Answers

Section B *Marks*

1 (a) GKL Ltd

The transfer pricing methodologies the tax bureau can use are:

– the comparable uncontrolled price method;
– the cost plus method;
– the resale price method;
– the profit split method; and
– the transactional net margin method.

Any TWO of the above – 1 mark each 2

(b) CD Ltd – Enterprise income tax (EIT) for 2017

	RMB	Marks
Grossed up income before tax of T Ltd (950,000 ÷ 95% ÷ 80%)	1,250,000	1
Net of tax dividend from T Ltd	(950,000)	0.5
Turkmen tax paid	300,000	
EIT on income from T Ltd (1,250,000 x 25%)	312,500	0.5
Foreign tax credit	(300,000)	0.5
EIT payable on dividend income from T Ltd	12,500	
Grossed up income before tax of U Ltd	1,000,000	0.5
EIT on income from U Ltd (1,000,000 x 25%)	250,000	0.5
US tax paid (300,000 + 70,000) = RMB370,000		0.5
Foreign tax credit	(250,000)	0.5
EIT payable on dividend income from U Ltd	0	
Foreign tax credit carried forward (370,000 – 250,000)	120,000	0.5
		5

(c) STuv Ltd

(i) Value added tax (VAT) and enterprise income tax (EIT) to be withheld

	RMB	Marks
Tax base for VAT and withholding tax (1,000,000 ÷ (1 – 10%))	1,111,111	1
VAT (1,111,111 x 6%)	66,667	0.5
EIT (1,111,111 x 10%)	111,111	0.5
		2

(ii) The VAT can be credited, hence, the cost of the royalty is RMB1,111,111 (1,000,000 + 111,111). 1

10

2 (a) Susan/Ten-day Hotel

(i) A mixed sale is a sales transaction which involves both goods and services or services under different tax categories. 1

A composite sale is a principal sale transaction with an ancillary component(s) which is/are under different tax categories. 1

The sale of a soft drink from the mini bar is a composite sale. 1

3

(ii) The free breakfast is not a deemed sale of services. The hotel is not providing breakfast free of charge since Susan has to pay the accommodation charges for her stay before she can get the breakfast. 2

[**Tutorial note:** *This is a bundled sale.*]

Marks

(iii) Ten-day Hotel output value added tax (VAT)

	RMB	
Accommodation (1,600 ÷ 1·06 x 6%)	91	1
Mini bar sale (40 ÷ 1·17 x 17%)	6	1
	97	2

(b) O-source Ltd

(i) Output value added tax (VAT)

	RMB	
Service income from overseas customers (exempt)	0	0.5
Service income from domestic customers (6,000,000 x 6%)	360,000	0.5
	360,000	1

(ii) Input VAT

	RMB	
Periodic costs and expenses (185,000 x 6,000,000/10,000,000)	111,000	1
Equipment (all recoverable)	170,000	1
	281,000	2
		10

3 Elsa Chen

(a) Using a proprietorship business

Individual income tax (IIT) for 2017

	RMB	RMB	
Net profit		19,000	
Add:			
Salary of Elsa	130,000		0.5
Non-deductible entertainment expenses (1,600 – 960)	640		1
[(60% x 1,600) = 960; maximum deduction: (300,000 x 0.5%) = 1,500]			
		130,640	
Less: Allowance for proprietorship		(42,000)	0.5
Taxable income		107,640	
IIT (107,640 x 35% – 14,750)		22,924	1

Alternative method for calculating taxable income:

	RMB	*RMB*	
Sales		*300,000*	
Cost of sales	*100,000*		
Salary of Elsa	*0*		*0.5*
Deductible entertainment expenses (lower of 1,600 x 60% = 960; or 300,000 x 0.5% = 1,500)	*960*		*1*
Other costs and expenses (all deductible)	*49,400*		
		(150,360)	
		149,640	
Less: *Allowance for proprietorship*		*(42,000)*	*0.5*
Taxable income		*107,640*	

