Answers

The suggested answers are of the nature of general comment only. They are not offered as advice on any particular matter and should not be taken as such. No reader should rely on the suggested answers as the basis for any decision. The examiners expressly disclaim all liability to any person in respect of any indirect, incidental, consequential or any other damages relating to the use of the suggested answers.

1 Report to the Director of Company J

To: Mr Cheng
From: Tax advisor
Date: 7 June 2010
Subject: Utilisation of idle production plant and sale and lease back of machinery

Company J is considering various alternative options for utilising its idle production plant and the sale and lease-back of its machinery to help raise funds. You have requested me to address all the China tax implications regarding the alternative options and advise on the sale and lease-back arrangement, my comments are as follows:

(a) Option 1 – Sale of the production plant

The sale of plant is considered an asset-type transaction. Any gain on the disposal is subject to enterprise income tax (EIT), and the tax payable will be RMB 75,000 [(500,000 – (1,000,000 – 800,000)) x 25%] (ignoring the immaterial effect of stamp duty, which is an allowable deduction).

As the transfer does not involve immovable property or an intangible asset, business tax (BT) is not chargeable.

Sales of used assets are exempt from value added tax (VAT) if the following three conditions are satisfied:

(1) The plant is listed on the fixed assets register of the company.
(2) The plant is treated as a fixed asset and has been used in the past.
(3) The sales consideration is lower than the original cost.

Therefore, it is most likely that the transaction will be exempt from VAT. If this is not the case then VAT will be levied.

Tutorial note: As the exemption from VAT previously available for the sale of used fixed assets where the sale value did not exceed the original cost of the asset was cancelled with effect from 1 January 2009, the sale value would now be subject to VAT at 17% (Circular (2008) 170).

Stamp duty (SD) is payable on the sales contract at the rate of 0·03% by both parties (i.e. Company J and Company K). The SD payable by Company J will be RMB 150 (RMB 500,000 x 0·03%).

Option 2 – Lease of plant without transfer of title

According to *Guoshuifa* (2003) 45, as the lease period is substantially the same as the remaining life of the plant, it will be treated as a finance lease.

According to *Guoshuihan* (2000) 514, if there is no transfer of title at the end of the lease, the transaction is taxed under the category of leasing services, i.e. under BT; and no VAT is payable. The BT payable will be RMB 2,500 (50,000 x 5%) for each of the five years.

According to *Guoshuidizi* (1988) 30, for SD purposes a finance lease is taxed under the category of a loan contract at 0·005% of the loan amount by each of the parties, and the SD payable by Company J will be RMB 12·50 (50,000 x 5 x 0·005%). (According to the *Provisional Rules on SD*, Art 3, SD payable shall be rounded to the nearest *jiao* (one-tenth of RMB 1).)

Since this is a finance lease, the depreciation allowance is claimed by the lessee (Company K). The EIT payable by Company J is therefore RMB 1,875 [(50,000 – 2,500 BT – 200,000/5 the cost of giving up the remaining depreciation allowance) x 25%] for each of the five years (ignoring the immaterial effect of stamp duty, which is an allowable deduction).

Option 3 – Lease of plant with transfer of title

Since the lease period is substantially the same as the remaining life of the plant, it is again treated as a finance lease.

According to *Guoshuihan* (2000) 514, if there is a transfer of title at the end of the lease, the transaction is taxed under VAT and no BT is payable. VAT payable will be RMB 8,718 (60,000/1·17 x 17%) for each of the five years.

As under Option 2, according to *Guoshuidizi* (1988) 30, a finance lease is taxed under the category of a loan contract at 0·005% of the loan amount by each of the parties, and the SD payable by Company J will be RMB 15 (60,000 x 5 x 0·005%).

Again, since this is a finance lease, the depreciation allowance is claimed by the lessee (Company K). EIT payable by Company J is therefore RMB 5,000 [(60,000 – 200,000/5 the cost of giving up the remaining depreciation allowance) x 25%] for each of the five years (ignoring the immaterial effect of stamp duty, which is an allowable deduction).

