Answers

Marks

1 (a) Company Y

(i)

1.		The sale of goods at a price lower than the original cost is deductible.	1
2.	(i)	The deduction for entertainment expenses is subject to a limit of 60% of the actual expenses incurred (i.e. RMB 48,000), but with the total allowable entertainment expenses not exceeding 0·5% of the sales revenue of the current year (i.e. RMB 62,500). Therefore, the lower of the two amounts, i.e. RMB 48,000, is allowable.	1·5
	(ii)	The deduction for advertising and promotion expenses cannot exceed 15% of the sales of the current year (i.e. RMB 1,875,000) but the excess portion can be carried forward to future years. The actual amount for 2012 of RMB 1,200,000 plus the amount brought forward from the previous year of RMB 580,000 (i.e. RMB 1,780,000) can all be deducted within the limit.	1·5
	(iii)	A general provision is not deductible.	1
	(iv)	The debt has not been collected over the last three years but as the company has not got any proof of action taken to recover the debt, the amount is not deductible.	1·5
	(v)	Compensation paid to a customer for breach of contract is deductible.	1
3.		Interest expense on a loan borrowed from an individual is deductible but only at the market rate of interest for a financial institution, i.e. at the rate of 5% or RMB 50,000.	1·5
4.	(i)	Staff welfare and benefits are deductible up to 14% of the amount of wages and salaries, i.e. RMB 532,000.	1
	(ii)	A penalty for the late filing of a tax return is not deductible.	1
	(iii)	A donation to a school is not deductible.	1
5.	(i)	Interest income on national bonds is tax exempt.	1
	(ii)	A dividend received from another China tax resident company is tax exempt.	1
	(iii)	A gain on the disposal of national bonds is taxable.	1
			15

(ii) Enterprise income tax (EIT) for 2012

		RMB	
	Taxable profit before adjustment	1,210,000	
	Add:		
1.	No adjustment	0	0·5
2.(i)	Non-allowable entertainment (80,000 – 48,000)	32,000	0·5
2.(iii)	Provision for doubtful debts	200,000	0·5
2.(iv)	Bad debt written off	135,000	0·5
2.(v)	No adjustment	0	0·5
3.	Non-allowable interest expense (300,000 – 50,000)	250,000	0·5
4.(i)	Non-allowable staff welfare and benefits (650,000 – 532,000)	118,000	0·5
4.(ii)	Non-allowable penalty	2,000	0·5
4.(iii)	Non-allowable donation	10,000	0·5
5.(iii)	No adjustment	0	0·5
		1,957,000	
	Less:		
2.(ii)	Additional deduction for advertising and promotion (1,780,000 – 1,200,000)	(580,000)	0·5
5.(i)	Tax exempt interest on national bonds	(30,000)	0·5
5.(ii)	Tax exempt dividend from a subsidiary in China	(120,000)	0·5
	Adjusted taxable profit	1,227,000	
	Tax rate	25%	
	Tax payable	306,750	0·5
			7

			Marks
(b)	**Company A**		
(i)	Tax losses can be carried forward and set off against the taxable profits of the next five consecutive tax years.		1·5
	Any losses unused at the end of the five-year carry forward period will expire and be wasted.		0·5
			2
(ii)	The loss of 2005 would be offset against the profits of 2008.		0·5
	The loss of 2006 would be offset against the balance of profits of 2008, and the profits of 2009 and 2011. The remaining, unused, loss (of RMB 140,000) will become expired in 2012.		1·5
	Therefore, the losses available for offset in 2012 will be those for 2007 and 2010, i.e. RMB 1,200,000.		1
			3
(c)	**Company H**		
		RMB	
(i)	Loan	10,000,000	
	Interest rate (net)	4·25%	
	Net-of-tax interest	425,000	
	Business tax	5%	
	Enterprise income tax (EIT) by withholding	10%	
	Gross interest [i.e. 425,000/(1 – 5% – 10%)]	500,000	1
(ii)	Gross interest	500,000	
	Business tax at 5%	25,000	0·5
	EIT (or withholding tax) at 10%	50,000	0·5
			1
(iii)	A non-resident enterprise is an enterprise which is established under the law of a foreign country (or tax region) and whose effective management or control is located outside China but which has an establishment in China, or which does not have any establishments in China but has income sourced from China.		3
(iv)	Bank K is a non-resident enterprise as it does not have any establishments in China. It will pay EIT on its income sourced from China.		1·5
	Bank W is a non-resident enterprise but it does have an establishment (its branch) in China. It will pay EIT on its income sourced from China and any income sourced outside China but actually connected with its branch in China.		1·5
			3
			35

