Answers

1 Report

To: The management of Nova Company Limited
From: Tax Advisers
Date: 2 June 2008

Subject: Customs duty and value added tax (VAT) implications of Newco's export business

As instructed this report sets out the customs duty and VAT costs which would be incurred under the three business models being considered.

(a) The VAT export refund rate for Product X is 13%

(1) Contract manufacturing

As all the finished products will be shipped out of China to the foreign consignor, the raw materials sourced outside China by the consignor can be imported by Newco into China free of Chinese import duty and import (VAT) (i.e. they may be bonded).

Further, under contract manufacturing, the processing fee income of Newco (the Processor) can be exempted from 17% output VAT. However, the input VAT incurred by Newco on local purchases (e.g. local raw materials, utilities) cannot be recovered nor refunded, thus this will become a real cost to Newco and should be charged to its cost of goods sold (COGS).

Non-recoverable VAT = the input VAT incurred by Newco on local purchases (e.g. local raw materials, utilities): i.e. (RMB 100 + RMB 100) x 17%= RMB 34

(2) Import manufacturing

Customs import duty and import VAT on imported raw materials can be exempted, provided that all the processed finished goods are re-exported. As Newco will export all of Product X this exemption will apply.

Newco's export sales income can be exempt from output VAT, and it can also receive from the Chinese tax authority a refund of the input VAT incurred on local purchases (e.g. local raw materials, utilities). However, only if the refund rate is 17%, will all of the VAT incurred on the local purchases be refunded. As the refund rate is lower than 17%, part of the VAT incurred on the local purchases cannot be refunded, hence 'non-refundable VAT' which is a real cost to the export manufacturer will arise. Therefore, non-refundable VAT calculated using the following formula should be charged to the 'cost of goods sold' (COGS) of Newco.

Non-refundable VAT = (FOB value of the exported product – the value of import bonded raw materials) x (17% – the applicable VAT refund rate for the exported product):
i.e. (RMB 2,000 – RMB 1,000) x (17% – 13%) = RMB 40

(3) Non-bonded export trade

Neither the customs import duty nor the 17% import VAT can be exempted on the imported raw materials.

As in (2) above, Newco's export sales income can be exempt from output VAT, and it can also receive a refund of the input VAT incurred on the purchase of local raw materials. However, again as the refund rate is lower than 17%, non-refundable VAT will arise, resulting in a real cost to Newco.

Non-refundable VAT = FOB value of the exported product x (17% – the applicable VAT refund rate for the exported product):
i.e. RMB 2,000 x (17% – 13%) = RMB 80

There is no provision for a refund on the import duty on importation and the whole amount of this becomes a cost to the manufacturer.

Non-refundable import duty = Duty rate x value of imported raw materials:
i.e. 10% x RMB 1,000 = RMB 100

Conclusion

Based on the above, the first business model, contract manufacturing, incurs the least amount of non-refundable VAT and Chinese import duty as such this should be the preferred business model for Newco to carry out the intended export business.

(b) The VAT export refund rate for Newco's Product X drops to 0%

(1) Contract manufacturing

There will be no impact on the bonded tolling arrangement if the VAT export refund rate drops to 0%. The non-recoverable VAT is therefore the same as that in (a) (1) above, i.e. RMB 34.

(2) Import manufacturing

If the refund rate drops to 0%, Newco cannot receive any refund of the input VAT incurred on local purchases of raw materials and utilities from the Chinese tax authority.

Further, the export sales will be deemed as 'domestic sales' upon which a 17% output VAT will be charged. Input VAT incurred by Newco in purchasing relevant raw materials and utilities would however be creditable against this deemed output VAT.

Output VAT = FOB selling price/(1 + VAT rate) x VAT rate:
i.e. [RMB 2,000/(1 + 17%)] x 17% = RMB 291

Input VAT cost = Local purchases x 17%:
i.e. (RMB 100 + RMB 100) x 17% = RMB 34

Total VAT payable = RMB 291 – RMB 34 = RMB 257

However, if part of the raw materials are bonded import materials, then output VAT will only be charged at 6% but the input VAT incurred on local purchases will not be creditable/refundable.

