
Answers

| | | <i>Marks</i> |
|---|--|--------------|
| 1 | (a) Company B | |
| | (i) Enterprise income tax (EIT) treatment of items | |
| 1 | The accrued termination bonus payable in 2017 of RMB 500,000 is not deductible in 2013. Hence the deductible wages and salaries are RMB 2,400,000. | 1 |
| 2 | (i) The amount of entertainment expenses deductible is limited to 60% of the amount incurred, i.e. RMB 67,920 (113,200 x 60%); and no more than 0.5% of turnover, i.e. RMB 58,900 (11,780,000 x 0.5%). Hence, RMB 54,300 (113,200 – 58,900) is not deductible. | 1.5 |
| | (ii) The amount of deductible advertising and promotion expenses is limited to 15% of turnover, i.e. RMB 1,767,000 (11,780,000 x 15%). The amount of RMB 100,000 brought forward from 2012 is also deductible within this limit. Hence, the total deductible in 2013 is RMB 910,300 (810,300 + 100,000). | 1.5 |
| 3 | The interest expense is at the same market rate as from a bank, so the amount incurred is fully deductible and no adjustment is required. | 1 |
| 4 | (i) Deductible staff welfare and benefits are limited to 14% of deductible wages and salaries, i.e. RMB 336,000 (2,400,000 x 14%). Hence, RMB 64,000 (400,000 – 336,000) is not deductible. | 1 |
| | (ii) Deductible labour union fees are limited to 2% of deductible wages and salaries, i.e. RMB 48,000 (2,400,000 x 2%). So the amount of RMB 40,000 incurred is fully deductible and no adjustment is required. | 1 |
| | (iii) A penalty paid to a government authority is not deductible. | 1 |
| | (iv) Goodwill on the acquisition of a business is not deductible until the sale of business or liquidation of the company. | 1 |
| | (v) No adjustment is required where the depreciation period is longer than the minimum period, which for computers (electronic equipment) is three years. | 1.5 |
| | (vi) A sponsorship fee to a local school is not deductible. | 1 |
| 5 | In addition to the qualifying R&D expense of RMB 320,000, there is a further 50% deductible on qualifying R&D expenses, i.e. RMB 160,000 (320,000 x 50%). | 1 |
| 6 | (i) A non-specific purpose financial subsidy is taxable. No adjustment is required. | 1 |
| | (ii) The asset loss not covered by insurance compensation is deductible. No adjustment is required. | 1 |
| | (iii) The maximum EIT credit on the US sourced income is RMB 125,000 (500,000 x 25%). Hence, the USA tax paid of RMB 20,000 can be fully credited against the EIT to be payable. | 1.5 |
| | | <u>17</u> |

Tutorial note: According to the State Administration of Taxation Announcement 2012 No. 15, if the depreciation period adopted for accounting purposes exceeds that of the taxation law, no adjustment is required for EIT.

(ii) EIT payable for 2013

| | RMB | RMB | |
|---|---------|-------------|-------|
| Loss per accountant's computation | | (757,000) | |
| <i>Add:</i> | | | |
| 1 Accrued bonus | 500,000 | | 0.5 |
| 2 (i) Entertainment expenses | 54,300 | | 0.5 |
| 4 (i) Staff welfare and benefits | 64,000 | | 0.5 |
| 4 (iii) Penalty to government | 100 | | 0.5 |
| 4 (iv) Goodwill on acquisition | 515,000 | | 0.5 |
| 4 (vi) Sponsorship fee to a school | 10,000 | | 0.5 |
| 6 (iii) US tax paid | 20,000 | | 0.5 |
| | <hr/> | 1,163,400 | |
| | | 406,400 | |
| <i>Deduct:</i> | | | |
| 2 (ii) Advertising expenses | | (100,000) | 0.5 |
| 5 Additional R&D deduction | | (160,000) | 0.5 |
| | | <hr/> | |
| Taxable income | | 146,400 | |
| EIT at 25% | | 36,600 | 0.5 |
| Less: Foreign tax credit | | (20,000) | 0.5 |
| EIT payable | | <hr/> <hr/> | |
| | | 16,600 | |
| <i>No effect items:</i> | | | |
| 3 Interest on shareholder's loan | | | 0.5 |
| 4 (ii) Labour union fees | | | 0.5 |
| 4 (v) Depreciation on computers | | | 0.5 |
| 6 (i) Non-specific purpose financial subsidy | | | 0.5 |
| 6 (ii) Write-off of furniture destroyed in a fire | | | 0.5 |
| | | | <hr/> |
| | | | 8 |

(b) Company H representative office (RO)**Business tax (BT) and enterprise income tax (EIT) for 2013**

| | RMB | |
|---|---------|-------|
| Taxable costs | 160,000 | |
| Deemed revenue [160,000 ÷ (1 - 15% - 5%)] | 200,000 | 1.5 |
| BT at 5% | 10,000 | 0.5 |
| Deemed profit at 15% | 30,000 | |
| EIT at 25% | 7,500 | 1 |
| | | <hr/> |
| | | 3 |

(c) Principle of 'effective management'

An enterprise registered outside China but with an effective management inside China can be considered as a China tax resident. The place of effective management means the place where the enterprise has the effective and overall power to control and manage the enterprise's:

- business operation;
- employees;
- financial and accounting books; and
- assets.

