Answers

		Marks
1 (a)	Company F:	
(i)	(1) In addition to the actual expense, a further deduction of 100% of the amount paid to disabled employees is allowable for enterprise income tax (EIT) purposes.	1
	(2) Subject to the maximum amount of 0·5% of the sales/business income of the year, 60% of entertaining expense is deductible.	1
	(3) Qualifying advertising and promotion expenses are deductible up to 15% of the sales/business income of the year. Any excess amount can be carried forward to the following years.	1
	(4) Charitable donations to approved organisations are deductible up to 12% of the annual accounting profits.	1
	(5) In addition to the actual expense, a further deduction of 50% of the research and development expense is allowable.	1
	(6) Staff and worker benefits are deductible up to 14% of total salaries and wages.	1
	(7) Staff education expenses are deductible up to 2·5% of total salaries and wages. Any excess amount can be carried forward to the following years.	1
	(8) Sponsorship of non-business activities is non-deductible.	1
	(9) A penalty for late tax payment is not tax allowable.	1
	(10) A gain on the disposal of listed shares is taxable.	1
	(11) Interest income from national debentures is exempt.	1
	(12) A gain on the disposal of a national debenture is taxable.	1
	(13) Only the tax written down value is an allowable deduction on the write off of a fixed asset.	1
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(ii) Enterprise income tax (EIT) computation for the year 2010

	RMB	RMB	
Taxable profit before adjustment		39,105,000	
Add:			
(2) Non-allowable entertainment expense (40% of RMB 900,000)	360,000		0·5
(3) No adjustment within limit	0		0·5
(4) No adjustment within limit	0		0·5
(6) No adjustment within limit	0		0·5
(7) No adjustment within limit	0		0·5
(8) Non-allowable sponsorship	60,000		0·5
(9) Tax penalty	20,000		0·5
(10) No adjustment – taxable	0		0·5
(12) No adjustment – taxable	0		0·5
(13) Tax written down value over limit (180,000 – 120,000)	60,000	500,000	0·5
Less:			
(1) Additional deduction for disabled employees	120,000		0·5
(5) Additional deduction for research expense	240,000		0·5
(11) National debenture interest – exempt	12,000	(372,000)	0·5
Adjusted taxable amount		39,233,000	
Tax rate		25%	
EIT payable		9,808,250	0·5
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(b)	A non-resident enterprise is an enterprise that is neither incorporated in the PRC in accordance with the PRC's laws and administrative regulations; nor whose place of effective management is located in the PRC.	1
	Place of effective management refers to an establishment that exercises, in substance, overall management and control over the production and business, personnel, accounting, properties, etc of the enterprise.	1
	For a non-resident enterprise with an establishment in China, only the income effectively connected to the enterprise's establishment within the PRC will be subject to EIT.	1

Marks

For a non-resident enterprise without an establishment in China, only the income sourced within the PRC will be subject to EIT. 1

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(c) Company H

As Company H sent personnel from overseas to provide training in China for two years, it is deemed to have an establishment in China. Therefore only the income effectively connected to the training services within the PRC will be subject to EIT. 1

According to GuoShufa [2010] 19, where a non-resident sells equipment and also provides after-sales services in China and the service fee is not specified in the sales contract, the tax bureau should assess the services performed in China by reference to the pricing standard in the same or similar service sector. 1

Where reference is not available, the tax bureau may apportion the contract amount to the service income and the proportion shall not be less than 10% of the total contract amount. Also, the deemed profit rate shall not be less than 15%. 1

Therefore:

Taxable income = 100,000,000 x 10% = RMB 10,000,000 0·5
Business tax payable = 10,000,000 x 5% = RMB 500,000 0·5

Deemed profit = 10,000,000 x 15% = RMB 1,500,000 0·5
Income tax payable = 1,500,000 x 25% = RMB 375,000 0·5

Company K, as the withholding agent should theortically file the withholding tax return with the tax bureau and pay the tax within seven days of the payment to Company H. 1

However, in practice due to the foreign exchange control in China, Company K will need to file the return and pay the relevant withholding tax first so as to obtain a tax payment completion certificate, with the support of which, the remittance to overseas Company H can be made. 1

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(d) (i) Dividends paid out of pre-2008 earnings from a foreign invested enterprise are exempt from EIT withholding. 1