Total income after tax in 2017

	RMB	
Total income (130,000 + 19,000)	149,000	0.5
Less: IIT payable (as above)	(22,924)	0.5
After-tax income of Elsa	126,076	
		4

			Marks

(b) Using a company

(i) Enterprise income tax (EIT) for 2018

	RMB	Marks
Net profit	19,000	
Add: Non-deductible entertainment expenses	640	
Taxable income	19,640	1
EIT at 10% (small profit enterprise)	1,964	0.5
Net profit of EC Hand Ltd	19,000	
Less: EIT	(1,964)	
Net profit after tax = dividend to Elsa	17,036	0.5
		2

(ii) Individual income tax (IIT) payable by Elsa for 2018

	RMB	Marks
On dividend (17,036 x 20%)	3,407	0.5
On monthly salary ((10,000 – 3,500) x 20% – 555) = 745		1
For 12 months (745 x 12)	8,940	0.5
On bonus (find tax rate: 10,000 ÷ 12 = 833 => 3%; IIT = 10,000 x 3%)	300	1
Total IIT	12,647	3

(iii) Total income after tax in 2018

	RMB	Marks
Total income (130,000 + 17,036)	147,036	0.5
Less: IIT (from (ii) above)	(12,647)	0.5
Total after tax income of Elsa	134,389	1
		10

4 (a) Uanke Ltd – land appreciation tax (LAT) on sale to JD-Mart

	RMB	RMB	Marks
Land use right	30,000,000		0.5
Deed tax	900,000		0.5
Construction costs	20,000,000		0.5
Development costs		50,900,000	
Administrative expenses (capped at 50,900,000 x 5%)	2,545,000		0.5
Bank loan interest	4,500,000		0.5
Development expenses		7,045,000	
Sales tax: surtaxes on value added tax (VAT)		960,000	0.5
Deduction for property developer (50,900,000 x 20%)		10,180,000	0.5
Total LAT deductions		69,085,000	
Sales proceeds		150,000,000	
Less: Total LAT deductions		(69,085,000)	0.5
Land appreciated value		80,915,000	
Land appreciation ratio (80,915,000 ÷ 69,085,000)		117%	0.5
LAT (80,915,000 x 50% – 69,085,000 x 15%)		30,094,750	0.5
			5

Marks

(b) JD-Mart

(i) Land appreciation tax (LAT) on planned sale

	RMB	RMB	
Sale proceeds		250,000,000	0.5
Replacement cost of a building of same wear and tear (220,000,000 x 90%)	198,000,000		1
Sales tax: surtaxes on value added tax (VAT)	1,320,000		0.5
Total LAT deductions		(199,320,000)	
Land appreciated value		50,680,000	
Land appreciation ratio (50,680,000 ÷ 199,320,000)		25%	0.5
LAT (50,680,000 x 30%)		15,204,000	0.5
			3

(ii) Estimated profit on sale for enterprise income tax (EIT)

	RMB	RMB	
Sales proceeds		250,000,000	
Total costs	162,500,000		0.5
Deductible taxation costs (4,500,000 + 1,320,000 + 15,204,000 (land appreciation tax (LAT)))	21,024,000		1.5
		(183,524,000)	
Net profit before EIT		66,476,000	2
			10

5 (a) Mr Zhang

(i) Mr Zhang will continue to be a China tax resident during the period of his secondment. He habitually resides in China due to household, family and economic benefit reasons. His stay in Zambia is due to the reasons of work only. 2

(ii) Individual income tax (IIT) in December 2017

	RMB	
Gross salary	30,000	0.5
Less: Employee's social security contribution in China	(2,400)	0.5
	27,600	
Less: Allowance	(4,800)	0.5
	22,800	
IIT (22,800 x 25% – 1,005)	4,695	0.5
IIT on lottery (USD1,000 x 6 x 20%)	1,200	1
Total IIT	5,895	
Less: Foreign tax credit for Zambian tax paid (2,000 + 500 x 6))	(5,000)	1
IIT payable by Mr Zhang	895	4