Option 4 – Lease of plant to different users

Since the lease period is substantially less than the remaining life of the plant, it is treated as an operating lease.

The transaction is taxable under the category of leasing services, i.e. under BT and no VAT is payable. BT payable is RMB 2,750 (55,000 x 5%) for each of the five years.

An operating lease is taxed under the category of a property leasing contract at 0·1% of the leasing fee, by both parties (Company J and the lessee) and the SD payable for each year by Company J will be RMB 55 (55,000 x 0·1%).

Since this is an operating lease, the depreciation allowance is claimed by the lessor, i.e. Company J. EIT payable is therefore RMB 3,062 [(55,000 – 2,750 BT – 200,000/5 depreciation allowance) x 25%] for each of the five years (ignoring the immaterial effect of stamp duty, which is an allowable deduction).

Option 5 – Contributing the plant as capital without sharing business risk

Since Company J does not share in the business risk, this is deemed to be a sales transaction. Thus, any gain on the disposal is subject to EIT, and the tax payable is RMB 3,000 [52,000 – 200,000/5 the cost of giving up the remaining depreciation allowance) x 25%] for each of the five years (ignoring the immaterial effect of stamp duty, which is an allowable deduction).

The BT and VAT implications will be the same as for Option 1.

SD will be payable on the sales contract by both parties at the rate of 0·03% and Company J will be liable to pay RMB 78 (RMB 52,000 x 5 x 0·03%).

Option 6 – Contributing the plant as capital and sharing business risk

Since Company J will share in the business risk, this is not a sales transaction. No EIT, VAT, or BT will by payable. Nor will any SD be payable by Company J, but Company L, as the initiator of the contract, will pay SD on the document transferring the plant to Company Y at the rate of 0·05% of its market value.

(b) Sale and lease back of machinery

The basic structure of a sale and lease back arrangement is that one party (Company J) sells an asset to the other party (Company L) and then leases back the use of the same asset. The first party will thus obtain the required funds but continue to have use of the asset in return for an annual rental payment.

Sale of the machinery

The sale of the machinery should be at net book value, as this will result in there being no gain on disposal and thus, no charge to EIT for Company J. Further, as the machinery will be sold at below its original cost, the transaction is likely to be exempt from VAT.

Tutorial note: As the exemption from VAT previously available for the sale of used fixed assets where the sale value did not exceed the original cost of the asset was cancelled with effect from 1 January 2009, the sale value would now be subject to VAT at 17% (Circular (2008) 170).

Lease back of the machinery

Provided that the lease is a short one (substantially less than the remaining life of the asset) then it will be treated as an operating lease. But for this to apply, Company J and Company L will need to sign a new rental agreement annually.

In the case of an operating lease, Company J will be able to deduct the rental as an expense, while Company L will have to pay both BT and EIT on the rental income received. Company L, being the lessor, will be entitled to a depreciation allowance on the machinery. If the annual rental is set at an amount equal to the annual deprecation allowance, then Company L will be able to use any interest expense and the BT paid to reduce its own EIT burden.

End of Report

2

Tax Consultant
Firm's address

Mr Zhu
Managing director
Lingbao Property Development
Client's address

7 June 2010

Dear Mr Zhu,

It was a pleasure to meet with you last week to discuss the China tax implications of the sale and lease of the residential properties, my advice in relation to which is given below.

(a) Receipts from advance sales of the residential properties

Where a real estate development enterprise prepays enterprise income tax (EIT) on income from advance sales of properties under development, it will calculate its predetermined profits according to the given predetermined profit margins. Such profits are included in the total profits for the prepayment, and then adjusted according to the actual profits after completion of the properties.

The predetermined profit margin is specified according to the standards as follows:

(1) Where the real estate development project is in the rural and urban areas of provinces, autonomous regions and cities specifically designated in the State plan, the predetermined profit margin shall not be lower than 15%.

(2) Where the projects are in the rural and urban areas of the prefecture-level cities and regions, the predetermined profit margin shall not be lower than 10%.