1

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3**(d) The tax authorities can assess an enterprise to enterprise income tax (EIT) on the deemed basis if:**

- the taxpayer does not have to have accounting books according to the law;
- the taxpayer does not have accounting books even though it is required to do so under the law;
- the taxpayer has destroyed its accounting books;
- the taxpayer refuses to provide information for tax filing purposes;
- the taxpayer has accounting books but the cost, income and expenses are incomplete and it is not possible to assess the profits;

- the taxpayer has a tax obligation but does not file tax on the due date and tax has still not been paid after a request from the tax authorities; or
- the tax base is obviously low without reasons.

FOUR items only required; 1 mark for each, maximum

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2 Ms Chen

(a) Individual income tax (IIT)

- | | |
|---|-----------|
| (1) The business trip expenses reimbursed and the employer's mandatory contribution to social security are exempt from IIT. | 1 |
| Therefore, the monthly taxable salary is RMB 11,500 (10,000 + 500 + 1,000). | 1 |
| Monthly IIT = (11,500 – 3,500) x 20% – 555 = RMB 1,045 | 1 |
| (2) The applicable tax rate for the bonus is 10% (40,000 ÷ 12 = 3,333). | 1 |
| IIT on the bonus = 40,000 x 10% – 105 = RMB 3,895 | 0.5 |
| (3) An article published twice is taxed as a single item. | |
| IIT = 20% x (6,000 – 20% x 6,000) x (1 – 30%) = RMB 672 | 1.5 |
| (4) The gross amount of dividend is RMB 50,000 (40,000 ÷ (1 – 20%)). | 0.5 |
| IIT on dividend = 50,000 x 20% = RMB 10,000 | 0.5 |
| (5) A gain on investing in A-shares is tax exempt. | 1 |
| (6) Consultancy fee of USD20,000 x 6 = RMB 120,000. | |
| IIT = (120,000 – 20% x 120,000) x 40% – 7,000 = RMB 31,400 | 1 |
| IIT after crediting foreign tax = 31,400 – (2,000 x 6) = RMB 19,400 | 1 |
| (7) Income from an estate is tax exempt. | 1 |
| (8) The donation for the Sichuan earthquake is fully deductible against income. | 1 |
| IIT on royalty income = (100,000 – 15,000) x (1 – 20%) x 20% = RMB 13,600 | 1 |
| (9) The gross interest income is RMB 6,400 (4,800 ÷ (1 – 5% – 20%)). | 1.5 |
| IIT on interest = 6,400 x 20% = RMB 1,280 | 0.5 |
| | 16 |
| (b) (i) A withholding agent who does not properly withhold individual income tax (IIT) is subject to a penalty of from 50% to 300% of the IIT. | 1 |
| (ii) Where a withholding agent fails to withhold the required tax, the taxpayer still remains liable for the tax due and must file a return with the relevant tax authority. | 1 |
| Ms Chen can file the IIT return either in the next month after she received the income or during the annual self-assessment. | 1 + 1 |
| | 3 |
| | 20 |

3 (a) Company T

(i) No value added tax (VAT) or no VAT credit items

The following transactions are either not chargeable to VAT or a credit for the VAT charged is not allowed:

- Item (4), the export of a service is exempt from VAT.
- Item (8), input VAT credit is not applicable to a general invoice issued by a small-scale taxpayer.
- Item (9), business tax not VAT applies to rent.

- Item (10), a VAT credit is not allowed on the transportation fee which relates to expenditure incurred for staff benefit.
- Item (11), a free of charge service for a charitable organisation is exempt from VAT.

1 mark each 5

(ii) VAT payable

| Item | | Input VAT RMB | Output VAT RMB | |
|------|---|--------------------------------|---------------------|------------|
| (1) | Client A | $(30,000 + 1,000) \times 6\%$ | 1,860 | 1·5 |
| (2) | Client B | $40,000 \div 106\% \times 6\%$ | 2,264 | 1·5 |
| (3) | Client Z | $100,000 \times 6\%$ | 6,000 | 1·5 |
| (5) | Legal advisory services | $15,000 \times 6\%$ | 900 | 1 |
| (6) | Trademark fee | $50,000 \times 6\%$ | 3,000 | 1 |
| (7) | Computers purchased | $20,000 \times 17\%$ | 3,400 | 1 |
| (12) | Leasing charge for photocopying machine | $6,000 \times 17\%$ | 1,020 | 1 |
| | Totals | <u>8,320</u> | <u>10,124</u> | |
| | VAT payable (output VAT – input VAT) | | <u><u>1,804</u></u> | <u>0·5</u> |
| | | | | <u>9</u> |

(b) Company M**(i) Irrecoverable input value added tax (VAT) on exported goods**

Export FOB value \times (17% – refund rate) = $200,000 \times (17\% - 13\%) =$ RMB 8,000 1