In Newco's case, as it can continue to carry out import manufacturing after the VAT refund rate drops to 0%, the actual VAT cost will be the 6% output VAT plus the 17% input VAT incurred on local purchases.

Output VAT cost = [FOB selling price/(1 + 6%)] x 6%:
i.e. [RMB 2,000/(1 + 6%)] x 6% = RMB 113

Input VAT cost (as calculated above) = RMB 34

Total VAT cost = RMB 113 + RMB 34 = RMB 147

(3) Non-bonded export trade
If the refund rate drops to 0%, Newco cannot receive any refund of the input VAT incurred on local purchases of raw materials and utilities, and the export sales will be deemed as 'domestic sales' upon which a 17% output VAT will be charged, with the input VAT incurred by Newco in purchasing relevant raw material and utilities creditable against that deemed output VAT. Thus, as previously calculated, the VAT payable will be RMB 257.

In addition, as in (a) above, non-refundable import duty of RMB 100 will be incurred by Newco.

Conclusion
Through the above comparison, if the VAT refund rate drops to 0%, contract manufacturing will still result in the least non-refundable VAT and Chinese import duty and is, thus, confirmed as the preferred business model for Newco.

2 Company X and Company Y

(a) (i) Tax preferential period
Under Guoshuifa (1997) No.71, if the business activities of the enterprise after the merger still comply with the requirement stated in the relevant laws and regulations, the post-merger enterprise will inherit the pre-merger tax preferential treatment. The detailed tax treatments are as follows:

– If the tax holiday for the pre-merger enterprises has already expired, the post-merger enterprise cannot re-enjoy the tax holiday.
– If the tax holiday for the pre-merger enterprises has not expired and the term of the tax holiday remaining is the same for each pre-merger enterprise, the post-merger enterprise will inherit the rest of the tax holiday until it expires.
– If the terms of the tax holiday of the pre-merger enterprises are different or one of the pre-merger enterprises is not entitled to a tax holiday, the post-merger enterprise must separately account for the income or loss generated by the respective businesses before the merger and calculate its taxable income or loss under the terms applicable to the respective enterprises before the merger. In the case of businesses with different remaining terms of tax preferential treatment, the related taxable incomes are entitled to the respective remaining tax holidays. In the case of a business without any tax holiday, the related taxable income is not entitled to any tax preferential treatment.

(ii) Pre-merger accumulated losses
According to Guoshuifa (1997) No.71, the unutilised tax losses of pre-merger enterprises can be carried forward to offset against the taxable profits of the post-merger enterprise within the remaining years of the five-year period stipulated by tax law. If the post-merger enterprise has separate manufacturing operations which are subject to different FEIT rates or these operations have different tax positions in respect of the tax holiday, the income of the respective operations should be separately accounted for and the accumulated tax loss used to offset against the profit of the entities with reference to Articles 91, 92 and 93 of the Implementation Rules and Regulations of the PRC Foreign Investment Enterprise and Foreign Enterprise Income Tax Law.

(b) According to Guoshuifa (1997) No.71, the post-merger enterprise and its branches should determine the applicable local or industrial reduced tax rates in accordance with their respective manufacturing operations and separately account for the respective taxable income.

Year 2001
As the Head Office and Branch Y continued to carry out the same businesses as before the merger, their post-merger statutory income tax rates would remain unchanged, i.e. 15% and 30% respectively. However, since the Head Office will inherit the rest of the tax holiday of Company X, year 2001 would be the fourth year of the five-year tax holiday and thus the applicable

income tax rate should be 7·5% i.e. 50% of the statutory income tax rate. As Branch Y is not entitled to any tax preferential treatment, its applicable income tax rate is 30%.

Year 2002
Same as year 2001, the applicable income tax rate for the Head Office should be 7·5% as this is the fifth year of its five-year tax holiday. The applicable income tax rate for Branch Y is 30%.

