
Answers

Marks

1 (a) Company F

(i) Correct treatment of items

- (1) The IIT borne by the company is for a business purpose and is tax allowable.
- (2) The interest is of a capital nature and is not tax allowable.
- (3) Subject to the maximum amount of 0.5% of the sales/business income of the year (i.e. RMB 750,000) 60% of the entertainment expense is deductible.
- (4) Qualified advertising and promotion expenses, are deductible up to 15% of the sales/business income of the year, i.e. RMB 22,500,000
- (5) In addition to the actual expenses, an additional deduction of 50% of the research and development expense is allowable.
- (6) Staff and worker benefits cannot exceed 14% of the total salaries and wages, i.e. RMB 1,400,000.
- (7) Staff education expenses cannot exceed 2.5% of the total salaries and wages, i.e. RMB 250,000.
- (8) Union expenses cannot exceed 2% of the total salaries and wages, i.e. RMB 200,000.
- (9) A direct donation to a non-approved entity is not tax allowable.
- (10) The gain on the disposal of listed 'A' shares is taxable.
- (11) Interest income from a national debenture is exempt.
- (12) The gain on the disposal of a national debenture is taxable.
- (13) Only the tax written down value of RMB 300,000 is allowable.

(1 mark each)

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(ii) Enterprise income tax (EIT) for 2008

	RMB	RMB	
Taxable profit before adjustment		15,010,000	
<i>Add:</i>			
(2) Capital nature interest	100,000		0.5
(3) Non-allowable entertainment expense: 40% of RMB 1,500,000	750,000		0.5
(4) No adjustment	0		0.5
(6) Over-limit staff and worker benefits	600,000		0.5
(7) No adjustment	0		0.5
(8) No adjustment	0		0.5
(9) Non-allowable donation	200,000		0.5
(10) No adjustment	0		0.5
(12) No adjustment	0		0.5
(13) Tax written down value over limit (400,000 – 300,000)	100,000		0.5
	<hr/>	1,750,000	
<i>Less:</i>			
(1) No adjustment	0		0.5
(5) Additional deduction for research and development expense	100,000		0.5
(11) National debenture interest – exempt	40,000		0.5
	<hr/>	(140,000)	
Adjusted taxable profit		<hr/> 16,620,000	
Tax rate		25%	
Tax payable		<hr/> 4,155,000	0.5
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- (b) (i) A resident enterprise is an enterprise that is incorporated in the PRC in accordance with the PRC's laws and administrative regulations; or an enterprise that is incorporated under the laws of other countries or regions but whose place of effective management is located in the PRC. 2

Place of effective management refers to an establishment that exercises, in substance, overall management and control over the production and business, personnel, accounting, properties, etc of the enterprise. 2

A resident enterprise is liable to pay enterprise income tax on its income sourced **BOTH** from within and outside of the PRC. 1

