Answers

Marks

1 (a) Company A

(i) (1) The salaries and bonuses paid to staff are fully allowable. ½
(2) The interest is only allowable to the extent of an equivalent loan from a commercial bank. 1
(3) Subject to the maximum amount of 0·5% of the sales/business income of the year, 60% of the amount of the entertaining expense shall be deductible. 1
(4) A penalty for late tax payment is not tax allowable (but it is allowable for accounting purposes). 1
(5) Payment of EIT is not an expense for either accounting or tax purposes. 1
(6) The union expenses are fully allowable as they do not exceed 2% of total salaries and wages (2% of RMB10,000,000 = 200,000). 1½
(7) Approved donations are deductible up to 12% of the accounting profits. 1
(8) A direct donation to a non-approved entity is not tax allowable. 1
(9) Amortisation of approved self-developed intangible assets enjoys an additional deduction of 50% of the expenses for tax purposes. 1

9

(ii) Accounting profits
(1) The under-recorded profit arising from the omission of sales is:
10,000/(1 + 17%) – 1,000 x (1 – 7%) = 8,547 – 930 = 7,617 2
(2) The under-recorded profit arising from omission of the donation receipt is:
100,000 + 17,000 = 117,000 1½

The correct accounting profits =15,100,000 + 7,617 + 117,000 + 200,000 (EIT payment) = 15,424,617 1½

5

(iii) Enterprise income tax (EIT) computation

	RMB	RMB	Marks
Accounting profit (from (ii))		15,424,617	
Add:			
Interest over limit (100,000 x (5 – 4)/5)	20,000		½
Non-allowable entertainment (working)	1,000,000		1
Tax penalty	20,000		½
EIT payment (already adjusted in the accounting profit)	0		½
Charity donation over the limit (2,000,000 – 12% x 15,424,617)	149,046		1
Non-allowable donation	200,000		½
	1,389,046		
Less:			
Additional deduction for research expenses (50% x 50,000)	(25,000)		½
Total adjustment		1,364,046	
Adjusted taxable profit		16,788,663	
Tax rate		25%	½
Tax payable		4,197,166	
Tax credit for energy-saving equipment (10% x 1,170,000)		(117,000)	1
Final tax payable		4,080,166	6

Working:
Non-allowable entertainment expense:
The allowable amount is the lesser of: 0·5% of RMB 100,000,000 = 500,000
and 60% of RMB 1,500,000 = 900,000
Thus the disallowed amount is 1,500,000 – 500,000 = 1,000,000

(Examiner note: For a more accurate answer, the turnover can be RMB 100,007,617 after the consideration of Q1(a) (ii). However a student can get full marks if an answer can be approximately given as above.)

(iv) Company A should, within 15 days after the end of each quarter, file an EIT return with, and make the tax payment to, the tax authority. 1

If Company A has difficulty in determining the actual profit for each quarter, it may settle the pre-payment based on the average quarters profit of the previous tax year or such other method as determined by the tax authority. Once confirmed, the method shall not be arbitrarily altered during that tax year. 2

3

Marks

(v) Foreign currency income must be converted into RMB using the middle exchange rate on the last day of each quarter. 1

When Company A performs its annual EIT reconciliation after the year end, any income on which EIT has not been paid shall be converted into RMB using the middle exchange rate on the last day of the year. 1

If, after examination by the tax authority, Company A has under-reported or over-reported income, it shall convert the under-reported or over-reported income using the middle exchange rate on the last day of the month after which the examination is completed. 1

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(b) Company B

(i) The general provision is not tax allowable and RMB3,000, RMB6,000 and RMB3,000 should be added back to the accounting profit of years 1, 2 and 3 respectively. $1\frac{1}{2}$

(ii) The actual returns of RMB1,000 and RMB7,000 will be allowable as the losses are incurred in the course of business. $1\frac{1}{2}$

(iii) Given that the provision of RMB3,000 was added back in calculating the taxable profit in year 1, the over-provision RMB2,000 should not be treated as taxable income in year 2. 1

Given that the provision of RMB6,000 was added back in calculating the taxable profit in year 2, the under-provision of RMB1,000 should be treated as taxable income in year 3. 1