(3) Where the projects are in other regions, the predetermined profit margin shall not be lower than 5%.

(4) For economically affordable housing, price-restricted housing and properties reconstructed from damaged housing, the predetermined profit margin shall not be lower than 3%.

Where a real estate development enterprise makes its initial tax return for the income generated from the advance sales of economically affordable house projects, they must submit documents and other related testimonials for the projects and sales that are approved by the relevant authorities. Where they fail to comply with these provisions or fail to submit the documents and other related testimonials that are approved by the related authorities, the project will be handled in accordance with the provisions concerning the sale of normal houses (*Guoshuihan* (2008) 299).

(b) Recognition of income under different payment terms

Income from the sale of real estate is recognised on an accrual basis. The exact time for recognising the income under the different payment terms is thus:

(1) One-off payment in full – sales revenue is recognised on the date the invoice is issued, or the date when the collection right is confirmed.

(2) Instalment payments – sales revenue is recognised based on the price and payment date set by the sales contract or agreement. In the case of advance payments, sales revenue is recognised on the actual payment day.

(3) Payments through housing loans – sales revenue is recognised based on the price set in the sales contract or agreement. The initial payment will be recognised when received, and the remainder when the bank transfers the loans.

(4) Sales by means of entrustment

  (i) For service charges paid to an agent, sales revenue is recognised based on the sales contract or agreement on the day when the list of sold development units is received from the agent.

  (ii) For buyout sales, sales revenue is recognised at the higher of the buyout price or the price set in the sales contract or agreement when the list of sold development units is received from the agent.

  (iii) For base price (minimum price) and profit-sharing for excess price, sales revenue is recognised at the higher of the base price or the price per the sales contract or agreement when the list of sold development units is received from the agent.

  (iv) For exclusive sales, sales revenue is recognised in accordance with the relevant provisions of the exclusive contract and the aforesaid items (i) to (iii). Where a development product has not been sold after the expiration of the exclusive sales term, the development enterprise will recognise the revenue in accordance with the settled price and means of payment stipulated in the sale contract or agreement.

(c) Leasing of properties and uncollectible rental income

With respect to the leasing of the units, Lingbao Property Development (LPD) will be subject to business tax (BT), EIT and stamp duty (SD) as follows:

(1) BT – the rental income will be subject to BT at 5%.

(2) EIT – the rental income will be subject to EIT while the cost of the units should be amortised. The amortisation cost will be allowed as a deduction.

(3) SD – the leases of the units will be subject to SD at the rate of 0·1% on the rental income.

With respect to uncollectible rental income, the BT and EIT implications are as follows:

(1) BT – if the rental income has been reported to the local tax authorities for BT purposes, no refund of BT paid will be allowed. However, if the rental income has not yet been reported, for tax purposes, any uncollectible income will be excluded for BT purposes.

(2) EIT – Upon pre-approval, LPD may claim a deduction for provisions for uncollectible rentals (bad debt losses) due to the following conditions:

  – the tenant has been declared bankrupt, is dissolved, dead or missing, etc;
  – the debts which remain unpaid are over three years and there is conclusive evidence showing that the tenant has no capacity to repay the debts.

Bad debt losses should first be written-off against any bad debt provision before being charged directly to expenses. The amount in excess of the provisions may be deducted from taxable income. Bad debt losses must be deducted within the year when the losses are incurred, and such deduction claims cannot be advanced or postponed. If LPD fails to declare such losses

timely without reasonable reason, such losses cannot be deducted afterwards (*Guojiashuiwuzongjuling* (2005) 13). Recovered bad debt losses are included in the taxable income of the year of recovery.

(d) Sale of units at a discount to senior management

If some of the units are sold to LPD's senior management at a discount, the Chinese tax authorities may challenge the reasonableness of the sales price and adjust it to the fair market value for the purposes of LPD's EIT.

In the case of the senior management, the Chinese tax authorities may challenge that the discount actually represented an in-kind benefit under their employments. As such, the discount may attract individual income tax as part of their taxable employment income.

