Answers

Marks

1 (a) Company K

(i)

		Marks
(1)	Refurbishing expenses cannot be fully written off immediately for tax purposes, but should be amortised over five years.	1·5
(2)	A penalty for the late payment of business tax is not tax deductible.	1
(3)	The cost of entertaining expenses cannot be deducted in full, but is limited to a percentage of turnover as follows: [5,000,000 x 1% + (30,000,000 – 5,000,000) x 0·5%] = RMB 175,000.	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 (2,000,000 + 1,000,000) = 3,000,000 = RMB 420,000	1·5
(6)	Union expenses cannot exceed 2% of total salaries and wages, i.e. 2% of 3,000,000 = RMB 60,000.	1
(7)	Staff and workers education expenses cannot exceed 1·5% of total salaries and wages i.e. 1·5% of 3,000,000 = RMB 45,000.	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 as follows: Actual tax paid is [27,000/(1 – 10%)] x 10% = RMB 3,000 Limit of the tax credit = [27,000/(1 – 10%)] x 33% = RMB 9,900 Therefore, the whole amount of RMB 3,000 can be set off against the income tax liability.	3
(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 (100,000 – 80,000) = RMB 20,000 is allowable, not the net book value of RMB 30,000.	1
(11)	The treatment is correct because any non-payable liability over two years old is taxable.	1·5
(12)	The membership fee income is wholly taxable in the year it is received, only if the company is in the pre-operation period can it be spread over five years.	2
		17

(ii)

Foreign enterprise income tax computation:	RMB	RMB	
Taxable profit before adjustment		6,597,000	
Add:			
(1) Refurbishing of the office (50,000 – 10,000)	40,000		0·5
(2) Late payment penalty	1,500		0·5
(3) Entertainment over limit (200,000 – 175,000)	25,000		0·5
(5) Staff benefit over limit (500,000 – 420,000)	80,000		0·5
(6) Union fee over limit (100,000 – 60,000)	40,000		0·5
(7) Staff and workers education over limit (50,000 – 45,000)	5,000		0·5
(8) Tax withheld from overseas dividend (gross up)	3,000		0·5
(9) Interest expense for the loan borrowed by the investor	200,000		0·5
(10) Tax written down value over limit (30,000 – 20,000)	10,000		0·5
(12) Membership fees added back (500,000 – 100,000)	400,000		0·5
		804,500	
Adjusted taxable amount		7,401,500	
Income tax at 33%		2,442,495	0·5
Less: foreign tax credit		(3,000)	0·5
Income tax payable		2,439,495	
			6

(b)

		Marks
(i)	The general provision is not tax allowable and RMB 5,000 should be added back to the accounting profit of year one.	1
(ii)	An actual bad debt will be allowable if: the debtor is in bankruptcy; or it is recoverable from the estate of a deceased debtor; or it is over two years from the due date and the debt is still outstanding. If the RMB 1,000 debt can satisfy any one of these conditions, then this amount can be deducted from the accounting profit in year two.	3
(iii)	Given that the provision of RMB 5,000 was added back in calculating the taxable profit in year one, the write back should not be treated as taxable income in year two.	2
		6

Marks

(c) **(i)** Re-invested amount is 500,000 x 60% = RMB 300,000. 0·5
Tax refund due = [300,000/1 – (30% + 3%)] x 30% x 100% = RMB 134,328. 2·5

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(ii) The conditions are:
(1) The re-investment made by Company F must either:
– increase the registered capital of Company P before the profits were distributed; or
– establish another foreign investment enterprise if the profits were distributed. 2
(2) The profits must be reinvested for at least five years, otherwise, the refund must be paid back to the tax authority. 1

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2 **(a)** **(i)** **Mr C: Individual income tax (IIT)**

1. Concert performance: the maximum tax allowable amount is 30% of the income i.e. RMB 30,000
Tax payable = (100,000 – 30,000) x (1 – 20%) x 40% – 7,000 = RMB 15,400 2
2. Insurance compensation is exempt 0·5
3. Lottery prize: tax payable = 50,000 x 20% = RMB 10,000 1
4. Interest on personal loan: tax payable = 40,000 x 20% = RMB 8,000 1
5. Interest on national debt is exempt 1
6. Overseas speech: tax payable = 10,000 x (1 – 20%) x 20% = RMB 1,600
As the overseas tax deducted of RMB 1,500 is lower than RMB 1,600, IIT of the RMB 100 difference is payable. 2
7. Income from publishing a book overseas: tax payable = 10,000 x (1 – 20%) x 20% x (1 – 30%) = RMB 1,120
But as the overseas tax deducted of RMB 2,000 is greater than this amount, no additional IIT is payable. 2

Total IIT payable for 2006 is (15,400 + 10,000 + 8,000 + 100) = RMB 33,500 0·5

10

(ii) Mr C should submit the returns and pay the tax to the tax authorities at the location where he derived the taxable income. Where income is received outside China, Mr C should lodge the return and pay the tax at his place of permanent or ordinary residence. 2

(b) **Mr D Guaoshuifa [2006] 74 and Guishuifa [2006] 108**

(i) The full amount is exempt for business tax (BT) as the personal ordinary home was bought more than five years before the date of sale. 1

The full amount is also exempt from individual income tax (IIT) as again the personal ordinary home was bought more than five years before the date of sale. 1

2

(ii) As the sale is within five years of the date of purchase, BT is payable on the gross proceeds (turnover)
BT = 2,000,000 x 5% = RMB 100,000 1

As the sale is within five years of the date of purchase, IIT is payable on the net proceeds, i.e. after deduction of the original cost plus reasonable expenses.
IIT = (2,000,000 – 600,000 – 200,000 – 400,000 – 100,000) x 20% = RMB 140,000 2