For dividends paid out of post-2008 earnings the withholding tax rate is 10%, but this may be reduced under an applicable tax treaty. 1

2

(ii) Interest is generally subject to a 10% withholding tax rate, but this may be reduced under an applicable tax treaty. 1

(iii) Royalties are generally subject to a 10% withholding tax rate, but this may be reduced under an applicable tax treaty. 1

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2 (a) Mr Wu – Individual income tax (IIT) for the month of September 2010

(1) IIT for monthly employment income: (15,000 – 2,000) x 20% – 375 = RMB 2,225. 1

IIT for the yearly bonus is:

Divide the bonus by 12: 20,000/12 = 1,667 to find the applicable tax rate of 10% and the fast deduction factor of RMB 25

Apply to the bonus amount: 20,000 x 10% – 25 = RMB 1,975. 1

(2) IIT on publishing the album:

USD 5,000 x 7 = 35,000 x (1 – 20%) x 20% x (1 – 30%) = RMB 3,920 1

Tax of USD 750 (RMB 5,250) has been withheld and this can be used to offset the IIT payable in full. 1

The balance of RMB 1,330 can be carried forward for the next five years and offset against IIT payable on other US income. 0·5

(3) IIT on publishing the postcard: 5,000 x (1 – 20%) x 20% x (1 – 30%) = RMB 560 1

(4) The gain from trading in listed shares is exempt. 0·5

			Marks
	(5)	Taxable income from the property sale: (200,000 – 160,000) – (200,000 x 5%) = RMB 30,000	1
		IIT on the profit from the property sale: 30,000 x 20% = RMB 6,000	0·5
	(6)	The bank deposit interest is exempt.	0·5
	(7)	The insurance compensation is exempt.	1
	(8)	IIT on sale of an antique: (50,000 – 20,000) x 20% = RMB 6,000	1
	(9)	IIT in relation to giving a lecture in France:	
		(300 x 9·5 – 800) x 20% = RMB 410	1
		So, IIT of RMB 10 (410 – 400) needs to be paid in China.	1
			12
(b)		Under IIT and the related rules directorship fees are taxed as 'income from personal services' at progressive rates from 20% to 40%.	1·5
		Where the executive takes both an employment position and a directorship from his employer, the director's fees should be combined with the employment income and subject to the standard progressive rates for employment income of from 5% to 45%. Guoshuifa [2009][21]	1·5
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(c)		An individual is regarded as a PRC resident taxpayer if he/she either:	
		(1) has his/her domicile in the PRC; or (2) has no domicile in the PRC, but has resided in the PRC for one year.	2
		An individual is deemed to have a domicile in the PRC if he/she habitually resides in the PRC due to registered native place, family ties or economic relationship.	1
		'Residing for one year in the PRC' means residing in the PRC for 365 days in a calendar year. Absence out of the PRC for a consecutive period of not more than 30 days in a single trip, or absence over a number of trips with an aggregate period of not more than 90 days within the same calendar year, are treated as 'temporary absences' and are disregarded.	2
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3 Company Z

(a)	(1)	Input value added tax (VAT) on acquiring wheat from the farmer = 50,000 x 13% = RMB 6,500	1
		Input VAT on flouring fee = 1,200/(1 + 17%) x 17% = RMB 174	1
	(2)	Input VAT on purchase of tools = 5,000/(1 + 3%) x 3% = RMB 146	1
		Total Input VAT = 6,500 + 174 + 146 = RMB 6,820	0·5
	(3)	VAT output = 140,000 x 13% = RMB 18,200	1
		The corn flour distributed to the company's own staff is a deemed sale:	
		VAT output = 140,000/7 x 13% = RMB 2,600	1
	(4)	VAT output = 80,000 x 17% = RMB 13,600	1
	(5)	The stock loss is an abnormal loss, which is not allowed for VAT purposes:	
		Input VAT transferred-out for stock value = (6,000 – 800)/(1 – 13%) x 13% = RMB 777	1·5
		Input VAT transferred-out for freight = 800/(1 – 7%) x 7% = RMB 60	1·5
		Total Input VAT transferred-out = 777 + 60 = RMB 837	0·5
	(6)	Because the machine was bought after 1 January 2009	
		VAT output = 7,000/(1 + 17%) x 17% = RMB 1,017	1
		Total VAT output = 18,200 + 2,600 + 13,600 + 1,017 = RMB 35,417	0·5
		VAT payable = 35,417 – 6,820 + 837 = RMB 29,434	0·5
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			Marks
(b)	(i)	As the loss arose from an earthquake, being an event beyond managements control:	
		For VAT, there is no need to transfer out.	1
		For enterprise income tax (EIT), the stock loss of RMB 12,000 is fully deductible.	1
	(ii)	As the loss arose from mismanagement:	
		The VAT input must be transferred out of (32,000 – 2,000) x 17% + 2,000/(1 – 7%) x 7% = RMB 5,251	2
		The deductible amount for EIT is (32,000 + 5,251) = RMB 37,251	1
			5
(c)	**(i)**	Taxpayers with a one month assessable VAT period must report and pay the VAT due within 15 days following the end of the month.	1
	(ii)	For assessable periods of less than a month (one day, three days, five days, ten days and 15 days), the VAT due must be prepaid within five days following the end of the period and a monthly return filed within 15 days from the first day of the following month together with the balance of tax due (if any).	2
			20