(b) Ms Yang – Individual income tax (IIT) in July 2017

		RMB	*Marks*
(1)	Salary	60,000	0.5
(2)	Reimbursement of cost of leasing serviced apartment	0	0.5
(3)	Meal allowances paid on a cash basis	10,000	0.5
(4)	Reimbursement of her children's education fees for studying in the United States	31,500	0.5
(5)	Reimbursement of cost of learning Putonghua	0	0.5
(6)	Reimbursement of her third home leave air ticket	6,200	0.5
(7)	Reimbursement of hotel charges on business trips	0	0.5
(8)	Director's fee from a subsidiary (taxed as wages and salaries)	30,000	1
	Taxable income	137,700	
	Less: Monthly allowance	(4,800)	1
		132,900	
	IIT on wages and salaries (132,900 x 45% – 13,505)	46,300	0.5
(9)	Taxable income on stock options (150,000 x (50 – 1))	7,350,000	0.5
	Find tax rate: 7,350,000 ÷ 12 = > 45%		0.5
	IIT on stock options ((7,350,000 ÷ 12 x 45% – 13,505) x 12)	3,145,440	0.5
(10)	Gain on disposal of shares listed in China Stock Exchange	0	0.5
(11)	IIT on publication and re-publication of articles (((1,000 + 1,000) – 800) x 20% x 70%)	168	1
			9
			15

Marks

6 Sun Ltd – Enterprise income tax (EIT) for 2017

		RMB	
	Net profit	85,000	
(1)	Goods sold returned in 2018	0	0.5
	[**Tutorial note:** *No adjustment for both accounting and taxation on goods returned in subsequent year*]		
(2)	Inventory valued at weighted average method	0	0.5
(3)	Non-deductible interest in excess of the thin capitalisation threshold ((100 – (30 million x 2)) x 6%)	2,400,000	1
(4)	Bad debt written off	0	0.5
(5)	Provision for bad debt	360,000	0.5
(6)	Deemed sale on donation	75,000	0.5
(6)	Non-deductible donation recorded in cost of sales	40,000	0.5
	[**Tutorial note:** *The corresponding entry for the deemed sale is a donation of RMB75,000. Since a donation to a school is not deductible, no adjustment is required for the donation as this was not recorded in the accounts.*]		
(7)	Donation to the China Red Cross (excess over the deductible limit (18,000 – 85,000 x 12%))	7,800	0.5
(8)	Tax depreciation on new equipment (1,500,000 x 2/60)	(50,000)	0.5
(9)	Additional deduction for research and development expenses (1,374,000 x 75%)	(1,030,500)	1
	[**Tutorial note:** *The additional deduction rate was increased from 50% to 75% from 1 January 2017.*]		
(10)	Provision for bonus paid in April 2018	0	0.5
(11)	Stock option incentive provided for on grant date but not yet exercised	680,000	0.5
(12)	Tax depreciation (6,000,000 x 4/15)	(1,600,000)	1
	Accounting depreciation (6,000,000 ÷ 5)	1,200,000	0.5
(13)	Residual amount of specific financial subsidy (500,000 – 480,000)	20,000	0.5
	[**Tutorial note:** *A specific financial subsidy is not taxable on granting but the balance is taxable on completion of the specific project.*]		
(14)	Non-taxable specific financial subsidy	(720,000)	0.5
	Non-deductible specific expenses	232,000	0.5
(15)	General purpose financial subsidy	0	0.5
(16)	Promotion and advertising expenses (cap for deduction: (25,000,000 x 15%) = 3,750,000; amount incurred + carried forward from 2016 = (3,200,000 + 400,000) = 3,600,000; total amount deductible in 2017 = 3,600,000)	(400,000)	1
(17)	Dividend from subsidiary	(50,000)	0.5
(18)	Interest on government bonds	(30,000)	0.5
(19)	Interest on corporate bonds	0	0.5
(20)	Dividend from A-shares held for less than 12 months	0	0.5
	Taxable income	1,219,300	
	EIT at 15%	182,895	0.5
(8)	EIT credit on energy and water saving equipment (1,500,000 x 10%)	(150,000)	1
	EIT payable	32,895	
			15