Answers

Section A

1 The correct answer is Option 4

The use of the coupon of RMB100 and the bonus points exchanged for a microwave oven are not taxable. Individual income tax (IIT) on lucky draw = 5,000 ÷ (1 – 20%) x 20% = RMB1,250.

2 The correct answer is RMB58,000

(80,000 + 500,000) x 10% = RMB58,000

The importation of raw materials and production machines to a Free Trade Zone is exempt from customs duty. The importation of food and motor cars is taxable.

3 The correct answer is RMB430,000

Irrecoverable input value added tax (VAT) on export = 5,000,000 x (16% – 15%) = 50,000

Refundable VAT = 480,000 – 50,000 = RMB430,000

Which is less than 5,000,000 x 15% = RMB750,000

4 The correct answer is RMB22,642

Interest (2,000,000 x 12%) = 240,000

Tax base = 240,000 ÷ (1 + 6%) = RMB226,415

Withholding tax = 226,415 x 10% = RMB22,642

5 The correct answer is 2 only

Under the Tax Collection and Administrative Law and tax notice *Guoshuifa* [2008] No. 30, the tax authorities can use the deemed basis to assess the taxable income of a resident enterprise.

Kon Ltd lost its accounting records in a fire, which is not an act of violation of the tax law, hence, there is no penalty.

6 The correct answer is Option 3

Lucky Ltd: 2,100,000 x 5% = RMB105,000

Consumption tax is levied on the retail of the golden necklaces.

7 The correct answer is Option 2

The value added tax (VAT) filing deadline for a general taxpayer is the 15th day of the next month.

The annual enterprise income tax filing deadline is 31 May of the next year.

The individual income tax withholding filing deadline is the 15th day of next the month.

8 The correct answer is Mr Smith is a China tax resident and his salary from SHG Ltd is taxable in China

Under the amended Individual Income Tax Law effective from 1 January 2019, a foreigner residing in China for 183 days or more is a China tax resident.

9 The correct answer is 1, 3 and 4 only

According to tax notice *Caishui* [2008] No. 137, an individual selling residential property is exempt from LAT.

10 The correct answer is RMB8·5 million

(50 million x 25%) – 4 million = RMB8·5 million

Marks

11 The correct answer is RMB680,000

1,000,000 x 60% + 32,000 + 48,000 = RMB680,000

Input value added tax (VAT) of RMB240 on the ordinary invoice is not creditable whilst the input VAT from a small-scale taxpayer who can provide a VAT special invoice is creditable.

Tutorial note: *From 1 April 2019 onwards, input VAT on acquisition of immovable properties can be fully credited in the month of acquisition.*

12 The correct answer is Option 2

Laws are enacted by the Standing Committee of the National People's Congress. Regulations are enacted by the State Council. Detailed implementation rules are announced by the Ministry of Finance. The State Administration of Taxation (renamed State Taxation Administration from 2019) issues public announcements and notices on interpretations of the law.

13 The correct answer is RMB242,647

(5,600,000 – 100,000) ÷ (1 – 15%) x 15% x 25% = RMB242,647

A non-resident enterprise cannot enjoy the tax incentive of small-profit enterprises. The penalty is not an operating expense; hence, it is excluded from calculating the taxable revenue.

14 The correct answer is RMB613,500

(4,000,000 x 50% – 60,000) x 35% – 65,500 = RMB613,500

15 The correct answer is RMB24,000

The stolen inventory due to mismanagement is considered as a value added tax (VAT) abnormal loss and so the amount of input VAT of RMB24,000 is irrecoverable.

2 marks each **30**

Section B *Marks*

1 (a) Sally and Kathy

Sally is a China tax resident. She has a China domicile and habitually resides in China due to household registration, family and economic benefits. After her studying abroad, she will return to China. 2

Kathy is a China tax resident. She does not have a China domicile but she will have resided in China for at least 183 days in 2019. 2

4

Note: *Marks were awarded if, rather than 'resided', candidates used the term 'stayed' (which was the same as 'resided' before 1 January 2019).*

(b) Robert

Alternative 1: Sole proprietorship

	RMB	
Tax adjusted profit (920,000 + 30,000)	950,000	0·5
Less: Annual allowance	(60,000)	0·5
Taxable income taxed under operations income	890,000	
Individual income tax (IIT) (890,000 x 35% – 65,500)	246,000	1
Profit from sole proprietorship	920,000	0·5
Less: IIT	(246,000)	0·5
Net-of-tax income	674,000	

Alternative 2: R Ltd

	RMB	
Tax adjusted profit (920,000 + 30,000)	950,000	
Enterprise income tax (EIT) at 10%	(95,000)	0·5
Profit of R Ltd	920,000	0·5
Less: EIT	(95,000)	
Profit after EIT = dividend	825,000	0·5
IIT at 20%	(165,000)	0·5
Net-of-tax income	660,000	
		5

Note: *Candidates were not penalised if they applied the new tax incentive of small-profit enterprise (which is effective from 1 January 2019).*