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(iii) This will be treated as a sale by a business for personal non-ordinary home, so the taxable value is the revenue received less the original cost.
BT = (2,000,000 – 600,000) x 5% = RMB 70,000 2

IIT = (2,000,000 – 600,000 – 200,000 – 400,000 – 70,000) x 20% = RMB 146,000 1

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Marks

3 Company G

(a) Value added tax (VAT)

1. Input VAT for the tobacco purchased from a general VAT payer = 234,000 x 17%/(1 + 17%) = RMB 34,000	1
2. Input VAT for the tobacco purchased from a local farmer = 42,000 x 13% = RMB 5,460	1
3. Input VAT for the transportation fee = 30,000 x 7% = RMB 2,100	1
4. Input VAT on the subcontracting fee = 93,600 x 17%/(1 + 17%) = RMB 13,600	1
5. Deemed sales for staff welfare = 36,000,000 x 2/18,000 = RMB 4,000	1
Output VAT = (36,000,000 + 4,000) x 17% = RMB 6,120,680	1·5
VAT liability = (6,120,680 – 34,000 – 5,460 – 2,100 – 13,600) = RMB 6,065,520	0·5
	7

(b) Consumption tax (CT)

Since the contractor has not paid CT on the company's behalf, Company G will need to pay the CT based on the composite value of:

1. The cost of goods from the farmer without VAT = 42,000 – 5,460 = RMB 36,540	1
2. The transportation cost without VAT = 30,000 – 2,100 = RMB 27,900	1
3. The subcontracting fee without VAT = 93,600 – 13,600 = RMB 80,000	1
The composite value = (36,540 + 27,900 + 80,000)/(1 – 30%) = RMB 206,343 and the related CT = 206,343 x 30% = RMB 61,903	1·5
To avoid the double taxation of continuous production: the deductible CT is 50% of 61,903 + 50% of 200,000 x 30% = RMB 60,952	1·5
The CT on the turnover is (18,000 + 2) x 150 + 36,000,000 x 45% = RMB 18,900,300	1·5
The CT for the month is (18,900,300 – 60,952 + 61,903) = RMB 18,901,251	0·5
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4 (a) (i)

Only the broadcasting expenses are deductible. BT = (500,000 + 100,000 – 200,000) x 5% = RMB 20,000	2

(ii)

BT on the room rental income = (100,000 + 15,000) x 5% = RMB 5,750	1
BT for the night club = (10,000 + 15,000) x 20% = RMB 5,000	1
BT for the restaurant = (50,000 + 5,000) x 5% = RMB 2,750	1
Total BT = (5,000 + 5,750 + 2,750) = RMB 13,500	
The kiosk income is subject to VAT:	
VAT = (8,000) x 4%/(1 + 4%) = RMB 308	1
	4

(b) Company M

(i)

The deductible expenses include land use rights, construction cost, business tax and education surcharge: 25,000,000 + 30,000,000 + (25,000,000 + 30,000,000) x 10% + 5,000,000 + 1,000,000 = RMB 66,500,000.	3
As a real estate developer, Company M is entitled to an additional 20% deduction of: (25,000,000 + 30,000,000) x 20% = RMB 11,000,000.	1
Land value added = 100,000,000 – 66,500,000 – 11,000,000 = RMB 22,500,000	0·5
The rate between added value and total deductible value is: 22,500,000/77,500,000 = 29%	1
Land appreciation tax payable is 22,500,000 x 30% = RMB 6,750,000.	0·5
	6

Marks

(ii) If Company M is not a real estate property developer, there is no additional 20% deduction
Land value added = 100,000,000 – 66,500,000 = RMB 33,500,000: — 1

The rate between added value and total deductible value is thus:
33,500,000/66,500,000 = 50·4% — 0·5

Land appreciation tax payable:
– the portion that is less than 50%: LAT = 33,250,000 x 30% = RMB 9,975,000
– the portion that is more than 50%: LAT = 250,000 x 40% = RMB 100,000

Total LAT is 9,975,000 + 100,000 = RMB 10,075,000 — 1·5

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5 (a) (i) According to the relevant tax rule, the amount of tax to be withheld in the case of a listed company, is half the standard rate of 20%. Thus, the income tax withheld will be 100,000 x 0·1 x 20% x 50% = RMB 1,000 — 2

(ii) The half-rate preference treatment applies to listed company dividends only, thus the income tax withheld will be 100,000 x 0·1 x 20% = RMB 2,000 — 2

(iii) The half-rate preference treatment also applies to foreigners, therefore, the income tax withheld will be 100,000 x 0·1 x 10% x 0·5 = RMB 500 — 2

(iv) Again the half-rate preference treatment applies to listed company's only, thus the income tax withheld will be 100,000 x 0·1 x 10% = RMB 1,000 — 1

(v) According to the relevant rule, dividend income paid by a foreign invested enterprise to a foreigner is exempt. — 1

(b) (i) A withholding agent must remit the tax withheld to the State Treasury within seven days after the end of the month. — 1

(ii) The documents that shall be submitted are:
– a certificate of tax withheld;
– a return of individual income tax withheld;
– a detailed individual income payment list stating the payee name, position, income and tax payment; and
– any other relevant documents required by the tax authority.

1 mark per item, maximum — 3

(iii) If the withholding agent fails to submit the required documents, the payments made to the individuals will not be allowed as deductible costs for the calculation of the withholding agent's taxable income. Also the agent may face a penalty of up to RMB 10,000. — 2

(iv) A handling fee equal to 2% of the amount of tax withheld can be awarded to the withholding agent by the tax authority. — 1

15