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# Answers

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Section A

Marks

- 1 A The Standard Committee of the National People's Congress and the State Council.
- 2 B Government is not subject to land appreciation tax.
- 3 C RMB341,880 and RMB34,188  
Value added tax ( $400,000 \div 1.17$ ); consumption tax ( $341,880 \times 10\%$ ).
- 4 A RMB14,530 ( $50 \times 2,000 \div 1.17 \times 17\%$ )  
This is a bundled sale and no deemed sales for hair conditioner.
- 5 D RMB32,000 ( $200,000 \times (1 - 20\%) \times 20\%$ )
- 6 B USD3,000 ( $200,000 \times 25\% - 30,000 - 17,000$ )  
*Tutorial note: Foreign tax credit is allowed for the enterprise income tax paid by a non-resident subsidiary and this is limited to three layers of non-resident subsidiary.*
- 7 D RMB50,000 and RMB0  
Enterprise income tax ( $500,000 \times 10\%$ ); the dividend is not subject to business tax.
- 8 B To be given as souvenirs to the company's customers.
- 9 D RMB60,000 ( $(510,000 - 150,000 - 120,000) \times 25\%$ )
- 10 C The importation of goods into a China free trade zone; and of raw materials under a processing trade.
- 11 A RMB16,000 ( $100,000 \times 16\%$ )
- 12 C RMB750 ( $3,000 \div (1 - 20\%) \times 20\%$ ); IIT is withheld and paid to the tax bureau by the supermarket.
- 13 A RMB1.6 million ( $32 \text{ million} \times 5\%$ )
- 14 C Tax evasion.
- 15 B Business tax of RMB1,000 ( $200,000 \times 10\% \times 5\%$ )  
A VAT general taxpayer is still subject to business tax on interest income.

2 marks each

30

## Section B

Marks

## 1 Lambda Ltd

## (a) Disposal of the factory building

	RMB	
Business tax (6,000,000 – 4,000,000) x 5%	<u>100,000</u>	1
Land appreciation tax (LAT) Selling price	6,000,000	0.5
Less:		
Replacement costs	5,000,000	0.5
Business tax (as above)	100,000	0.5
City construction and maintenance tax and education levy (100,000 x 12%)	<u>12,000</u>	0.5
Total deductions	(5,112,000)	
	<u>888,000</u>	
% to total deductions (888,000 ÷ 5,112,000)	17%	0.5
LAT (888,000 x 30%)	266,400	0.5
		<u>4</u>

## (b) Sale of cosmetic products

Consumption tax of RMB117,949 (460,000 ÷ 1.17 x 30%) 1

## (c) Expired cosmetic products

This is not a value added tax (VAT) abnormal loss. An abnormal loss for VAT is the losses due to theft, spoilage and deterioration due to poor management. [Under Article 24 of VAT Regulations] 2

## (d) Sale of inventories

Output VAT is RMB95,897 ((460,000 + 200,000) ÷ 1.17 x 17%) 2

## (e) There is no VAT refund due on the liquidation of a company.

1  
**10**

## 2 Mr Lin – Individual income tax (IIT) for February 2014

## (1) Salary:

	RMB	
Basic salary	4,500	0.5
Meal allowance	3,000	0.5
Reimbursement of expenses on business trips (not taxable)	0	0.5
Air tickets and hotel charges for vacation outside China	8,200	0.5
Employer's social security contributions (exempt)	0	0.5
Less: Employee's social security contributions	<u>(1,250)</u>	0.5
Taxable salary	<u>14,450</u>	

IIT: ((14,450 – 3,500) x 25% – 1,005) = RMB1,733 1

## (2) Lecture fees [taxed as service income]:

IIT: ((1,000 x 3 – 800) x 20%) = RMB440 1  
[Three lectures in a month are taxed as one time]