Tutorial note: *In January 2019, the State Council announced new tax incentives allowing qualified small-profit enterprises to pay EIT at 5% for the first RMB1,000,000 taxable profit and 10% for the further RMB2,000,000 taxable profit. This new tax incentive was not covered in this exam since it was announced after 30 September 2018.*

(c) The tax filing deadline for the 2019 annual IIT returns on income from operations is 31 March 2020. 1

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2 (a) Longing Ltd

	RMB	Marks
Dutiable value (2,000 x (50 + 10) + 1,800 + 200) x 6	732,000	1·5
Customs duty at 10%	73,200	0·5
Tax base for value added tax (VAT) and consumption tax (CT)		
(732,000 + 73,200) ÷ (1 – 15%)	947,294	0·5
CT at 15% (947,294 x 15%)	142,094	0·5
Import VAT at 16% (947,294 x 16%)	151,567	0·5
Output VAT on sales (1,400 x 700 x 16%)	156,800	0·5
Input VAT (import VAT above)	(151,567)	
Irrecoverable input VAT on cosmetics given to staff (151,567 x 100/2,000)	7,578	0·5
VAT payable (156,800 – (151,567 – 7,578))	12,811	0·5
		5

Tutorial note: *According to Article 10 of the Provisional VAT Regulations, the corresponding input VAT for goods purchased for collective welfare or individual consumption should be treated as irrecoverable.*

(b) Celia Restaurant

(i) VAT general taxpayer

	RMB	
Output VAT (4,800,000 ÷ 1·06 x 6%)	271,698	0·5
Input VAT	(150,000)	0·5
VAT payable	121,698	
Sales, net of VAT (4,800,000 ÷ 1·06)	4,528,302	0·5
Less: Costs with VAT special invoices (net)	(1,500,000)	0·5
Costs with VAT ordinary invoices (gross)	(1,030,000)	0·5
Gross profit	1,998,302	

(ii) Small-scale taxpayer

	RMB	
VAT (4,800,000 ÷ 1·03 x 3%)	139,806	0·5
Sales, net of VAT (4,800,000 ÷ 1·03)	4,660,194	0·5
Less: Costs with VAT special invoices (gross)	(1,650,000)	0·5
Costs with VAT ordinary invoices (gross)	(1,030,000)	
Gross profit	1,980,194	
		4

Note: *Candidates were not penalised if they applied the new tax incentive of additional input VAT credit (which is effective from 1 April 2019).*

(c) The monthly VAT exemption threshold is RMB30,000 in 2018. — 1

10

Tutorial note: *The threshold increased to RMB100,000 per month from 1 January 2019.*

			Marks
3 (a) KL Ltd			
	RMB million	RMB million	
Selling price (425 – 25)		400·0	0·5
Land use right	100·0		
Deed tax	4·0		
	104·0		0·5
Construction costs	165·0		0·5
	269·0		
Deductible development expenses (269 x 10%)	26·9		0·5
Tax paid on sale (surtaxes)	3·0		0·5
Deduction for property developer (269 x 20%)	53·8		0·5
Total deductions for land appreciation tax		(352·7)	
Land appreciated value		47·3	0·5
% of appreciation (47·3 ÷ 352·7)		13·4%	
Land appreciation tax (LAT) (47·3 x 30%)		14·19	0·5
			4

(b) PN Ltd			
	RMB million	RMB million	
Selling price (380 x (1 + 20%))		456	0·5
Valuation of office tower	(420)		0·5
Surtaxes	(6)		0·5
Total deductions for LAT		(426)	
Land appreciated value		30	
% of appreciation (30 ÷ 426)		7%	
LAT (30 x 30%)		9	0·5
			2

(c) GS Ltd			
	RMB million	RMB million	
Selling price of factory building (315 – 15)		300	0·5
Deductible value (60 x (1 + 8 years x 5%)	(84)		1·5
Taxes on sale (surtaxes + deed tax)	(5)		1
Total deductions for LAT		(89)	
Land appreciated value		211	
% of appreciation (211 ÷ 89)		237%	0·5
LAT (211 x 60%) – (89 x 35%)		95·45	0·5
			4
			10

4 (a) Fus Bell Ltd (FBL)

(i) The amount of related parties loan on which interest is allowable under the thin capitalisation rules is RMB10 million (RMB5 million x 2). 1

The deductible interest expense at the actual interest rate of 7%, which applies because it is lower than the rate of other financial institutions, is RMB0·7 million (RMB10 million x 7%). 1

2

(ii) FBL should prepare transfer pricing documentation on special issue on thin capitalisation to be able to deduct the interest expense in full. 1

(iii) The transfer pricing documentation should be submitted to the tax bureau within 30 days of the request. 1

				Marks
(b) **(i)** Taxation losses can be carried forward for 10 years by high and new technology enterprises from 2018 onwards.				1

(ii)

Year	Current year profit/(cumulative loss) RMB million	Enterprise income tax (EIT) rate	EIT payable RMB million	
2010	(15)	0%	0	0·5
2011	(13)	0%	0	0·5
2012	3	0%	0	0·5
2013	(102)	0%	0	0·5
2014	(91)	12·5%	0	0·5
2015	(68)	12·5%	0	0·5
2016	(50)	12·5%	0	0·5
2017	(19)	15%	0	0·5
2018	(7)	15%	0	0·5
2019	28	15%	4·2	0·5
				5
				10