Year 2003
As the five-year tax holiday for the Head Office expires in the year 2003, a 15% income tax rate would be applied to the Head Office. The applicable income tax rate for Branch Y is still 30%.

(c) According to Articles 91 and 92 of the Implementation Rules for the Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises, where the enterprise files its foreign enterprise income tax (FEIT) return on a consolidated basis, and different tax rates apply to the related branches, each branch's taxable income should be calculated separately.

After the offsetting of the losses against the profits for each branch, FEIT shall be paid on the remaining profits based on the FEIT rate applicable to the profit-making branch. A branch that has incurred losses shall offset those losses using profits of the subsequent year and FEIT shall be paid on the profit remaining after the offsetting of such losses based on the branch's applicable FEIT rate. Further, FEIT shall be paid on the offsetting amounts based on the FEIT rate applicable to the branch that offsets the losses incurred by another branch.

If the terms of the tax holiday or the applicable income tax rates for the pre-merger enterprises are different, the merged enterprise must separately account for the income or loss generated by the respective businesses before the merger and calculate its taxable income or loss under the terms applicable to the respective enterprises before the merger. The apportionment methods for taxable income are as follows:

– If the post-merger enterprise establishes respective branches to inherit pre-merger business activities, and the post-merger enterprise can maintain separate account books to accurately calculate the taxable income of each branch, the taxable income for each branch will be computed based on its actual taxable income.
– If the post-merger enterprise has not established respective branches or is unable to calculate separately the taxable income of the respective businesses before the merger, it may apportion its total taxable income between the businesses using appropriate ratio(s), i.e. business revenue ratio, cost and expense ratio, asset ratio, employee ratio or salary ratio, etc.

(d) The taxable income and tax payable by Company X, the post-merger enterprise for each of the three years 2001, 2002 and 2003 is as follows:

Year 2001
The brought-forward losses incurred in 1998 and 1999 from the business undertaken by the pre-merger Company Y will be offset against the profit of RMB 5,000,000 generated from the pre-merger Company X's business in 2001, the first year after the merger.

The taxable income for the post-merger enterprise is nil and thus the tax payable is zero.

Taxable income = RMB 5,000,000 – (RMB 2,000,000 + RMB 3,000,000) = 0

Year 2002
The brought-forward loss of RMB 4,000,000 incurred in 2000 by the pre-merger Company Y as well as RMB 2,000,000 (out of RMB 3,000,000) of the 2001 loss from the business undertaken by Branch Y will be offset against the profit of RMB 6,000,000 generated from the pre-merger Company X's business.

The taxable income for the post-merger enterprise is again nil and thus the tax payable is zero.

Taxable income = RMB 6,000,000 – (RMB 4,000,000 + RMB 2,000,000) = 0

Year 2003
The unutilised losses of RMB 1,000,000 and the loss of RMB 1,000,000 suffered from the business undertaken by Branch Y in the years 2001 and 2002 respectively will be offset against the profit of RMB 16,000,000 generated from the business undertaken by Branch Y.

The taxable income of the merged entity is thus:

Taxable income = RMB 4,000,000 + RMB 16,000,000 – (RMB 1,000,000 + RMB 1,000,000) = RMB 18,000,000

In addition, the effect of the losses of RMB 11,000,000 used to relieve the Head Office's income in 2001 and 2002 is reversed in 2003 and the previous brought-forward losses offset against Branch Y's income.

Tax payable = (RMB 4,000,000 x 15% + RMB 5,000,000 x 7·5% + RMB 6,000,000 x 7·5%) + (RMB 16,000,000 – RMB 13,000,000) x 30% = RMB 2,325,000

Tutorial note:
The consolidated effect of the above is summarised in the table below:

	Head Office			Branch Y			Tax payable combined
	Profit/(loss)	Tax rate	Tax payable	Profit/(loss)	Tax rate	Tax payable	
Year 2001	5,000,000			(3,000,000)			
Y's loss – 1998	(2,000,000)						
Y's loss – 1999	(3,000,000)						
Taxable income	–			(3,000,000)			
Tax payable	–			–			–
Year 2002	6,000,000			(1,000,000)			
Y's loss – 2000	(4,000,000)						
Part of Y's loss – 2001	(2,000,000)						
Taxable income	–			(1,000,000)			
Tax payable	–			–			–
Year 2003	4,000,000			16,000,000			
Part of Y's loss – 2001				(1,000,000)			
Y's loss – 2002				(1,000,000)			
	4,000,000	15%	600,000	14,000,000			
Loss claw back (98–99)	5,000,000	7·5%	375,000	(5,000,000)			
Loss claw back (00–01)	6,000,000	7·5%	450,000	(6,000,000)			
				3,000,000	30%	900,000	
Total tax payable			1,425,000			900,000	2,325,000

3 Company A

(a) The tax implications related to the sale of the office building

Business tax (BT)
According to the BT regulations, the sale of immovable properties in the PRC should be subject to 5% BT. BT is generally determined by multiplying the gross turnover by the applicable tax rate (i.e. 5%). However, as per Caishui (2003) No.16, where an entity or individual sells or transfers a purchased immovable property, the balance after the purchase price or original transfer price of the immovable property is subtracted from the income that shall be regarded as the turnover. As the proposed selling price of RMB 200 million for Company A's office building is less than the original purchase price of RMB 252 million, the sale of the office building will not be liable to BT.

Stamp duty (SD)
According to the SD regulations, 0·05% SD will be imposed on a transfer of property. The SD liability of Company A is, thus, RMB 100,000 (i.e. RMB 200 million x 0·05%).

Land appreciation tax (LAT)
According to the tax regulations, LAT applies to the sale or transfer of land-use rights, buildings and their attached facilities in the PRC. LAT is payable on the added value gained by the taxpayer through the assignment of real estate.

In Company A's case, the LAT payable due to the transfer of the office building will be calculated as follows:

Total amount of deductible items = Evaluation value x depreciation discount rate + SD paid + evaluation fee paid:
RMB 200 million x 60% + RMB 100,000 + RMB 50,000 = RMB 132·15 million

The land appreciation value = Selling price – total amount of deductible items:
RMB 200 million – RMB 132·15 million = RMB 67·85 million

The appreciation ratio = RMB 67·85 million/RMB 132·15 million = 51%

LAT payable = (RMB 132·15 x 50%) x 30% + (RMB 67·85 – RMB 66) x 40% = RMB 20·54 million

or alternatively, using the quick reckoning method:
(RMB 67·85 million x 40% – RMB 132·15 million x 5%)

(b) Tax implications related to the capital investment of the office building

Business tax (BT)
According to Caishui (2002) No.191, where an enterprise becomes a shareholder in a company by means of investing immovable assets, the investment of immovable assets is exempt from BT if the enterprise is subject to the operating risks of the company.

As such, the capital investment of the office building by Company A would not be liable to BT.

Land appreciation tax (LAT)
According to Caishui (1995) No.48, if real estate is used as an investment, then a temporary exemption from LAT will apply for the period the real estate is assigned to the investment enterprise.

However, if the investment enterprise reassigns that real estate, LAT will be levied accordingly.

Foreign enterprise income tax (FEIT)
According to Caishuizi (1994) No.83, if a foreign investment enterprise (FIE) injects land or a building into another enterprise as a capital investment, the excess of the appraisal value of the land or building over and above the net book value of the land or building should be regarding as a capital gain and taxable for FEIT purposes.

In Company A's case, the appraisal value of the office building is RMB 200 million while the net book value of the office building is RMB 102 million. The excess amount of RMB 98 million should be treated as capital gains and subject to FEIT.

4 Company C

(a) The normal income tax rate which is applicable across the board is 33%. However, as Company C is located in the GETDD which is approved by the State Council, the applicable income tax rate is reduced from 33% to 15% in accordance with Article 7 of the FEIT Law, provided that the Company carries out manufacturing activities.

