**10**

**5 (a) Mrs Li – Individual income tax (IIT) for 2015**

(1) Sports lottery prize: (876,000 x 20%) = RMB175,200 1

**Tutorial note:** *A prize of RMB10,000 or less is exempt from IIT.*

(2) Insurance compensation: exempt from IIT. *[Article 4, IIT Law]* 0·5

(3) Interest on time deposit with a bank: temporarily exempt from IIT. 0·5

(4) Villa received from a divorce: not subject to IIT. *[Tax notice Guo Shui Fa (2009) No. 121]* 1

(5) Dividend from a listed company on shares held for over one year: temporarily exempt from IIT. *[Tax notice Cai Shui (2015) No. 101]* 1

(6) Non-competition payment: (8,000,000 x 20%) = RMB1,600,000 1

**Tutorial note:** *Taxed as incidental income according to tax notice Caishui (2007) No. 102.*

5

**(b) Ms Wu – IIT on employment income for 2015**

| | RMB | RMB | |
|---|---|---|---|
| Housing allowance (exempt) | 0 | | 0·5 |
| Meal allowance (exempt) | 0 | | 0·5 |
| Tuition fees for children studying in Hong Kong | 12,000 | | 0·5 |
| Medical insurance [**Tutorial note:** *From 1 January 2016 onwards, qualified medical insurance within the limit for 31 pilot cities can be exempt from IIT under tax notice Cai Shui (2015) No. 126*] | 500 | | 0·5 |
| Salary | 12,500 | | 0·5 |
| Taxable salary each month | 25,000 | | |
| IIT each month [(25,000 – 4,800) x 25% – 1,005] | 4,045 | | 1 |
| IIT on monthly salary for 11 months | | 44,495 | 0·5 |
| First bonus – the special formula is applicable: (360,000 ÷ 12) = RMB30,000 → tax rate of 25% | | | 0·5 |
| IIT on first bonus (360,000 x 25% – 1,005) | | 88,995 | 0·5 |
| Second bonus – added to monthly salary: [((25,000 + 360,000) – 4,800) x 45% – 13,505] | | 157,585 | 1 |
| Total IIT payable | | 291,075 | |
| | | | 6 |

**Tutorial notes:**

– *Reasonable amount of housing allowances and meal allowances received on a reimbursement basis by an expatriate are exempt from IIT provided the relevant supporting documents are available.*
– *Only one bonus can use the special formula to calculate IIT and the other bonuses will be added to the salary of the month to calculate IIT.*
– *Since Ms Wu lives in Guangzhou, she is not qualified for the tax exemption for tuition fees for her children studying in Hong Kong, based on tax notice* Caishui *[2004] No. 29.*

| | | | | Marks |
|---|---|---|---|---|
| **(c)** | **Mr Huang – IIT on filing the annual return for 2015** | | | |
| | | RMB | RMB | |
| | Monthly salary | 11,400 | | |
| | IIT on salary = [(11,400 – 3,500) x 20% – 555] | 1,025 | | 0·5 |
| | IIT for 12 months | | 12,300 | 0·5 |
| | *Less:* IIT withheld | | (4,140) | 0·5 |
| | Additional IIT on salary | | 8,160 | |
| | IIT on leasing income: [20,000 x (1 – 20%) x 10% x 12] *[IIT rate reduced to 10% for individual leasing residential property under tax notice Cai Shui (2008) No. 24]* | | 19,200 | 1 |
| | IIT on authorship fee: [(USD2,500 x 6) x (1 – 20%) x (1 – 30%) x 20%] | 1,680 | | 1 |
| | European tax withheld (USD200 x 6) | (1,200) | | 0·5 |
| | Additional IIT payable in China | | 480 | |
| | Total IIT payable | | 27,840 | |
| | | | | 4 |
| | | | | **15** |

## 6 GFH Ltd

**(a) Enterprise income tax (EIT) for 2015**

| | | RMB | RMB | |
|---|---|---|---|---|
| | Profit for the year | | 2,590,400 | |
| (1) | Using FIFO method [LIFO is not allowed under the EIT Regulations] | 350,100 | | 0·5 |
| (2) | Provision for obsolete inventory (not deductible) | 123,450 | | 0·5 |
| (3) | Scrapping of equipment – no adjustment | 0 | | 0·5 |
| (4) | Payment in lieu of notice – no adjustment | 0 | | 0·5 |
| (5) | Depreciation of display antique vase (not for earning taxable income – not deductible) (3,500,000 ÷ 10) | 350,000 | | 0·5 |
| (6) | Additional deduction for R&D expenses (123,000 x 50%) | (61,500) | | 1 |
| (7) | Additional deduction for disabled employee salaries (100%) | (345,120) | | 1 |
| (8) | Donation to students (not deductible) | 25,000 | | 0·5 |
| (9) | Interest on loan from a finance institution (tax deductible even though rate is higher than the People's Bank of China) – no adjustment | 0 | | 0·5 |
| (10) | Entertainment expenses (maximum deduction: the lower of RMB3,126,120 (5,210,200 x 60%) and RMB193,378 (38,675,500 x 0·5%)) | | | |
| | Amount not deductible (5,210,200 – 193,378) | 5,016,822 | | 1·5 |
| (11) | Amortisation of goodwill (not deductible) (6,500,000 ÷ 10) | 650,000 | | 0·5 |
| (12) | Amortisation of patent – no adjustment | 0 | | 0·5 |
| (13) | Dividend to shareholder (not deductible) | 1,200,000 | | 0·5 |
| (15) | Loss on destroyed warehouse – no adjustment | 0 | | 0·5 |
| (16) | Irrecoverable VAT on abnormal loss – no adjustment | 0 | | 0·5 |
| (17) | Government subsidy – no adjustment | 0 | | 0·5 |
| (18) | Foreign tax paid on royalty income (90,000/(1 – 10%)) | 10,000 | | 0·5 |
| (19) | Profit of associated company | (123,100) | | 0·5 |
| | | | 7,195,652 | |
| | Taxable profit | | 9,786,052 | |
| | EIT at 25% | | 2,446,513 | 0·5 |
| (14) | EIT credit on purchase of safety equipment (2,500,000 x 10%) | (250,000) | | 1 |
| (18) | Foreign tax credit | (10,000) | | 0·5 |
| | | | (260,000) | |
| | EIT payable | | 2,186,513 | |
| | | | | 13 |

| | | Marks |
|---|---|---|
| **(b)** | Preferential treatments available | |
| (1) | Qualified integrated circuit enterprise: a two-year exemption and three-year half rate of EIT starting from the first profit making year. | 1 |
| (2) | Encouraged industry under the Central and Western catalogue: 15% tax rate until the end of 2020. | 1 |
| | | 2 |
| | | **15** |