I hope the above addresses all your concerns regarding the China tax implications of the sale and lease of the residential properties. Please do not hesitate to contact me again if you have any questions.

Yours faithfully,

Tax Consultant

3 (a) It is significant to determine whether a taxpayer's income is taxable as 'employment income' or 'individual service income' because of the different tax rates which apply to the respective income categories.

The tax treatment for employment income is as follows:

(i) Employment income is taxed at progressive rates from 5% to 45%.
(ii) The deductible amount for a Chinese national is RMB 2,000.
(iii) The taxable income includes salaries, wages, bonuses, stock options, allowances, subsidies and any other income related to the employment.

The tax treatment for individual service income is as follows:

(i) Each payment of income is taxed at a fixed rate of 20%. However, if the taxable income exceeds RMB 20,000 but is less than RMB 50,000, the tax rate for the excess amount is increased by 50% (i.e. to 30%); and if taxable income exceeds RMB 50,000, the applicable tax rate for the excess amount is increased by 100% (i.e. to 40%).
(ii) The deductible amount for computing the net taxable income is 20% of the taxable income or RMB 800, whichever is the higher.
(iii) The taxable income comprises the service fees paid to the individual service provider.
(iv) If there is more than one payment in a month, all the income for the month will be added together for the purpose of computing the tax liability.

(b) *Guoshuifa* (1994) 89 clarifies the difference between employment income and remuneration for individual services. 'Employment income' is the remuneration received by an individual for performing non-independent individual labour activities, while 'individual service income' is the remuneration derived by an individual providing individual skills or services independently. The main difference is that wages and salaries are derived in circumstances involving an employer/employee relationship whereas no such relationship exists when a taxpayer derives individual service income.

Apart from the provisions of *Guoshuifa* (1994) 89, there is no clear definition of an 'employment' or 'individual service'. In practice, in the event of uncertainty, the tax authorities may look at the manner in which the taxpayer performs his/her work. Independent contractors can usually be identified as meeting any one or more of the following criteria:

(i) the taxpayer provides his/her own tools and equipment at work;
(ii) the taxpayer is not required to attend a fixed place of work at regular hours; and/or
(iii) the taxpayer is not covered by workers compensation insurance or does not enjoy staff medical or other fringe benefits (e.g. overtime, housing, annual leave, social benefits, etc), which are otherwise provided to employees only.

In the case of Sam, although instruments are supplied for Sam's use, there are no regular working hours and he is not entitled to staff medical or other fringe benefits. It is therefore highly likely that the tax authorities will regard Sam as a provider of 'individual service'.

(c) Regardless of the nature of the appointment of Sam, as Entertainment Ltd will bear his IIT, the tax payment will be a taxable benefit and the net of tax income must be 'grossed up' to arrive at the taxable amount (*Guoshuifa* (1994) 89, Art 14).

(i) If his appointment is regarded as an employment, the grossing up formula will be as follows:

$$\text{Grossed-up taxable income} = \frac{(A - B - D)}{(1 - C)}$$

where:
A = net of tax income
B = fixed standard deduction
C = applicable tax rate
D = applicable quick deduction

The IIT liability of Sam, assuming his appointment is regarded as an employment, would thus be calculated as follows:

$$\text{Grossed-up taxable income} = \frac{(30,000 - 2,000 - 1,375)}{(1 - 25\%)}$$

$$= \text{RMB } 35,500$$

IIT payable = (Gross-up taxable income x C) – D
= [(35,500 x 25%) – 1,375]
= RMB 7,500

(ii) If his appointment is regarded as one of individual services, the net of tax income grossing-up formula will be as follows:

$$\text{Grossed-up taxable income} = \frac{(A - D) \times (1 - 20\%)}{1 - [C \times (1 - 20\%)]}$$

The IIT liability of Sam, assuming his appointment is regarded as the provision of individual service, would thus be calculated as follows:

$$\text{Grossed-up taxable income} = \frac{(30,000 - 2,000) \times (1 - 20\%)}{1 - [30\% \times (1 - 20\%)]}$$

$$= \text{RMB } 29,474$$

IIT payable = (Gross-up taxable income x C) – D
= [(29,474 x 30%) – 2,000]
= RMB 6,842

Tutorial note: Alternative calculations using other methods will be accepted.