(ii) VAT payable for December 2013

| | Input VAT RMB | Output VAT RMB | |
|---|------------------|---------------------|------------------|
| Domestic sales ($180,000 \times 17\%$) | | 30,600 | 0·5 |
| Imported materials ($12,000 \times (1 + 10\%) \times 17\%$) | 2,244 | | 1·5 |
| Purchased materials ($160,000 - 10,000 \times 17\%$) | 25,500 | | 1·5 |
| Transportation ($10,000 \times 11\%$) | 1,100 | | 0·5 |
| | <u>28,844</u> | | |
| Less: Irrecoverable input VAT on export | <u>(8,000)</u> | | 0·5 |
| Creditable input VAT | | <u>(20,844)</u> | |
| VAT payable | | <u><u>9,756</u></u> | <u>0·5</u> |
| | | | <u>5</u> |
| | | | <u>20</u> |

4 (a) Company S**(i) Consumption tax (CT) on import of cosmetics sets**

Tax base for CT = $(\text{USD}100 \times 300 \times 6) \times (1 + 10\%) \div (1 - 30\%) =$ RMB 282,857 1·5

CT is RMB 84,857 ($282,857 \times 30\%$). 0·5

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(ii) Item (4) – not subject to consumption tax.

1

Item (5) – not subject to consumption tax.

1

Item (6) – subject to consumption tax.

1

3

Tutorial note: Consumption tax is levied on the production and sale of goods. The purchase and sale of cosmetics without further production or processing is not subject to consumption tax.

(iii) CT on sales for October 2013 is: $450 \times 1,000 \times 30\% =$ RMB 135,000

1

(b) Company P

Land appreciation tax (LAT) on sale of office

| | RMB | RMB | |
|---|---------------|---------------------|----------|
| Selling price | | 20,000,000 | 0.5 |
| Appraised value | 15,000,000 | | 1 |
| Business tax (BT) (20,000,000 – 3,000,000 x 5%) | 850,000 | | 0.5 |
| City maintenance and construction tax and education levy at 10% of BT | 85,000 | | 0.5 |
| Stamp duty (20,000,000 x 0.05%) | <u>10,000</u> | | 0.5 |
| <i>No further deductions</i> | | | 0.5 |
| Total deduction | | <u>(15,945,000)</u> | |
| Land appreciated value | | <u>4,055,000</u> | |
| % of appreciation (4,055,000 ÷ 15,945,000) | | 25% | 0.5 |
| Tax rate | | 30% | 0.5 |
| LAT (4,055,000 x 30%) | | <u>1,216,500</u> | 0.5 |
| | | | <u>5</u> |

Tutorial note: *The appraised value instead of the actual acquisition cost is used as the deduction base for used (old) properties.*

Per tax notice Cai Shui [2003] No. 16, the cost of the property can be deducted from the selling price when calculating business tax.

(c) Shop R

This is a mixed sale, where a single transaction involves both the supply of goods which is subject to value added tax (VAT) and non-VATable services which on their own would be subject business tax (BT). 2

Mixed sales made by an entity principally engaged in the sale of goods are subject to VAT. 1

Therefore, Shop R should pay VAT on the installation fee. 1

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5 (a) (i) The term ‘tax evasion’ under the Tax Collection and Administration Law means ‘a taxpayer:

- forges, revises, conceals or destroys its account books or supporting vouchers for the accounts without official permission, or
- overstates the expenses or does not state or understates its income in its account books, or
- refuses to file tax returns despite notification by the tax authorities, or files fraudulent tax returns or refuses to pay or underpays the tax due.’

3

Tutorial note: *The amended Criminal Law has amended the term and criminal penalty on ‘tax evasion’ in 2009. The State Council has made a proposal to the National People’s Congress to amend the Tax Collection and Administration Law to be consistent with the Criminal Law. The proposal includes revising the term ‘tax evasion’ to ‘avoidance of tax payment’ as ‘taxpayer using the means of deception and concealment for fraudulent tax declaration or non-declaration to avoid payment of taxes’.*

(ii) There is no statute of limitation on the recovery of taxes in the case of tax evasion. 1

(b) Company A

– The deduction of expenses not related to its business would constitute the overstatement of expenses which is considered as tax evasion under the Tax Administration Law. 1

– The reporting of taxable income at an obviously low amount without reason would not constitute an act of tax evasion but a transaction between related parties not conducted at an arm’s length price would be challengeable under the transfer pricing rules. 1

2

| | <i>Marks</i> |
|---|---|
| (c) The taxpayer can appeal to the tax authority at one level higher than the original authority which made the decision. | 1 |
| The appeal should be made within 60 days from the date of receiving the decision of the tax authority. | 1 |
| The taxpayer should pay the tax assessed by the original authority before making the appeal. | 1 |
| The taxpayer can appeal to the People's Court if he/she still disagrees with the decision of the tax administrative review. | 1 |
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| | <hr style="width: 100%; border: 0.5px solid black;"/> |
| | 10 |