Answers

Marks

1 (a) Company A

(i) Enterprise Income Tax (EIT) Treatment

		Marks
(1)	A down payment for sales in 2014 should not be treated as income in the current year but as an advanced receipt. The amount of turnover should be reduced by RMB 10,000.	1
(2)	The amount should be recognised as sales in 2013. No adjustment is required.	1
(3)	Normal wastage is deductible. No adjustment is required.	1
(4)	Interest on a shareholder's loan at a rate lower than the market rate is deductible. No adjustment is required.	1
(5)	An unrealised foreign exchange loss is deductible. No adjustment is required.	1
(6)	Compensation to a customer is deductible. No adjustment is required.	1
(7)	60% of the amount incurred is RMB 6,000 (RMB 10,000 x 60%) but the deductible amount is capped at the limit of entertainment expenses of RMB 9,200 (RMB 1,840,000 x 0.5%).The excess amount brought forward from last year is not deductible. An amount of RMB 4,000 (RMB 10,000 – 6,000) should be added to taxable profit.	2
(8)	The deduction limit for advertising expenses is RMB 276,000 (RMB 1,840,000 x 15%). The amount exceeding the deduction limit brought forward can also be deducted in the current year within the limit. The extra amount deductible is RMB 216,000 (RMB 276,000 – 60,000).	2
(9)	The foreign tax withheld is not deductible but should be treated as a foreign tax credit. The amount of RMB 800 should be added to profit and credited against the enterprise income tax (EIT) payable.	1
(10)	Interest income from national bonds is tax exempt.	1
(11)	A dividend paid to a shareholder is not deductible and the amount of RMB 100,000 should be added to taxable profit.	1
		13

(ii) Enterprise income tax (EIT) payable for 2013

		RMB	RMB	
Taxable profit per the question			423,800	
	Add:			
(7)	Entertainment expenses	4,000		0·5
(9)	Foreign tax on royalties	800		0·5
(11)	Dividend to shareholder	100,000		0·5
			104,800	
	Less:			
(1)	Down payment for sales of 2014	10,000		0·5
(8)	Advertising expenses	216,000		0·5
(10)	Interest income from national bonds	1,600		0·5
			(227,600)	
	Revised taxable profit		301,000	
	EIT at 25%		75,250	0·5
	Less: (9) Foreign tax paid		(800)	0·5
	EIT payable		74,450	
				4

(iii) The dividend tax withheld is RMB 10,000 (RMB 100,000 x 10%). 1

		Marks

(b) P Ltd

(i) Business tax (BT) and enterprise income tax (EIT) payable

	RMB	Marks
Gross service fee	100,000	
Deemed profit at 50%	50,000	1
EIT at 25%	12,500	1
BT (100,000 x 5%)	5,000	1
		3

(ii) The tax authorities can assess the taxable profits of a non-resident on a deemed basis where the accounting records are incomplete or information is missing such that it is difficult to be audited, or the taxable profit cannot be accurately calculated due to other reasons. 2

(c) (i) The following types of income are exempt:

- Interest on national bonds 1
- Income from equity investments such as dividends and bonuses (profit) between qualified resident enterprises 1
- Income received by the China establishment of a non-resident enterprise from equity investments such as dividends and bonuses (profit) from a resident enterprise, where the income is effectively connected with the China establishment 1
- Donations received by a qualifying non-profit making organisation 1

4

(ii) Expenses incurred in relation to non-taxable income are not deductible but expenses incurred in relation to tax exempt income are deductible. 2

(d) Company Cap

(i) Cost base of new factory building

		RMB	Marks
(1)	Net book value of demolished building	60,000	1
(2)	Materials for construction at cost	90,000	1
(3)	Interest on loan from 1 January to 15 November (500,000 x 8% x 10·5/12 months)	35,000	1·5
(4)	Cost of construction of new building	700,000	0·5
	Cost base of new building	885,000	
			4

(ii) Depreciation for 2013

	RMB	Marks
Cost base (from (i) above)	885,000	
Less: Residual value (10%)	(88,500)	0·5
Depreciable value (90%)	796,500	
Depreciation per year (÷20)	39,825	0·5
Depreciation for December 2013	3,319	1
		2
		35

Tutorial note: *For buildings and properties which are demolished for reconstruction, the net book value (i.e. the original cost after tax depreciation) should be included in the cost base of the reconstructed fixed asset and depreciation is based on the depreciation period under tax law starting from the next month after the new asset is put into use.*

According to tax notice Guo Shui Han [2008] No. 828, changing the usages of goods within the company is not considered as deemed sales for enterprise income tax. Hence, the original cost of materials will be used for calculating the cost base of fixed assets.