In addition, provided that Company C carries out manufacturing activities, it is also eligible for the five-year tax holiday in accordance with Article 8 of the FEIT Law. The tax holiday consists of a two-year exemption followed by a three-year 50% reduction, starting from the company's first profit-making year (after utilising any tax losses brought forward).

(b) **Years 2000 and 2001:**
According to the tax circular Guoshuifa (1995) No.140, the interest income earned in 2000 and 2001 is not treated as 'production revenue', thus it is not eligible for the tax holiday and will be subject to income tax at 33%. However, such income earned during the pre-operating period will not trigger the tax holiday.

Year 2000: RMB 300,000 x 33% = RMB 99,000
Year 2001: RMB 400,000 x 33% = RMB 132,000

Year 2002:
This is the first profit-making year for Company C. However, as the revenue derived from the trading activities is not treated as 'production revenue', the Company's 'production revenue' earned in year 2002 did not exceed 50% of the annual total revenue. Therefore, according to Article 2.1 of Guoshuifa (1994) No.209, Company C is not eligible for the tax holiday on the profits earned in year 2002.

Also, according to Article 2.2 of the Tax Circular No.209, Company C is not eligible for the reduction in tax rate because its 'production revenue' does not exceed the 50% threshold, thus the 33% tax rate applies.

Year 2002: RMB 3,000,000 x 33% = RMB 990,000

Year 2003:
As the company's 'production revenue' earned in 2003 exceeded 50% of the annual total revenue, it is eligible for the remaining tax holiday. As 2003 is the second year of the two-year exemption, a 0% tax rate applies.

Year 2004:
As the company's 'production revenue' earned in 2004 exceeded 50% of the annual total revenue, it is eligible for the tax holiday. As 2004 is the third year that Company C is in profit, the 7·5% tax rate applies (i.e. the first year of the three-year 50% reduction).

Year 2004: RMB 5,000,000 x 7·5% = RMB 375,000

Year 2005:
As the company's 'production revenue' earned in 2005 did not exceed 50% of the annual total revenue, it is not eligible for the tax holiday.

On the other hand, according to Article 2.2 of Tax Circular No.209, when Company C exceeded the 50% threshold for the first time in 2003, the applicable statutory income tax rate was reduced from 33% to 15% and Company C can enjoy this 15% low tax rate starting from 2003. As such, the applicable tax rate for 2005 is 15%.

Year 2005: RMB 6,000,000 x 15% = RMB 900,000

Year 2006:
As the company's 'production revenue' earned in 2006 exceeded 50% of the annual total revenue, it is eligible for the tax holiday. As 2006 is the fifth year that Company C is in profit, the 7·5% tax rate applies (i.e. the third year of the three-year 50% reduction).

Year 2006: RMB 7,000,000 x 7·5% = RMB 525,000

5 Mr Chan

(a) (i) According to Guoshuifa (1994) No.89, the income derived from a director's fee gained by an individual for assuming the post as a director is essentially income belonging to labour service remuneration. As such, Mr Chan's director's fee is subject to individual income tax under the taxable item of 'income from individual services'.

(ii) If a director performs the dual roles of director and manager in charge of the day-to-day operations of an enterprise, his or her director's fee shall be taxed as 'income from individual services' while his or her income as a manager shall be taxed as 'employment income'.

However, according to Guoshuifa (1996) No.214, if the director assumes direct management responsibilities simultaneously but only receives income in the name of director's fees or dividends and does not receive remuneration specifically for his or her role in management, the taxpayer must apportion his or her income into two parts, i.e. director's fee and salary. Individual income tax will then be levied respectively on the two different taxable items.

If the taxpayer does not allocate his or her income reasonably between his or her director and management duties, the tax authorities may assess the amount of his or her monthly salary attributable to his or her management duties. When assessing the taxpayer's employment income, the tax authorities may refer to the salary standards for comparable duties in comparable localities, industries and enterprises.

(b) (i) Benefits derived by employees from stock options are regarded as income related to employment and are subject to individual income tax.