4 (a) The store should be regarded as carrying out 'concurrent' sales activities for turnover tax purposes as the fast food business will be subject to business tax (BT) while the sales of souvenirs will be subject to value added tax (VAT). Income generated from the fast food business and from the sale of souvenirs should be separately accounted for, with the former income subject to BT at 5% and the latter income subject to VAT at 17%. If the respective incomes cannot be separately accounted for, the total income will be subject to the highest tax rate. In other words VAT at 17% will be imposed on the total income.

(b) The China tax implications of the various promotional activities are as follows:

(1) All souvenirs sold at a discount of 20%

VAT: FFL is subject to VAT with respect to its sales of souvenirs. The sales discount will be allowed for VAT purposes such that the output VAT will be computed on the net of discount price.

EIT: In computing the taxable profit of FFL, the discount can be deducted from the taxable profit and the net of discount price recorded as the sales revenue of the souvenirs.

IIT: No IIT should arise on the customers purchasing the souvenirs.

(2) For every purchase of souvenirs of RMB 50, a coupon for RMB 10 will be given for settlement against any further purchase

VAT: The output VAT should be computed based on the gross sales amount of RMB 50 only. However, when the customer uses the cash coupon to purchase goods, it is not at all certain whether the goods should be treated as sales subject to output VAT.

EIT: The value of the cash coupon will be treated as a promotional expense of FFL, and as such, will be allowed as an income tax deduction.

IIT: According to *Guoshuihan* (2000) 57, the cash coupons should attract IIT on the customers as 'other income'. FFL is required to deduct the withholding tax. As the customers are offered the cash coupons free at no additional cost, the IIT should be borne by FFL, and the cost of this will be allowed for EIT purposes.

(3) Using the souvenirs as free gifts for a lucky draw

VAT: The use of souvenirs as free gifts will be treated as 'deemed sales' for VAT purposes. The tax authority may assess the sales price of the souvenirs based on the fair market value or other appropriate basis.

EIT and IIT: The tax implications are the same as those in option (2) above.

(c) If the write off of the obsolete souvenirs is assessed by the competent tax authorities as a normal loss, the corresponding input VAT will be allowed for credit against the output VAT of the store.

If the write off is assessed as an abnormal loss, the corresponding input VAT will be computed and reversed from the input VAT account of the current period. In other words, the corresponding input VAT due to the abnormal loss should not be allowed for credit against the output VAT of the store.

5 (a) Brian is employed by Fast Ltd for a period of four years. As an expatriate who will live in China for more than one year but less than five years, Brian will be subject to IIT on his China-sourced income plus any income which is paid to him by an individual or enterprise located in China (*Individual Income Tax Implementation Rules* (IITIR), Article 6).

Certain types of income are exempt from IIT in accordance with the IITL and special circulars issued by the tax authorities. The application of these principles and exemptions to Brian is as follows:

(1) The monthly salary, monthly cost of living allowance and relocation allowance paid in cash for his employment in China are PRC-sourced incomes and taxable.

(2) According to the PRC tax regulations, a housing allowance received in a non-cash form or on a reimbursement basis by an expatriate can be exempted from IIT. Thus, the housing allowance reimbursed by Fast Ltd should be excluded from Brian's monthly taxable income.

(3) A home leave allowance earned by an expatriate, provided the amount is reasonable, will be exempt from IIT if the expatriate can provide the relevant receipts or invoices for transport expenses actually incurred by him/her to the tax authorities for review. Home leave allowance for the expatriate's (excluding spouses and children) trips from China to the expatriate's home (or the home of the expatriate's spouse or parents), of up to two trips per calendar year, is considered reasonable.

(4) Of the annual bonus received for the year 2009, only eight months (i.e. 1 May to 31 December 2009) relates to Brian's China secondment. Thus, only 8/12ths of this annual bonus will be subject to IIT.