(3) Insurance compensation is tax exempt [under Article 4 of IIT Law]. 0.5

(4) Red-packet money is not taxable. 0.5

## (5) Overseas lottery win:

IIT: (USD1,000 x 20% – 150) = USD50 = RMB300 1

	<b>Marks</b>
(6) Published article [manuscript income]: IIT: $((1,000 - 800) \times 70\% \times 20\%) = \text{RMB}28$	1
(7) Director's fee [taxed as service income]: IIT: $(60,000 \times (1 - 20\%) \times 30\% - 2,000) = \text{RMB}12,400$	1
(8) Profit on sale of investment: IIT: $((1,000,000 - 400,000) \times 20\%) = \text{RMB}120,000$	1
	<u>10</u>
<b>3 (a) Phi Ltd</b>	
<b>Tax withholding obligations</b>	
(1) Withholding agent.	1
(2) Withholding agent.	1
(3) Not withholding agent.	1
(4) Withholding agent.	1
<b>Tax to be withheld</b>	
(1) Individual income tax of RMB540 $((3,500 - 800) \times 20\%)$ .	1
(2) Individual income tax of RMB15,400 $(70,000 \times (1 - 20\%) \times 40\% - 7,000)$ .	1
(4) Enterprise income tax of RMB9,000 $(90,000 \times 10\%)$ .	1
	<u>7</u>
<b>(b) Jack</b>	
– The penalty for not conducting tax registration on time is up to RMB2,000. [Article 60 of the Tax Collection and Administrative Law]	1
– Late payment surcharge of 0.05% on the tax overdue calculated daily from the tax due date to the actual date of payment. [Article 32 of the Tax Collection and Administrative Law]	1
– The penalty for not filing tax returns which resulted in an underpayment of taxes is 50% to 500% of the taxes underpaid. [Article 64 of the Tax Collection and Administrative Law]	1
	<u>3</u>
	<u>10</u>
<b>4 (a) Hair Ltd – Business tax (BT)</b>	
<b>(i) Year</b>	
2012 Monthly turnover is RMB16,667 $(200,000 \div 12)$ , which is lower than the taxation threshold of RMB20,000. Exempt from BT.	1
2013 Monthly turnover is RMB25,000 $(300,000 \div 12)$ , which is over the taxation threshold. BT payable is RMB15,000 $(300,000 \times 5\%)$	1
2014 BT from January to July is RMB8,750 $(25,000 \times 5\% \times 7 \text{ months})$ . From August to December, the monthly turnover is below the revised threshold of RMB30,000, so exempt from BT.	1
	<u>4</u>
<b>(ii)</b> Enterprise income tax of 2014 = $\text{RMB}50,000 \times 50\% \times 20\% = \text{RMB}5,000$	2

**(b) Turnover taxes**

- |   |                  |
|---|------------------|
| (i) Value added tax (VAT) and business tax are mutually exclusive.  | 1                |
| (ii) Consumption tax is imposed to affect the consumption behaviour of people [on luxuries, harmful to health and environmentally unfriendly products]. | 1.5              |
| Levying the tax can increase the price of the goods and so reduce the demand.   | 1.5              |
|   | <u>3</u>         |
|   | <b><u>10</u></b> |

**5 (a) Mr Xu****Individual income tax (IIT) for 2014**

- |                 |   |                      |
|-----------------|---|----------------------|
| <b>Option A</b> | IIT on salary each month is RMB8,195 $((40,000 - 3,500) \times 30\% - 2,755)$<br>Find tax rate for bonus: $100,000 \div 12 = 8,333 \rightarrow 20\%$<br>IIT on bonus is RMB19,445 $(100,000 \times 20\% - 555)$<br>Total IIT for 2014 is RMB117,785 $(8,195 \times 12 + 19,445)$            | 1<br>0.5<br>1<br>0.5 |
| <b>Option B</b> | IIT on consultancy fee per month is RMB10,000 $((50,000 \times (1 - 20\%) \times 30\% - 2,000)$<br>Total IIT for 2014 is RMB120,000   | 1<br>0.5             |
| <b>Option C</b> | Taxable income of the sole proprietorship is RMB618,000 $(420,000 + 20,000 \times 12 - 3,500 \times 12)$<br>[The salary of Mr Xu is not deductible]<br>IIT of sole proprietorship is RMB201,550 $(618,000 \times 35\% - 14,750)$  | 1.5<br>1             |
| <b>Option D</b> | IIT on salary each month is RMB3,120 $((20,000 - 3,500) \times 25\% - 1,005)$<br>The dividend payable to Mr Xu is RMB315,000 $(420,000 - 420,000 \times 25\%)$<br>IIT on the dividend is RMB63,000 $(315,000 \times 20\%)$<br>Total IIT for 2014 is RMB100,440 $(3,120 \times 12 + 63,000)$ | 1<br>1<br>0.5<br>0.5 |
|                 |   | <u>10</u>            |