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	Marks
(ii) Company A is a PRC resident enterprise. Its income sourced both from within and outside of the PRC is subject to enterprises income tax (EIT) at the rate of 25%.	2·5
Company B is a non-PRC resident enterprise. Only the income effectively connected to its establishment within the PRC will be subject to enterprises income tax (EIT) at the rate of 25%.	2·5
Company C is a non-PRC resident enterprise. Only the income sourced in the PRC will be subject to enterprises income tax (EIT). The tax rate will be 10% if it is resident in a non-treaty country and between 5% and 10% for a treaty country.	2·5
Company D is a non-PRC resident enterprise. Only the income sourced in the PRC is subject to enterprises income tax (EIT). As above the tax rate will be 10% for a non-treaty country and between 5% and 10% for a treaty country.	2·5
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2 (a) Company G – general manager’s bonus payment	
(i) IIT for non-quarter months: $[(20,000 - 2,000) \times 20\% - 375] \times 8 = \text{RMB } 25,800$	1
IIT for quarter months: $[(50,000 - 2,000) \times 30\% - 3,375] \times 4 = \text{RMB } 44,100$	1
IIT for the whole year: RMB 69,900	0·5
(ii) IIT for each month: $[(20,000 - 2,000) \times 20\% - 375] = \text{RMB } 3,225$	1
IIT for the bonus: Divide 120,000/12 = 10,000 to find the rate and deduction, i.e. 20% and 375 respectively. Thus, IIT for bonus: $[120,000 \times 20\% - 375] = \text{RMB } 23,625$	1·5
IIT for whole year: RMB 62,325	0·5
Option (ii) is the more tax efficient	0·5
	<u>6</u>
(b) Mr Chen – individual income tax (IIT) for 2008	
(1) IIT on selling two works: $230,000 \times (1 - 20\%) \times 20\% + 180,000 \times (1 - 20\%) \times 20\% = \text{RMB } 65,600$	1·5
(2) IIT on publishing the collection of paintings: $\text{USD } 40,000 \times 7 = 280,000 \times (1 - 20\%) \times 20\% \times (1 - 30\%) = \text{RMB } 31,360$	1·5
Tax of USD 6,000 (RMB 42,000) has been withheld and this can be used to offset the IIT payable in full, and the balance of RMB 10,640 can be carried forward for the next five years.	1
(3) IIT on interest income from a foreign bank: $\text{USD } 3,000 \times 7 = 21,000 \times 5\% = \text{RMB } 1,050$	1
Tax of USD 100 (RMB 700) has been withheld and this can be used to offset the IIT payable amount; only the balance of RMB 350 needs to be paid additionally.	1
(4) IIT on three lectures to the public Since the total income is RMB 2,400 for three lectures, this is on average, RMB 800 per lecture. Thus, by applying the formula: IIT = (each time – 800) x 20% – no IIT is payable.	1·5
Total IIT payable for 2008 = $[65,600 + 350] = \text{RMB } 65,950$.	0·5
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(c) The following are exempt fringe benefits for expatriates:	
– relocation and moving expenses, on both the commencement and termination of the assignment;	
– provision of housing/actual accommodation rental;	
– meals or reimbursement of meal costs;	
– cost of children’s education;	
– business trip expenses;	
– laundry;	
– language training in China; and	
– cost of ‘home leave’ to the extent of the travel cost between China and the expatriate’s country of residence, up to twice per year.	
1 mark each, maximum	<u>6</u>
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		Marks
3	(a) Company K – value added tax (VAT)	
	(1) Retail sales: $[10,000 \times 100 \times 17\%] = \text{RMB } 170,000$	0.5
	Sales to wholesalers: $[300,000 \times 100 \times 80\% \times 17\%] = \text{RMB } 4,080,000$	1.5
	(2) Deemed sales: $[(500 + 300) \times 100 \times 17\%] = \text{RMB } 13,600$	1
	(3) Scrap sales: $[30,000 \times 17\%] = \text{RMB } 5,100$	0.5
	(4) Used item: the selling price is greater than original cost, thus: $[20,000/1.04 \times 4\% \times 0.5] = \text{RMB } 385$	2
	(5) The unusual loss of raw materials is not VAT input deductible, thus, input VAT needs to be transferred out of: $[200,000 \times 17\%] = \text{RMB } 34,000$	1.5
	(6) VAT on sub-contracting work: $[100,000 \times 17\%] = \text{RMB } 17,000$	0.5
	(7) Purchased materials: $[20,000,000 \times 17\%] = \text{RMB } 3,400,000$	0.5
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	(b) Bowling centre	
	Where an enterprise runs several business lines with different business tax (BT) rates at the same time, the tax should be calculated using the applicable tax rate for each business line if there is clear bookkeeping for the separate business lines. If there is no separate bookkeeping, the whole business turnover of the entity is subject to the highest applicable BT tax rate among the business lines.	2
	In this case, the tax rates are 5% and 20% for bowling and electronic games activities respectively, if there is clear bookkeeping. If not, the sum of these two activities is subject to BT at 20%.	2
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	(c) Company M – value added tax (VAT)	
	(i) (1) Output VAT of domestic sales = $500,000 \times 17\% = 85,000$	0.5
	(2) Input VAT on imported materials = $(280,000 + 20,000) \times 17\% = 51,000$	1
	(3) Input VAT on domestic market = $350,000 \times 17\% = 59,500$	0.5
	(4) Input VAT on transportation cost = $20,000 \times 7\% = 1,400$	1
	(5) Non-deductible VAT re exported materials = $450,000 \times (17\% - 14\%) = 13,500$	1
	(6) VAT payable = $85,000 + 13,500 - 51,000 - 59,500 - 1,400 = (13,400)$ refund	1
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	(ii) Non-deductible VAT on exports = $(450,000 - 280,000) \times (17\% - 14\%) = 5,100$	1.5
	VAT on domestic transactions as for (i) above	0.5
	VAT payable = $85,000 + 5,100 - 59,500 - 1,400 = 29,200$	1
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4	(a) ‘Evasion of tax’ is defined as occurring where a tax payer fails to pay, or pays less than the amount of tax actually payable by means of forging, revising, concealing or destroying without authorisation an accounting book or supporting vouchers or by overstating expenses or understating income by filing fraudulent tax returns.	2
	(b) Company P	
	(i) Under recorded value added tax (VAT) and enterprise income tax (EIT)	
	(1) The cash discount is not tax allowable.	1
	Under-recorded VAT liability: $[100,000 \times 17\%] = \text{RMB } 17,000$	0.5
	Under-recorded EIT liability: $[100,000 \times 25\%] = \text{RMB } 25,000$	0.5
	(2) The cash sales should be recorded.	1
	Under-recorded VAT liability: $[2,000,000/(1 + 17\%) \times 17\%] = \text{RMB } 290,598$	1
	Under-recorded EIT liability: $[2,000,000/(1 + 17\%) \times 25\%] = \text{RMB } 427,350$	1
	(3) The raw materials have not been used for a production purpose.	1
	Thus, the related VAT input should be transferred out.	
	Over-recorded VAT input: $[300,000 \times 17\%] = \text{RMB } 51,000$	1
	Also the related cost of goods sold is overstated.	
	Under-recorded EIT liability: $[300,000 \times 25\%] = \text{RMB } 75,000$	1
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(ii) Potential fines and penalties