According to Caishui (2005) No.35, when an employee is granted stock options by an enterprise, the employee will not trigger individual income tax at the time of grant. When an employee exercises stock options, if the exercise price is lower than the fair market price on the day of purchase (closing price on the stock of the day), the difference is treated as employment related compensation and should be classified as 'salary and compensation' for IIT purposes.

The salary income relating to the exercising of stock options should be calculated separately from the monthly salary.

Mr Chan's IIT payable on exercising the stock options on 1 January 2008 is as follows:

Taxable stock option income = (USD 25 – USD 10) x 5,000 shares x RMB 7·3 = RMB 547,500

Taxable income spread over 12 months = RMB 547,500/12 months = RMB 45,625

Monthly IIT on stock options = RMB 45,625 x 30% – 3,375 = RMB 10,312

Total IIT on stock options = RMB 10,312 x 12 months = RMB 123,744

Note: As Mr Chan has resided in China throughout the vesting period he cannot take advantage of the provisions in Guoshuihan (2000) No.190, which permits an expatriate taxpayer who has resided in China for only a portion of the vesting period, to apportion the stock option income according to the number of months of working onshore and offshore respectively.

(ii) When stocks obtained through the exercise of stock options are subsequently disposed of, the proceeds are treated as income from the assignment of property. Currently, although the income from the transfer of stocks listed on the Chinese Stock Market is tax-exempt, gains from the sale of overseas shares are taxable for local employees and for expatriate employees who are taxable in the PRC on their worldwide income because they have lived in China for more than five years.

Thus, as the shares received are in Company F's US investor, whether or not tax is payable on their disposal will depend on Mr Chan's PRC tax residence status at the time of the sale.

		Marks	
1	**Nova Company Limited/Newco**		
(a)	Contract manufacturing:		
	Imported raw material free of duty and import VAT, with reason	2	
	Processing fee exempt from output VAT	1	
	No recovery or refund of input VAT on local purchases	1	
	Real cost to Newco, part of COGS	1	
	Non-recoverable VAT: formula	1/2	
	calculation	1/2	
	Import manufacturing:		
	Imported raw materials duty and import VAT exempt, with reason	2	
	Export sales income exempt from output VAT	1	
	Refund available for input VAT on local purchases	1	
	Effect of refund rate being below 17%	1	
	Non-refundable VAT: formula	1	
	calculation	1/2	
	Non-bonded export trade:		
	Duty and import VAT payable on raw materials	1	
	Export sales income exempt from output VAT (as in (2))	1/2	
	Refund available for input VAT on local purchases (as in (2))	1/2	
	Non-refundable VAT: formula	1/2	
	calculation	1/2	
	Import duty not refundable	1	
	Non-refundable duty: formula/calculation	1/2	
	Conclusion	1	18
(b)	Contract manufacturing:		
	No impact on the bonded tolling arrangements	1	
	Non-recoverable VAT as in part (a)	1/2	
	Import manufacturing:		
	Nil refund available for input VAT on local purchases	1	
	Export sales treated as domestic sales for output VAT	1	
	Input VAT creditable against deemed output VAT	1	
	Output VAT: formula	1	
	calculation	1/2	
	Input VAT cost: formula/calculation	1/2	
	Net VAT payable	1/2	
	Reduced 6% output VAT rate for bonded imported materials	1	
	No recovery or refund of input VAT on local purchases	1	
	Application to Newco	1	
	Output VAT: formula/calculation	1/2	
	Input VAT: as previously calculated	1/2	
	Net VAT payable	1/2	
	Non-bonded export trade:		
	Nil refund for input VAT on local purchases; export sales treated as domestic sales but with input VAT credit (as in (2))	1	
	Non-refundable VAT amount as calculated in (2)	1/2	
	Non-refundable duty as in (a)	1	
	Conclusion	1	15
	Format and presentation of the report	1	
	Effectiveness of communication	1	2
			35