Marks

2 (a) Mr Chen – Individual income tax (IIT) for 2013

Plan 1:

IIT each month = (17,500 – 3,500) x 25% – 1,005 = RMB 2,495	1
For bonus, find tax rate: 90,000 ÷ 12 = 7,500 which is 20%	0·5
IIT on bonus = 90,000 x 20% – 555 = RMB 17,445	0·5
Total IIT for the year = (2,495 x 12) + 17,445 = RMB 47,385	0·5
Plan 2	
IIT each month except for June = (5,000 – 3,500) x 3% = RMB 45	0·5
IIT for June = [(120,000 + 5000) – 3,500] x 45% – 13,505 = RMB 41,170	1·5
For bonus, find tax rate: 120,000 ÷ 12 = 10,000 which is 25%	1
IIT on bonus = 120,000 x 25% – 1,005 = RMB 28,995	
Total IIT for the year = (45 x 11) + 41,170 + 28,995 = RMB 70,660	0·5
	6

Tutorial note: *Only one bonus can apply the special method to calculate IIT. Another bonus payment will be added together with the salary of that month and taxed accordingly.*

(b) Ms Li – Individual income tax (IIT) for 2013

(1) Coupons from a supermarket for bulk buying are not subject to IIT	1
(2) IIT on the lottery prize of a smart phone: 3,000÷ (1 – 20%) x 20% = RMB 750	1
(3) Bank deposit interest is temporarily exempt from IIT	1
(4) Interest income = 100,000 x 15% = RMB 15,000	0·5
IIT on interest = 5,000 x 20% = RMB 3,000	0·5
(5) Published in PP Daily for three days is treated as one income for IIT purposes.	
IIT = (1,500 x 3) x (1 – 20%) x (1 – 30%) x 20% = RMB 504	1·5
(6) A director's fee is taxed as service income and the payments received each month are considered as received on one occasion.	
IIT each month = 10,000 x (1 – 20%) x 20% = RMB 1,600	1
IIT for whole year = 1,600 x 12 = RMB 19,200	0·5
(7) Salary for the whole month of April = (2,800+ 2,500) = RMB 5,300	
IIT for the whole month = (5,300 – 3,500) x 10% - 105= RMB 75	1
	8

(c) (i) Mr Zhang

Mr Zhang is a China tax resident. He is subject to IIT on income sourced from China and outside China (i.e. worldwide tax) including income earned in Hong Kong.	2
(ii) Ms Robin	
Ms Robin is a non-resident. She is taxable on China-sourced income. Since her stay in China was less than an aggregate of 90 days (or 183 days in any 12 month period under the Avoidance of Double Taxation Arrangement with the HKSAR), her employment income will be exempt from China IIT.	2
	4

(d) Mr Wang

(i) Mr Wang is required to submit an annual IIT return as his income exceeds RMB 120,000.	1
(ii) The filing deadline for the annual IIT return is 31 March 2014.	1
	2
	20

Marks

3 (a) Electronic Ltd

(i) Value added tax (VAT) payable as a general taxpayer

	RMB	Marks
Output VAT (780,000 ÷1·17 x 17%)	113,333	1
Input VAT (600,000 x 17%)	(102,000)	0·5
VAT payable	11,333	
Gross profit as a general taxpayer		
Sales (780,000 ÷1·17)	666,667	1
Purchases	(600,000)	0·5
Gross profit	66,667	
		3