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(c) Company C

The branch should submit an application to the local tax authority within 30 days of obtaining a business licence, or from the commencement of the tax payment obligation, whichever is earlier, at the place of business operation. $1\frac{1}{2}$

The tax authority may impose a fine up to RMB2,000. If the case is serious, the tax authority may impose a fine greater than RMB2,000 but not more than RMB10,000. $1\frac{1}{2}$

Also the branch will not be able to open a bank account until registration is complete as the bank must ask the company to show its tax registration certificate before a bank account is opened. 1

4

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2 (a) Mr Wang – individual income tax (IIT)

(1) The bonus is divided by 12 to determine the applicable tax rate and the fast deduction factor: 30,000/12 = 2,500 (the applicable tax rate is 15% with fast deduction factor 125 1
IIT on 2007 annual bonus = [(30,000 – 125)/(1 – 15%)] * 15% – 125 = 5,147 1

(2) IIT on the dividend from a listed company = 3,800 * 20% * 50% = 380 1

(3) Gross up the translation income = (3,300 – 800 * 20%)/(1 – 20%) = 3,925 1
IIT on the translation income = (3,925 – 800) * 20% = 625 $\frac{1}{2}$

(4) Interest income from Government bonds is exempt from IIT 1

(5) IIT on patent income = 90,000 * (1 – 20%) * 20% – 8,000 = 6,400 $1\frac{1}{2}$

(6) IIT on authorship (book) = 66,000 * (1 – 20%) * 20% * (1 – 30%) = 7,392 $1\frac{1}{2}$
IIT on authorship (newspaper) = (3,500 – 800) * 20% * (1 – 30%) = 378 $1\frac{1}{2}$

(7) Income from the sale of listed shares is temporarily exempted from IIT for individuals. 1

(8) IIT on proof reading = 27,500 * (1 – 20%) * 30% – 2,000 = 4,600 1

(9) Taxable income from property sale = (690,000 – 370,000) – (690,000 * 5%) – 7,000 = 278,500 $1\frac{1}{2}$
IIT on the profit from the property sale = 278,500 * 20% = 55,700 $\frac{1}{2}$

IIT for salary earned during January and February 2008 (2 months):
= [(9,000 – 1,600) * 20% – 375] * 2 = 2,210 $\frac{1}{2}$
IIT for salary earned during March to December 2008 (10 months):
= [(9,000 – 2,000) * 20% – 375] * 10 = 10,250 $\frac{1}{2}$

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Marks

(b) Mr Roberson

(i) A temporary resident will be exempt from individual income tax (IIT) if all of the following three conditions are met:

1. The income is paid by an employer who is not a China individual or entity.
2. The income is not borne by a permanent establishment of a foreign employer in China or a Chinese entity.
3. The individual stays in China for less than 90 days continuously or cumulatively in a tax year. 2

Therefore, to have his 20 days salary exempt from IIT Mr Roberson should make sure that all of his salary is paid and borne by his employer in the US. 1

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(ii) A chief representative is deemed to have a position in a permanent establishment of a foreign employer in China. Therefore, he is unlikely to satisfy condition 2 (as stated in (i)) and thus, his 20 days salary will be subject to IIT even if it is paid to him in the US. 2

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3 Company D – value added tax (VAT)

(1) The stock loss is an abnormal loss, which is not allowed for VAT purposes:
Input VAT transferred-out for stock value = (213,950 – 13,950) * 17% = 34,000 1
Input VAT transferred-out for freight = 13,950/(1 – 7%) * 7% = 1,050 1

(2) As the service is attached to the selling activity, the freight costs should be included in the total consideration:
VAT output = (269,100 + 7,605)/(1 + 17%) * 17% = 40,205 2

(3) The wood acquired from the timber mill for the canteen is not allowable:
VAT input transferred out = 480,000 * 13% * 20% = 12,480 2

(4) The stock shortage is an abnormal loss and is not allowable for VAT purposes:
VAT input transferred out = (47,600 + 16,000 * 7%) * 10% = 4,872 $1^1/_2$