		Marks
2 Company X and Company Y		
(a) (i) Tax preferential period:		
Post-merger entity inherits if business activities still qualify	1	
Tax holiday period expired	1	
Unexpired tax holiday period terms are the same	1	
Unexpired tax holiday period terms differ:		
Need to separately account	2	
Entitled to respective remaining tax holidays	1	
No preferential treatment for parts without a tax holiday	1	7
(ii) Pre-merger accumulated losses		
Carry forward to post-merger enterprise for remainder of five year period	$1^1/_2$	
Offset against income of separately accounted for entities where tax holiday positions differ	$1^1/_2$	3
(b) Need to determine separate positions of head office and branch	1	
2001: respective post-merger rates unchanged, with reason	1	
Head Office	1	
Branch Y	1	
2002: Head Office	1	
Branch Y	$^1/_2$	
2003: Head Office	1	
Branch Y	$^1/_2$	7
(c) Need for separate calculation	1	
Position re offset of losses (3 x 1)	3	
Need for apportionment if applicable rates/tax holiday terms differ	1	
Separate books of account kept	$1^1/_2$	
Separate books not kept	$1^1/_2$	8
(d) 2001:		
Use of Company Y 1998 and 1999 pre-merger losses	1	
Determination of taxable income/tax payable as nil	$^1/_2$	
2002:		
Use of Company Y 2000 pre-merger loss	$^1/_2$	
Use of part of Branch Y 2001 loss	1	
Determination of taxable income/tax payable as nil	$^1/_2$	
2003:		
Use of remainder of Branch Y losses	1	
Calculation of taxable income	$^1/_2$	
Reversal of 2001 and 2002 Head Office offsets	$1^1/_2$	
Calculation of tax payable	$1^1/_2$	8
		33

		Marks	
3	**Company A**		
(a)	Business tax:		
	Normally rate – 5% of gross turnover	1	
	Reduction for purchase price available, with reason	1	
	Application to Company A – no BT	1	
	Stamp duty – 0·05%	1	
	Land appreciation tax:		
	Payable on added value	1	
	Computation: deductible items	1	
	appreciation value	1	
	appreciation ratio	1/2	
	tax payable	1/2	8
(b)	Business tax:		
	Exemption for investing immovable assets	1	
	Provided subject to operating risks	1	
	Application to Company A – no BT	1/2	
	Land appreciation tax:		
	Exemption for assignment to investment enterprise	1	
	Temporary deferral only	1/2	
	Circumstances in which levy will be re-instated	1	
	Foreign enterprise income tax:		
	Capital gain chargeable	1	
	Basis of calculation – appraisal value less NBV	1	
	Application to Company A	1	8
			16

4	**Company C**		
(a)	Income tax rate, with reasons	2	
	Tax incentive, with reasons	2	4
(b)	2000 and 2001:		
	Interest income not 'production revenue'	1	
	Tax holiday not triggered	1	
	2002:		
	Trading revenue not treated as 'production revenue', with reason	2	
	Not eligible for tax holiday	1	
	Not eligible for reduced rate, with reason	1	
	2003: 0% rate applies, with reasons	1	
	2004: 7·5% rate applies, with reasons	1	
	2005:		
	Not eligible for tax holiday, with reason	1	
	Is eligible for reduced rate, with reason	2	
	2006: 7·5% rate applies, with reasons	1	12
			16

			Marks	
5	Mr Chan			
(a)	**(i)**	Labour service remuneration	1	
		Taxed as income for individual services	1	2
	(ii)	Need to distinguish income from individual services and employment income	1	
		Obligation of taxpayer if no management remuneration	2	
		Power of the tax authorities to assess	2	5
(b)	**(i)**	Income related to employment	1/2	
		No IIT at time of grant	1	
		Basis of IIT charge on exercise	1	
		Need to calculate tax separately from monthly salary	1/2	
		Calculation of tax payable	2	5
	(ii)	Income from the assignment of property	1	
		Exemption for stocks listed on the Chinese Stock Market	1/2	
		Gains on overseas shares taxable	1/2	
		Including for expatriates who have lived in China for more than five years	1	
		Application to Mr Chan	1	4
				16