The annual bonuses received for the years 2010 to 2012 are all PRC-sourced income as they relate to his China secondment. Therefore, the full amount should be subject to IIT.

Of the annual bonus received for the year 2013, only four months (i.e. 1 January to 30 April 2013) will relate to Brian's China secondment. Thus, only 4/12ths of the annual bonus will be subject to IIT.

(5) Benefits derived by employees from stock options are regarded as income related to employment and are subject to IIT. According to *Caishui* (2005) 35, the granting of options will not trigger IIT at the time of the grant. When an employee exercises stock options, if the exercise price is lower than the fair market price on the day of purchase (i.e. the closing price), the difference is treated as employment related compensation and should be classified as 'salary and compensation' for IIT purposes. The salary income relating to the exercise of stock options should be calculated separately from the monthly salary.

In accordance with *Guoshuihan* (2000) 190, if it can be proved to the satisfaction of the tax bureau that a portion of the option (and hence the gain) is related to the services of the employee before the commencement of the China employment, such portion will not be taxable. By the same token, the gain from the exercise of options will be taxable if it is related to services rendered in China even though it is accrued or received by the employee after the completion of the employment and departure from China. Nevertheless, if the cost relating to the options exercised is not borne by an entity in China, the related gain can be exempt from IIT where the employee exercises the options after departure from China.

(6) The monthly rental income is non-PRC-sourced income. Therefore, as Brian will live in China for less than five years, it should not be subject to IIT in China.

(b) IIT is generally reported and paid through withholding agents. However, an individual taxpayer should lodge his/her own tax return and pay tax personally (i.e. perform IIT self-reporting) where:

(1) salaries and wages are received from two or more sources;
(2) taxable income is derived from outside China;
(3) taxable income is received for which there is no withholding agent;
(4) separate amounts of remuneration are received for one-off personal services, remuneration for manuscripts, royalties or property leasing income;
(5) taxable income is received and the tax withholding agent withholds tax in contravention of the applicable regulations; and
(6) the tax authorities require personal lodgement of tax returns (*Provisional Measures on Personal Lodgement of Individual Income Tax* (PMPLIIT), Art 2).

In addition:

– An individual taxpayer with annual taxable income of more than RMB 120,000 may be required to self-report his/her taxable income to the tax bureau in charge within three months after the year end (*Individual Income Tax Implementation Rule* (IITIR), Art 36).

– An individual taxpayer may be required to lodge a return and pay tax personally notwithstanding that a withholding agent has already declared the taxpayer's income and withheld tax.

In the case of Brian, as his annual income exceeds RMB 120,000, he will be required to perform IIT self reporting by no later than 31 March of the subsequent year; and complete the *Self-Filed Tax Returns of Tax Bearers*. The monthly IIT already withheld by Fast Ltd as his employer and paid over to the tax bureau will be deductible from the amount of tax payable on self-reporting (IITIR, Art 38; PMPLIIT, Art 4).

			Marks
1 (a)	**Option 1 – Sale of plant**		
	An asset-type transaction	0·5	
	EIT payable	1·5	
	No BT payable	1	
	Exempt from VAT	1·5	
	SD payable	1	5·5
	Option 2 – Lease of plant without transfer of title		
	A finance lease	1	
	BT payable	1	
	No VAT	0·5	
	SD payable	1·5	
	EIT payable	2	6
	Option 3 – Lease of plant with transfer of title		
	A finance lease	0·5	
	VAT payable	1	
	No BT	0·5	
	SD payable	1	
	EIT payable	1	4
	Option 4 – Lease of plant to different users		
	An operating lease	1	
	BT payable	1	
	No VAT	0·5	
	SD payable	1·5	
	EIT payable	1·5	5·5
	Option 5 – Contributing the plant as capital without sharing business risk		
	A sales transaction	0·5	
	EIT payable	1	
	BT and VAT implications (2 x 0·5)	1	
	SD payable	1	3·5
	Option 6 – Contributing the plant as capital and sharing business risk		
	Not a sales transaction	0·5	
	No EIT, VAT or BT payable	1	
	SD payable but by Company L	1	2·5
			27
(b)	**Sale and lease-back of machinery**		
	Basic structure of a sale and lease-back arrangement	1	
	Sale of machinery		
	Sale at NBV	1	
	EIT and VAT implications	1·5	
	Lease-back of machinery		
	An operating lease	1	
	Rental deductible by lessee	0·5	
	BT and EIT implications for lessor	2	7
	Appropriate format and presentation	1	
	Effectiveness of communication	1	2
	Total		**36**