5 **(a)** Susan

	RMB	
Comprehensive income		
(1) Salary (12,000 x 12)	144,000	0·5
(2) Consultancy fee (100,000 x 80%)	80,000	0·5
(3) Authorship fee (82,000 x 80% x 70%)	45,920	0·5
(4) Royalty on right to portrait (75,000 x 80%)	60,000	0·5
	329,920	
Less: Annual allowance	(60,000)	0·5
Specific and additional specific deductions	(72,600)	0·5
Taxable income	197,320	
Individual income tax (IIT) (197,320 x 20% – 16,920)	22,544	1
(5) Gain on sale of A-shares – exempt	0	0·5
(6) IIT on sale of shares (45,000 x 20%)	9,000	0·5
(7) IIT on dividend from A-shares holding over one month and less than one year (6,000 x 50% x 20%)	600	1
(8) IIT on dividend from country X (USD10,000 x 20% = 2,000, less foreign tax credit (FTC) USD2,100)	0	1
(9) IIT on lottery from country Y (USD1,000 x 20% = 200, less FTC USD50; IIT payable USD150 x 6)	900	1
(10) Bank interest – exempt	0	0·5
(11) IIT on loan interest (7,600 x 20%)	1,520	0·5
(12) Insurance compensation – exempt	0	0·5
(13) Internet red-pocket money from friends – not taxable	0	0·5
		10

Tutorial notes:

1. *FTC carried forward in relation to the country Y dividend is USD100 x 6 = RMB600.*
2. *FTC on IIT is calculated by country; hence, the tax credit on the dividend from country X cannot be offset against the IIT on the lottery winnings from country Y.*

(b) Ms Beth

	RMB	
RN Ltd		
Salary	20,000	0·5
Less: Monthly allowance for non-resident	(5,000)	0·5
	15,000	
IIT (15,000 x 20% – 1,410)	1,590	0·5

	RMB	*Marks*
QT Ltd		
Salary	35,000	0·5
Less: Monthly allowance for non-resident	(5,000)	0·5
	30,000	
IIT (30,000 x 25% – 2,660)	4,840	0·5
		3

(c) According to the anti-avoidance article of the IIT Law, the tax authority is empowered to use a reasonable method to carry out a tax adjustment when a tax resident who controls a company set up in a jurisdiction with an obviously low effective tax rate either does not distribute any of the company's profits or restricts profit distribution without a reasonable operating reason. As such, the tax authority can carry out a tax adjustment and treat Mr Ma as taxable on the profits of LB Ltd. 2

15

Tutorial note: *This is similar to the controlled foreign company rules under the Enterprise Income Tax law.*

6 Tool Ltd

		RMB	
	Accounting profit	2,840,000	
(1)	Commission not deductible (200,000 – 1,000,000 x 5%)	150,000	1
(2)	Inventory	0	0·5
(3)	Entertainment expenses (102,000 x 60% = 61,200 capped at 10,800,000 x 0·5% = 54,000; non-deductible = 102,000 – 54,000 = 48,000)	48,000	1
(4)	Marketing expenses (cap at 10,800,000 x 15% = 1,620,000; excess expenses of 2017 are deductible)	(200,000)	1
(5)	Additional deduction on research and development (R&D) expenses (240,000 x 75%)	(180,000)	0·5
(6)	Cash donation	8,000	0·5
(7)	Staff training (capped at 4,000,000 x 8% = 320,000, no adjustment)	0	1
(8)	Provision for obsolete inventory not deductible	150,000	0·5
(9)	Accrual for electricity (no adjustment)	0	0·5
(11)	Amortisation of goodwill not deductible	420,000	0·5
(12)	Social security contributions (no adjustment)	0	0·5
(13)	Commercial insurance for employees (not deductible)	80,100	0·5
(14)	Accounting depreciation (3,000,000 ÷ 5)	600,000	0·5
	Tax deduction (3,000,000 x 4/15)	(800,000)	1
(15)	Profit from partnership (taxable, no adjustment)	0	0·5
(16)	Interest on government bonds (tax exempt)	(12,500)	0·5
(17)	Bank interest income	0	0·5
(18)	Tax on royalty income from Vietnam	30,000	0·5
(19)	Tax borne on royalty expense	0	0·5
(20)	Penalty on breach of contract	0	0·5
(21)	Tax late payment surcharge	3,400	0·5
	Taxable income	3,137,000	
	EIT rate	25%	0·5
	EIT	784,250	
	Less:		
(10)	Tax credit on energy and water saving equipment (234,000 x 10%)	(23,400)	0·5
(18)	Foreign tax credit on royalty (capped at (70,000 + 30,000) x 25%	(25,000)	1
	EIT payable	735,850	
			15

Tutorial note: *Additional R&D deduction increased to 75% for all enterprises starting from 2018.*