2 (a) (i)	A China tax resident is an individual who is domiciled in China or does not have his/her domicile in China but has resided within China for a full year.		2
(ii)	A China tax resident is liable to individual income tax (IIT) on his/her worldwide income.		1
	A China non-tax resident is liable to IIT only on his/her China sourced income.		1
			2
(b)	**Mr Li – Individual income tax (IIT) payable in 2012**		
(1)	Monthly IIT on salary: (80,000 – 4,800) x 35% – 5,505 = RMB 20,815		1·5
	12 months IIT = 20,815 x 12 = RMB 249,780		0·5
(2)	The applicable tax rate and the quick deduction factor for the bonus is 25% and RMB 1,005 based on a monthly equivalent of RMB 10,000 (120,000/12).		
	IIT on bonus: 120,000 x 25% – 1,005 = RMB 28,995		1·5

		Marks
(3)	Fees for two lectures in the same month are treated as a one-time income for calculating IIT.	
	IIT on service income: (30,000 – 20% x 30,000) x 30% – 2,000 = RMB 5,200	1·5
(4)	Income on incidental (or ad hoc or contingency) income: 5,000 x 20% = RMB 1,000	1
(5)	Insurance compensation is tax exempt.	1
(6)	IIT on income from manuscript: 5,000 x (1 – 20%) x 20% x (1 – 30%) = RMB 560	1·5
(7)	Taxable income from the privately owned sole proprietorship: 400,000 + (10,000 x 12) – 42,000 = RMB 478,000.	1·5
	IIT on sole proprietorship income: 478,000 x 35% – 14,750 =RMB 152,550	1
		11

(c) An individual is subject to self-assessment for IIT if any one of the following criteria is met:

(1) Annual income is in excess of RMB 120,000.
(2) Wages and salaries are received from two or more sources (employers) within China.
(3) Income is received from outside China.
(4) Taxable income is received for which there is no withholding agent.
(5) Any other circumstance prescribed by the State Council.

1 mark each criteria	5
	20

3 Company Q

(a) Taxes payable on importation of wine

(i)	Customs tariff: 30,000 x 7·0 x 10% = RMB 21,000	1
	Tax base for consumption tax (CT): (210,000 + 21,000) ÷ (1 – 10%) = RMB 256,667	1
	CT: 256,667 x 10% = RMB 25,667	0·5
	Tax base for value added tax (VAT): (210,000 + 21,000 + 25,667) = RMB 256,667	1
	VAT: 256,667 x 17% = RMB 43,633	0·5
		4
(ii)	The import customs declaration should be made within 14 days of the arrival declaration.	1

(b) Value added tax (VAT) payable for 2012

Item		**RMB**	
(2)	Sales (2,000 x 300) x 17%	102,000	0·5
(3)	Gift (100 x 300) x 17%	5,100	1
(6)	Return of goods (50 x 300) x 17%	(2,550)	1
(7)	Discounted sale: no adjustment	0	0·5
	Total output VAT	104,550	
(1)	Import VAT for 3,000 bottles (as in (a)(i))	43,633	0·5
(4)	Loss due to flood: no adjustment	0	0·5
(5)	Irrecoverable input VAT (43,633 ÷ 3,000 x 200)	(2,909)	1·5
(8)	Input VAT on transportation expenses (20,000 x 7%)	1,400	1
(9)	Input VAT from small scale supplier (2,000 ÷ 1·03 x 3%)	58	1
	Total recoverable input VAT	42,182	
	VAT payable (Total output VAT – Total recoverable input VAT)	62,368	0·5
			8

Tutorial notes:

(1) Where a loss is due to a natural disaster, the related input VAT is not considered as an abnormal or extraordinary loss, hence the corresponding VAT is creditable/allowable. (VAT regulations effective 1 January 2009.)

(2) Where a discount for early settlement is given after the goods are sold/the invoice is issued, the discount given cannot be subtracted from the value of the sale proceeds for VAT purposes.

