Answers

		Marks
1 (a)	Company K	
(i)	Treatment of items	
(1)	The bonus payable is not allowable until it is actually paid.	1
(2)	The deemed sales principle is not applied to self-used products for EIT purposes, so no adjustment is required.	1
(3)	The non-deductible input VAT is tax allowable.	1
(4)	The customs duty paid for the purpose of importing raw materials is tax allowable.	1
(5)	Allowable entertaining expenses cannot exceed 0·5% of the sales/business income of the year, i.e. RMB60,000,000 x 0·5% = RMB300,000; a maximum of 60% of the entertainment expenses, i.e. RMB200,000 x 60% = RMB120,000 is deductible. Thus, RMB120,000 is deductible and RMB80,000 (200,000 – 120,000) is non-deductible. Also any excess amount cannot be carried forward.	2
(6)	Allowable advertisement expenses cannot exceed 15% of the sales/business income of the year, i.e. RMB60,000,000 x 15% = RMB9,000,000, so the whole of the current year's expense is deductible. Also any excess amount carried forward is deductible up to the limit. Thus, RMB7,300,000 + RMB1,700,000 from 2008 is deductible and RMB300,000 (2,000,000 – 1,700,000) is carried forward.	2
(7)	Staff and workers' benefits cannot exceed 14% of the total salaries and wages but sponsorship is not deductible regardless of amount. Thus, (RMB2,000,000 – RMB200,000) x 14% = RMB252,000 is deductible and RMB248,000 (500,000 – 252,000) is non-deductible. Any excess amount cannot be carried forward.	2
(8)	Union expenses cannot exceed 2% of the total salaries and wages, i.e. (RMB2,000,000 – RMB200,000) x 2% = RMB36,000. Thus, RMB64,000 (100,000 – 36,000) is non-deductible. Any excess amount cannot be carried forward.	2
(9)	Staff and workers' education expenses cannot exceed 2·5% of total salaries and wages, i.e. (RMB2,000,000 – RMB200,000) x 2·5% = RMB45,000, so the whole of the current year's expense is deductible. Also, any excess amount carried forward is deductible up to the limit. Thus, RMB30,000 + RMB15,000 from 2008 is deductible and RMB75,000 (90,000 – 15,000) is carried forward.	2
(10)	The interest should be capitalised as part of the cost of the office building on its completion.	1
(11)	The net loss on the stock, including the non-deductible input VAT should be tax allowable. The non-deductible input VAT is RMB850,000 x 17% + (RMB150,000/(1 – 7%)) x 7% = RMB155,790.	3
(12)	The writing off of a liability is taxable.	1
(13)	Interest income on a national debenture is exempt.	1
		20

Marks

(ii) Enterprise income tax computation for the year 2009

	RMB	RMB	Marks
Taxable profit before adjustment		16,600,000	0·5
Add:			
(1) Bonus payable	200,000		0·5
(5) Entertainment	80,000		0·5
(7) Staff benefit	248,000		0·5
(8) Union expenses	64,000		0·5
(10) Interest capitalised	200,000		0·5
		792,000	
Less:			
(6) Advertisement expenses	1,700,000		0·5
(9) Staff and workers' education expenses	15,000		0·5
(11) Non-deductible input VAT	155,790		0·5
(13) Interest on national debenture	300,000		0·5
		(2,170,790)	
Adjusted taxable profit		15,221,120	
			5

(iii) EIT payable

As Company K started operation in 2006, it will have enjoyed its first year of preference policy in 2006, so 2009 will be its second year of half rate. 1
The transitional rate applicable to 2009 is 20%; thus Company K will pay tax at 10%, and 1
the tax payable will be: RMB15,221,120 x 10% = RMB1,522,112. 1

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(b) The revenue base used for the calculation of allowable advertising expenses should include the business/sales income and other income of the enterprise, but not include its non-operation income/investment income, etc. 1

The three conditions are that (i) the advertisement must be produced by the media approved by the Commercial and Industrial Bureau; (ii) the advertisement must be conducted through the media; and (iii) the expense must be paid and a legitimate invoice obtained. 2

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(c) Company X

The taxable income arising from the donation is RMB200,000 + RMB34,000 = RMB234,000 1
The cost of the sales is RMB200,000 + RMB20,000 + (RMB6,000 x (1 – 7%)) = RMB225,580 1
The sales revenue is RMB500,000/(1·17) = RMB427,350 0·5
The taxable income arising from the sales is RMB427,350 – RMB225,580 = RMB201,770 0·5
So, the EIT payable is (RMB201,770 + RMB234,000) x 25% = RMB108,943. 1