4 Office X

Enterprise income tax (EIT) payable for year 2010

	RMB	RMB	
Total expenses per accountant		215,500	
Add: (1) Cost of office machinery (300,000 – 30,000)	270,000		1
(1) Cost of office car (100,000 – 20,000)	80,000		1
(1) Cost of office decoration (30,000 – 10,000)	20,000		1
(4) Interest income	500		1
(6) Sample costs	6,000		1
(7) Translator fee	4,000	380,500	1
Less: (2) Donation	5,000		1
(3) Penalty	1,000	(6,000)	1
Total expenses		590,000	

Deemed income = 590,000/(1 – 15% – 5%) = RMB 737,500 1·5
EIT payable = 737,500 x 15% x 25% = RMB 27,656 0·5

Explanations:

(1) The cost of the office machinery, the office car and the office decorations are fully expensed in the year the costs are incurred. 1·5

(2) The cash donation can be excluded as part of the office's costs. 0·5

(3) The late filing penalty can be excluded. 0·5

(4) The interest income cannot be used to reduce the office's costs. 0·5

(5) The payment on behalf of the purchase of goods from the head office can be excluded from the office's costs. 1

(6) The payment to the head office for the samples of goods can be included from the office's costs. 0·5

(7) The translator fee for the head office staff visit can be included in the office's costs. 0·5

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				Marks
5	**(a)**	Company R		
		Land appreciation tax (LAT)		
		(1)	Land appreciation = [56 – 42 – 1 – (5% x (56 – 42))] = RMB 12·3 million	1
			The ratio of increased value = 12·3/43·7 = 28%	0·5
			LAT is: 12·3 x 30% = RMB 3·69 million	0·5
		(2)	Statutory other development expenses = 6 (interest) + 5% x (30 + 60) = RMB 10·5 million	1
			Additional allowable deduction (because Company R is a property developer) = (30 + 60) x 20% = RMB 18 million	1
			Land appreciation = 180 – 30 – 60 – 1 – 10·5 –18 = RMB 60·5 million	1
			The ratio of increased value = 60·5/119·5 = 50·6%	0·5
			LAT is: (60·5 x 40%) – (119·5 x 5%) = RMB 18,225,000	0·5
				6

Tutorial note: *Alternatively if the quick deduction method had not been used, the LAT in (2) would have been calculated as follows:*

	RMB
For the portion not exceeding 50% of 119·5 = RMB 59·75 million	
LAT payable = 30% x 59·75	*17,925,000*
For the portion exceeding RMB 59·75 million	
LAT payable = 40% x (60·5 – 59·75)	*300,000*
Total LAT (as above)	*18,225,000*

			Marks
(b)	**(i)**	Income derived from an agricultural/forestry/animal husbandry project – Exempt from enterprise Income tax (EIT).	1
	(ii)	Income derived from a cultivation of flower/tea/sea farming project – EIT rate reduced by half.	1
	(iii)	Income derived from an approved infrastructure project – Exempt from EIT for the first to third years and a 50% reduction in the fourth to sixth years beginning from the tax year that the project derives its first operation revenue.	1
	(iv)	Income derived from an approved environmental protection/energy/water conservation project – Exempt from EIT for the first to third years and a 50% reduction in the fourth to sixth years beginning from the tax year that the project derives its first operation revenue.	1
			4
			10