	Marks
(c) Item (5) is an abnormal loss due to improper management and the input value added tax (VAT) in relation to such an abnormal loss is irrecoverable (transferred out).	1
The inventory loss should be reported to the tax authority and, subject to the approval of the tax authority, the loss can be deducted for enterprise income tax (EIT) purposes.	2
	3

(d) The transactions which can be considered as deemed sales are:

- consignment of goods to others;
- sales of consigned goods under consignment;
- transferring goods from one establishment to another and across cities or countries for sale by a taxpayer who has adopted consolidated tax filing;
- applying self-manufactured goods, or processed goods on consignment for non-taxable projects;
- providing self-manufactured goods, processed goods on consignment or purchased goods to other entities or individual business operators as a form of investment;
- distributing self-manufactured goods, processed goods on consignment or purchased goods to shareholders or investors;
- applying self-manufactured goods, processed goods on consignment for staff welfare or personal consumption; and
- donating self-manufactured goods, processed goods on consignment or purchased goods as free gifts.

Any FOUR items at 1 mark each, maximum	4
	20

4 (a) Company D – Business tax (BT) for May 2012

(i)	(1) The BT liability arises when the payment is due.	1
	(2) Both the service fee and the outlays are subject to BT. Outlays borne by the client are treated as an additional charge.	1
	(3) The write off has no effect on BT.	1
	(4) Interest income on a loan to an associate is subject to BT.	1
	(5) Interest income on a bank deposit is exempt from BT.	1
	(6) BT is payable based on the difference between the sale proceeds and the original cost of acquiring the property.	1
	(7) The sale of used computers is not subject to BT but will be subject to value added tax (VAT).	1
		7
(ii)	Total BT payable for the month is: [50,000 + (40,000 + 1,200) + 20,000 + (10,000,000 – 6,000,000)] x 5% = RMB 205,560	1

Marks

(b) Company P – Land appreciation tax (LAT)

	RMB	Marks
Amount of deductions for LAT:		
Cost of land use right (5,000,000 + 5,000,000 x 3%)	5,150,000	1
Construction costs (400,000 + 3,000,000)	3,400,000	1
	8,550,000	
Administrative expenses (capped at 10% x 8,550,000)	855,000	1
Sales taxes		
– Business tax (20,000,000 x 5%)	1,000,000	0·5
– City maintenance and construction tax and education levy (business tax x 10%)	100,000	0·5
Additional deduction for a property developer (8,550,000 x 20%)	1,710,000	1
Total amount of deductions	12,215,000	
Selling price	20,000,000	0·5
Land appreciation gain (20,000,000 – 12,215,000)	7,785,000	
Appreciation ratio (7,785,000/12,215,000)	63·7%	0·5
LAT payable = 7,785,000 x 40% – 12,215,000 x 5%	2,503,250	1
		7
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Tutorial note: *Article 9 of notice CaiShui [1995] No. 48 refers to the old accounting policy for construction and property development (abolished) which stipulated that stamp duty should be booked as part of management expenses. On the other hand, the accounting treatment of small and medium enterprises (SMEs) allows stamp duty to be recorded as 'Sales taxes'. In order to avoid ambiguity, candidates were told to ignore stamp duty in this question.*

5 (a) (i) Associated (or connected) parties are enterprises, other entities or individuals, which have any of the following relationships with an enterprise:

- direct or indirect control over such matters as finance, business operations, purchases and sales;
- both are directly or indirectly controlled by the same third party; or
- there are other common relationships due to associated interests. 3

Tutorial note: *The syllabus uses the term 'associated parties' whereas the study text uses the term 'connected parties'.*

(ii) The arm's length principle refers to the principle which unrelated parties abide by when carrying out business transactions in accordance with fair market prices and normal business practices. 2

(b) Company K

(i) The tax authority will make a special tax adjustment (or transfer pricing adjustment) to Company K's taxable income and impose late payment interest based on the basic RMB lending rate published by the People's Bank of China and an additional 5%. 2

(ii) The tax authority can collect the unpaid taxes arising from Company K's tax evasion, impose a fine ranging from 50% to five times the amount of the taxes underpaid, and late payment interest of 0·05% per day from the date of late tax payment. 3

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