**(b) Basis of individual income tax liability**

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|--|---|
| (1) Ms Wang has a domicile in China. She is habitually resident in China and only temporarily stayed outside China due to studying. At the end of her studying, she will go back to China. She is subject to China tax on a worldwide basis. | 2 |
| (2) Mr Beth does not have a China domicile but he has stayed in China for over five full years. He stayed in China for the full year in 2014. Hence, he is subject to China tax on a worldwide basis in 2014.                                | 2 |
| (3) Ms Ruth does not have a China domicile and she did not stay in China for a full year. She is not subject to China tax on a worldwide basis in 2014 [she is only subject to China tax on any income sourced from China].                  | 1 |

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## 6 Sware Ltd

## (a) Enterprise income tax (EIT) for the year 2014

	RMB	
Loss for the year	(3,385,150)	
<i>Add:</i>		
(1) Early settlement discount [no impact on taxable income but does affect sales – see (3) below]	0	0.5
(2) Staff welfare overprovided ((8,240,000 x 14%) – 1,026,350)	127,250	1
(3) Entertainment (maximum deduction is the lower of RMB580,200 (60% x 967,000) and RMB147,000 (0.5% x (29,345,000 + 55,000))); amount not deductible (967,000 – 147,000) [The amount not deductible in 2013 has no impact]	820,000	1.5
(4) Bad debt (tax deductible)	0	0.5
(5) Specific provision (not tax deductible)	78,000	0.5
(7) Compensation paid to customer (tax deductible)	0	0.5
(8) Penalty paid to government authorities (not tax deductible)	120,000	0.5
(9) Costs of Project Pibeta (incurred against a government financial subsidy which is a non-taxable income)	680,000	0.5
(10) Loss of assets in a fire after insurance compensation (tax deductible)	0	0.5
(11) Dividend to shareholders (not deductible)	5,000,000	0.5
(12) Donation to a qualifying charity (no more than 12% of sales – tax deductible)	0	0.5
(13) Donation to school (not tax deductible)	50,000	0.5
(14) Goodwill on acquisition (not tax deductible) [can be deducted on disposal or liquidation of the company]	6,260,000	0.5
(15) Interest income exceeding the market rate (taxable)	0	0.5
	<u>9,750,100</u>	
<i>Less:</i>		
(6) Additional deductible research and development costs (2,140,000 x 50%)	(1,070,000)	0.5
(16) Interest element of government bonds (tax exempt)	(15,000)	0.5
(17) Dividend from A-shares held over 12 months (tax exempt)	(92,100)	0.5
(18) Specific purpose government subsidy (non-taxable)	(2,300,000)	0.5
	<u>6,273,000</u>	
EIT payable at 25%	1,568,250	0.5
		<u>11</u>

## (b) Enterprise income tax (EIT) preferential treatments (other than the qualified research and development additional deduction)

Policies	Preferential treatment
Autonomous region granting a reduction in EIT	Reduction or exemption of the portion of EIT which belongs to the local government
High and new technology enterprise	EIT at the reduced rate of 15%
Software enterprise	A two-year exemption followed by a three-year 50% reduction in EIT

*TWO only required, 2 marks each, maximum*      4

**15**