(5) The sofas sold to the company's own staff and donated are deemed sales:
VAT output = (20 + 2) * 11,000/(1 + 17%) * 17% = 35,162 2

(6) Self-usage of furniture is a deemed sale using the comparable profits rate:
VAT output = 6 * 21,000 * (1 + 10%) * 17% = 23,562 2

(7) Sales recognition should be according to the terms of the contract:
VAT output = 300,000 * 17% = 51,000 $1^1/_2$

(8) For used fixed assets (non-automobiles, motorcycles and yachts) where the selling price is higher than the original cost, a half reduction in the 4% VAT rate is applied:
VAT output = 100,000/(1 + 4%) * 4%/2 = 1,923 2

(9) Furniture trade-in:
VAT output = (140,000 + 20,000) *17%/(1 + 17%) = 23,248 2

(10) VAT output for sales to wholesalers: 175·5/(1 + 17%) * 850 * 75% * 17% = 16,256 2
VAT output for other sales/deemed sales = 175·5/(1 + 17%) * (50 + 150) * 17% = 5,100 1

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4 (a) (i) 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 practices. 2

(ii) The existence of associated enterprises may be presumed where one enterprise has any one of the following relationships with another enterprise:

– direct or indirect control over the capital, operations, purchases and sales, etc of the other;
– direct or indirect common control by a third party; and
– any other relationships arising from mutual benefits. 3

(iii) Company E will need to make a transfer pricing adjustment so as to record the interest income at the commercial rate, i.e. RMB25,000 (500,000 at 5%) not RMB10,000 (500,000 at 2%). 2

Marks

Company F will have the amount of deductible interest restricted as the amount of the loan is greater than its registered capital plus 50%, i.e. RMB300,000. The amount deductible will thus be limited to RMB15,000 (300,000 at 5%). 2

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(b) Company G/Mr P

(i) In the case of independent personal services, income is taxed each time it is received at progressive rates from 20% to 40% after a deduction of RMB800 or 20% of the subject income whichever is the higher. $1^1/_2$

In the case of employment income, the income is taxed on a monthly basis at progressive rates from 5% to 45% after a RMB2,000 (for locals) or RMB4,800 (for foreigners) monthly allowance. $1^1/_2$

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(ii) Actions that Company G can take to increase the likelihood of Mr P being classed as an employee are:

– The contract signed between the two parties should state it is an employment contract.
– Company G should provide all the equipment for Mr P's performance of his duties.
– Mr P should be required to report/perform his duties at a regular place or at a regular time.
– Mr P should be covered by the social/staff benefits enjoyed by the other staff of Company G.

ANY 3 for 1 mark each, maximum 3

15

5 (a) (i) Mixed sales activities arise where a single sales transaction involves both taxable services that are subject to business tax and the sale of goods that are subject to value added tax (VAT). 1

For a taxpayer principally engaged in a production, wholesaling or retailing business, mixed sales activities are subject to VAT. For a taxpayer not engaged in such a business, mixed sales activities are subject to business tax. A taxpayer must have more that 50% of its annual sales value from its production, wholesaling or retailing business for it to be considered as 'principally'. 3

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(ii) (1) Company H is a retail business engaged in mixed sales activities, accordingly it will be subject to VAT at 17% on the total value of its sales. (Note, however, that the state tax bureau has the ultimate authority to determine whether it is taxed under business tax or VAT.) 1

(2) Although Company J provides a mixed sales activity it is not a production, wholesaling or retailing enterprise, therefore, the whole of the sales from the two activities will be subject to business tax. The rate is 3%. 1

2

(b) Company K

(i) Input VAT that needs to be transferred out if all transactions have been fully recorded:
(28,000 – 930) * 17% + 930/(1 – 7%) x 7% = 4,672 1
Input VAT for the month = 68,000 + 19,000 * 7% – 4,672 = 64,658 1

2

(ii) Input VAT that needs to be transferred out if there are no separate records:
(68,000 + 19,000 * 7%) * 150,000/(150,000 + 360,000) = 20,391 1
Input VAT for the month = 68,000 + 19,000 * 7% – 20,391 = 48,939 1

2

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