4

35

2 Mr Duan

(1) IIT in relation to the monthly salary:
RMB [(22,000 – 2,000) x 25% – 1,375] x 11 = RMB39,875 1
The RMB20,000 of salary donated to an approved charity in September is exempt from IIT. 1

IIT on the annual bonus:
The applicable IIT rate for the annual bonus is 15% (40,000/12 = 3,333·33)
RMB (40,000 x 15% – 125) = RMB5,875 1

(2) IIT in relation to the income from the provision of technical services:
IIT was paid by the enterprise, therefore if the tax paid equals 't':
(25,000 + t) x (1 – 20%) x 30% – 2,000 = t
Solving the equation the tax payable (t) equals RMB5,263 2

Marks

(3) IIT in relation to the publication of the novel and its serialisation:
RMB [(50,000 + 20,000) x (1 – 20%) x 20% x (1 – 30%) + 3,600 x 3 x (1 – 20%) x 20% x (1 – 30%)]
= RMB7,840 + RMB1,210 = RMB9,050 — 2

(4) IIT in relation to the income from the partnership:
RMB (135,000/3 x 30% – 4,250) = RMB9,250 — 1

(5) IIT on the dividend income from a listed company:
RMB25,000 x 50% x 20% = RMB2,500 — 1

(6) IIT on the sale of the debenture:
RMB (65,000 – 50,000 – 800 – 600) x 20% = RMB2,720 — 1

(7) Additional IIT required on the overseas income:
- For the professional article in Country A:
  IIT = (Euro 350 x 9·5 – 800) x 20% x (1 – 30%) = RMB354 — 1
  So, IIT of RMB104 (354 – 250) needs be paid in China — 0·5
- For the transfer of the patent in Country B:
  IIT = (Euro 8,000 x 9·5 x (1 – 20%)) x 20% = RMB12,160 — 1
  So, no further IIT need be paid in China since the tax paid in Country B of RMB12,500 exceeded this amount. — 0·5

Tutorial note: the excess of RMB340 (12,500 – 12,160) can be utilised as an IIT deduction for any taxable income from Country B in the coming five years.

(8) IIT in relation to acting as a translator:
RMB (3,500 – 800) x 20% = RMB540 — 1

(9) IIT in relation to giving lectures in Country C:
$2,000 x 7 x (1 – 20%) x 20% = RMB2,240 — 1
So, IIT of RMB140 (2,240 – 2,100) needs to be paid in China — 0·5

(10) IIT in relation to the rental income:
- Rental for November = RMB 5,000 x (1 – 3 % – 4%) x (1 – 20%) x 10% = RMB372 — 1
- Rental for December = RMB [5,000 x (1 – 3 % – 4%) – 600] x (1 – 20%) x 10% = RMB324 — 1

(11) Bank interest income is exempt from IIT. — 1
Interest income from a national debenture is exempt from IIT. — 0·5

(12) Income from selling an ‘A share’ is exempt from IIT. — 1

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3 (a) Company G

1. VAT payable = RMB100,000/(1 + 4%) x 4% x 50% = RMB1,923 — 1
2. VAT payable = RMB100,000/(1 + 17%) x 17% = RMB14,530 — 1
3. VAT payable = RMB100,000/(1 + 4%) x 4% x 50% = RMB1,923 — 1

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(b) Supermarket

(i) Sold on consignment without profit margin transactions between a commercial company and its suppliers will be subject to tax as follows:

(1) If the income received by the commercial company from the supplier is linked to the sales volume/quantity, etc, the income will be subject to value added tax (VAT) and the input VAT on the sales should be reduced by the amount of income x the VAT tax rate. — 2

(2) If the income received by the commercial company from the supplier is not linked to the sales volume/quantity, etc, the income will be subject to business tax (BT) — 1

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(ii) Regarding the sale of electronic goods:
Output VAT: RMB200,000/(1 + 17%) x 17% = RMB29,060 — 1
Input VAT: RMB200,000/(1 + 17%) x 17% – RMB20,000/(1 + 17%) x 17% = RMB26,154 — 1·5
So, the VAT payable is RMB29,060 – RMB26,154 = RMB2,906 — 0·5

	Marks
Regarding the entrance fee: BT payable: RMB100,000 x 5% = RMB5,000.	1
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(c) Company T