(ii) VAT payable as a small scale taxpayer

VAT payable = (780,000 ÷ 1·03 x 3%) = RMB 22,718 — 1

Gross profit if Electronic Ltd is a small scale taxpayer

	RMB	Marks
Sales	780,000	0·5
Purchases (600,000 x 1·17)	(702,000)	1
VAT payable	(22,718)	0·5
Gross profit	55,282	
		3

(b) Clothy Ltd

(i) Value added tax (VAT) refundable to Clothy Ltd for direct export

	RMB	Marks
Input VAT on purchase of materials (200,000 x 17%)	34,000	0·5
Input VAT on water, electricity and transportation, etc	10,000	0·5
	44,000	
Less: Irrecoverable input VAT on export [400,000 x (17% – 16%)]	(4,000)	1
VAT refundable	40,000	
		2

(ii) VAT refundable to trading company for export of purchased garments

360,000 x 16% = RMB 57,600 — 1

(c) Toyly Ltd

Month VAT liability crystallises:

		Marks
(1)	August	1
(2)	March (30 days after delivery in February which is March)	1
(3)	May	1
(4)	November	1
(5)	June	1
		5

(d) Softko Ltd

Input value added tax (VAT) for October 2013

		Marks
(1)	VAT withheld = 2,000 x 6 x 6% = RMB 720	1·5
(2)	VAT on fixed assets = 100,000 x 17% = RMB 17,000	1·5
(3)	Input VAT from small scale taxpayer = 30,000 ÷1·03 x 3% = RMB 874	1
(4)	VAT in relation to staff welfare is not creditable	1
(5)	VAT on assets specifically for providing tax exempt services is not creditable	1
		6
		20

Tutorial note on item (2): *No adjustment is needed for fixed assets partially used for the provision of VAT exempt services.*

		Marks
4	**(a) Business tax (BT) payable**	
	(1) Exempt from BT [education services provided by qualified schools are exempt from BT]	1
	(2) Subject to VAT instead of BT	1
	(3) BT on rental: 48,000 x 5% = RMB 2,400	1
	(4) Exempt from BT	1
	(5) BT on interest from another company: 38,000 x 5% = RMB 1,900	1
	(6) BT on construction services = 500,000 x 3% = RMB 15,000	1
	(7) Not subject to BT [transfer of land use right by government is not subject to BT but the transfer of which by other entities is subject to BT]	1
	(8) Not subject to BT	1
	(9) BT is based on the total fee: 1,300 x 5% = RMB 65	1
	(10) Exempt from BT	1
	(11) BT on receipts from tenants: (24,000 – 12,000) x 5% = RMB 600	1
		11

Tutorial note: *Per notice CaiShui [2003] No. 16, the allocation of electricity and water charges paid on behalf of the tenants can be deducted from the BT base but the allowed deductions do not include the salaries of the guards.*

	(b) Cosmet Ltd – Consumption tax (CT) payable	
	(1) CT for rouge and lipstick sets: 100 x 4,200 x 30% = RMB 126,000	1
	(2) CT for hand cream and lipstick sets: 50 x 1,000 x 30% = RMB 15,000	1
	Tutorial note: *The hand cream is also taxable as it is sold in a set.*	
	(3) CT on gifts: 100 x 40 x 30% = RMB 1,200	1
	(4) Not subject to CT [further sale of purchased goods].	1
		4
		15

5	**(a) The five special tax adjustment methods are:**	
	(1) Comparable uncontrolled price method	1
	(2) Resale price method	1
	(3) Cost plus method	1
	(4) Transaction net margin method	1
	(5) Profit split method	1
		5

(b) Company D

(i) Late payment surcharge

The due date for the enterprise income tax (EIT) for 2012 would have been 31 May 2013. The late payment surcharge will be calculated for 61 days (June: 30 days, July: 31 days) The surcharge due is therefore: 230,000 x 0.05% x 61 days = RMB 7,015. 2

(ii) The penalties which the tax bureau can impose in the case of an act of tax evasion range from 50% to 5 times the tax understated. 1

(c) Company E

Company E cannot get a tax refund from the tax bureau as a taxpayer can only get a refund of tax overpaid if they discover this is the case within three years. 2

5

10