Total under recorded tax liability:

$[17,000 + 25,000 + 290,598 + 427,350 + 51,000 + 75,000] = \text{RMB } 885,948$

Percentage of unpaid taxes = $[885,948 / (885,948 + 500,000 + 600,000)] = 44.6\%$

0.5

In addition to pursuing the under recorded tax together with surcharge of daily 0.05% on the overdue tax arising from the non-payment or underpayment, the tax authority will impose a fine of from 50% (i.e. RMB 442,974 $(885,948 \times 50\%)$) to 500% (i.e. RMB 4,429,740) of the amount of the tax evaded.

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Since the tax evasion involves an amount of more than 30% of the total amount of tax payable and, moreover, involves an amount of more than RMB 100,000, a term of more than three years but less than seven years imprisonment may be imposed on the company's directors and a fine of 100% (i.e. RMB 885,948) but less than 500% (i.e. RMB 4,429,740) of the amount of tax evaded may be imposed on the company.

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5 (a) (1) If a taxpayer or a tax withholding agent fails to pay tax at the time required under the relevant tax laws, the tax authority will impose a surcharge of 0.05% of the overdue tax payment calculated daily from the date the first tax liability arose.

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(2) Where the taxpayer or tax withholding agent avoids or by other means does not cooperate with a tax inspection, the tax authority shall order the taxpayer and/or agent to rectify and/or impose a fine of below RMB 10,000 or between RMB 10,000 and RMB 50,000 depending on the seriousness of the case.

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(b) If, due to the fault of the taxpayer or a withholding agent, a taxpayer underpays the tax he should pay, the tax authority can pursue the underpayment with interest on the overdue tax (as in (a)(1) above) within a period of three years. For cases involving a cumulative tax underpayment over RMB 100,000, the period can be extended to five years; and for cases of tax evasion, deception, etc, there is no time limit for the pursuit.

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Also, if the tax underpayment has been acknowledged by the taxpayer or determined by the tax authorities, there is no time limit for the pursuit (Guoshuihan [2005] 813).

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(c) A taxpayer can only be required to submit his books and records, or other documents relating to a previous year, for detailed examination and inspection with the approval of the head of a tax bureau at county level or above.

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Further, the tax authority must provide the taxpayer with a detailed list of the documents retained and return the documents within three months.

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