		Marks
(1)	As the raw materials are provided by the customer, it is subcontracting work and will be taxed at 17%. Output VAT: RMB100,000 x 17% + RMB20,000 x 17% = RMB20,400	2
(2)	As the raw materials are self-purchased and the final product is a book, it will be taxed at 13%. Output VAT: RMB150,000 x 13% = RMB19,500	2
(3)	No VAT input implications, as the input tax for the car is not creditable.	1
(4)	Input VAT: RMB30,000 x 17% = RMB5,100.	1
(5)	Output VAT: RMB400,000 x 17% = RMB68,000.	1
(6)	Output VAT: RMB4,000 x 17% = RMB680.	1
(7)	Input VAT: RMB1,000 x 7% = RMB70	1
(8)	Non-deductible VAT: RMB20,000 x 17% = RMB3,400.	1
		10
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4 Company B

(a) Under-recorded value added tax (VAT) and enterprise income tax (EIT)

		Marks
(1)	The overstated expenses are not tax allowable: Under-recorded EIT liability: RMB90,000 x 25% = RMB22,500	1
(2)	The cash sales should have been recorded: Under-recorded EIT liability: RMB1,000,000/(1 + 17%) x 25% = RMB213,675	1
	Under-recorded VAT liability: RMB1,000,000/(1 + 17%) x 17% = RMB145,299	1
(3)	The raw materials have been used for a non-production purpose: The related VAT input needs to be transferred out. Over-recorded VAT input: RMB300,000 x 17% = RMB51,000	1·5
	Also, the related cost of goods sold is overstated. Under-recorded EIT liability: RMB300,000 x 25% = RMB75,000	1
(4)	The donation of goods to an approved charity should be treated as a deemed sale: Under-recorded VAT liability: RMB2,200,000 x 17% = RMB374,000	1
	Under-recorded EIT liability: RMB2,200,000 x 25% = RMB550,000	1
	It is also necessary to ensure that the cost of the donation (including VAT) of RMB2,574,000 (2,200,000 + 374,000) is still within the limit of 12% of the accounting profits. Revised accounting profits: RMB (30,000,000 + 90,000 + 1,000,000/(1 + 17%)) = RMB30,944,701 x 12% = RMB3,713,364. Therefore the whole amount is deductible.	1·5
	Also, the EIT under-recorded will be reduced as a result of the additional donations deduction available by: RMB (2,574,000 – 1,800,000) x 25% = RMB193,500	1
		10

(b) Potential fines and penalties

	Marks
Total under-recorded tax liability: RMB (22,500 + 213,675 + 145,299 + 51,000 + 75,000 + 374,000 + 550,000 – 193,500) = RMB1,237,974	0·5
Percentage of unpaid taxes: 1,237,974/(1,000,000 + 1,600,000 + 1,237,974) = 32·3%	0·5
In addition to pursuing the under-recorded tax together with a daily surcharge of 0·05% of the overdue tax	1
arising from the underpayment, the tax authority will impose a fine for late payment of from 50% (i.e. RMB618,987) to 500% (i.e. RMB6,189,870)	1

	Marks
Since the tax underpayment involves an amount of more than RMB100,000 and more than 30% of the total amount of tax payable, 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 from 100% (i.e .RMB1,237,974) to 500%	1
(i.e. RMB6,189,870) of the amount of tax evaded may be imposed on the company.	1
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5 **(a)** There are three methods of determining the taxable income of a representative office:

1. Actual income basis
   This basis applies to any representative office that is able to provide information on both income and related expenses, e.g. sales and purchase contracts, and to support its operating expenses so as to determine the taxable profits. It also applies to offices engaging in consultancy services. 2
2. Actual income deemed profit basis
   This basis applies to any representative office that can provide information on its income, e.g. service contracts, but not accurate information on its expenses. The tax bureau may determine the profits ratio for tax purpose according to the average profits ratio in the industry. 2
3. Cost plus basis
   This basis applies to any representative office that can provide information on its expenses but not on its income. The tax authority may determine the taxable profits by calculating income in terms of the expenses plus a reasonable level of profits. The currently used reasonable profits ratio is 10%. 2

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(b) The deemed income of the representative office will be:

RMB1,000,000/(1 – 10% – 5%) = RMB1,176,471	1
Business tax (BT) payable: RMB1,176,471 x 5% = RMB58,824	1
Taxable income: RMB1,176,471 x 10% = RMB117,647	1
Enterprise income tax (EIT) payable: RMB117,647 x 25% = RMB29,412	1
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