		Marks
2 (a) Receipts from advance sales of the residential properties		
Predetermined profits included in total profits for prepayment of EIT	2	
Using predetermined profit margins – 15%	1	
– 10%	1	
– 5%	1	
– 3%	1	
Need to submit documents in support of 3%	1	7
(b) Recognition of income under different payment terms		
Accruals basis	1	
One-off payment in full	1	
Instalment payments	1	
Payments through housing loans	1	
Sales by means of entrustment		
For service charges paid to an agent	1	
For buyout sales	1	
For base price and profit-sharing for excess price	1	
For exclusive sales	1	8
(c) Leasing of properties and uncollectible rental income		
Leasing of properties		
BT implications	0·5	
EIT implications	1	
SD implications	0·5	
Uncollectible rental income		
BT implications	1	
EIT implications		
Conditions for claiming bad debts provision	2	
Provision limited to 0·5% of accounts receivable	1	
Treatment of bad debts written off	2	8
(d) Sales of units at a discount to senior management		
EIT implications to LPD	1·5	
IIT implications to senior management	1·5	3
Appropriate format and presentation	1	
Effectiveness of communication	1	2
Total		**28**

				Marks
3	**(a)**	Tax treatment for employment income		
		Tax rates	0·5	
		Deductible amount	0·5	
		Taxable income	0·5	
		Tax treatment for individual service income		
		Tax rates	1	
		Deductible amount	0·5	
		Taxable income	0·5	
		Payments added together	0·5	4
	(b)	Definition of employment income	1	
		Definition of individual service income	1	
		Significance of employer/employee relationship	1	
		Criteria for determination	3	
		Conclusion for Sam	2	8
	(c)	Grossing-up of net of tax income	1	
		Individual service		
		Grossing-up calculation	2	
		IIT payable	0·5	
		Employment		
		Grossing-up calculation	2	
		IIT payable	0·5	6
	Total			**18**
4	**(a)**	Concurrent sales activities for turnover tax	1	
		Income separately accounted for	1	
		Subject to BT and VAT separately	1	
		Otherwise, total income subject to VAT	1	4
	(b)	(1) Souvenirs sold at a discount		
		VAT implications	1	
		EIT implications	1	
		IIT implications	0·5	
		(2) Cash coupon for purchase of souvenirs		
		VAT implications	1·5	
		EIT implications	1	
		IIT implications	2	
		(3) Souvenirs as free gifts for lucky draw		
		VAT implications	2	
		EIT and IIT implications	1	10
	(c)	Souvenirs written off as normal loss	2	
		Souvenirs written off as abnormal loss	2	4
	Total			**18**

			Marks
5	**(a)** Subject to IIT on China-sourced income	1	
	IIT treatment of		
	Salary	0·5	
	Cost of living allowance	0·5	
	Relocation allowance	0·5	
	Housing allowance	1	
	Home leave allowance	1·5	
	Annual bonus for 2009 – portion taxable	1	
	2010 to 2012 – full amount taxable	0·5	
	2013 – portion taxable	1	
	Options – not taxable at time of grant	1	
	– taxable at time of exercise	1	
	– not taxable if related to foreign service	0·5	
	– taxable even if received post departure if related to China employment	1	
	– may be exempt if not borne by a China entity	1	
	Rental income	1	13
	(b) IIT self reporting		
	General circumstances (any 5 at 0·5)	2·5	
	When annual income exceeds RMB 120,000	0·5	
	When required by tax authority	0·5	
	Conclusion for Brian	1·5	5
	Total		**18**