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# Answers

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|          |  | <i>Marks</i>     |
|----------|--|------------------|
| <b>1</b> | <b>Circle SA</b>   |                  |
|          | <b>(a) Quarterly income tax for 2009</b>   |                  |
|          | Circle SA is a credit institution, thus it will make quarterly prepayments of corporate income tax in 2009 based on the corporate income tax registered in 2008 multiplied with the official inflation rate communicated by the tax authorities. | 1                |
|          | Each quarterly prepayment of corporate income tax will be: $1,600,000 \times (1 + 5.5\%) \times \frac{1}{4} = 422,000$ lei   | 1                |
|          | The deadline for making these payments is the 25th of the month following the quarter for which the amount is due, i.e. 25 April, 25 July, 25 October, 25 January.   | <u>1</u>         |
|          |  | <b><u>3</u></b>  |
|          | <b>(b) Final corporate income tax for 2009</b>   |                  |
|          |  | <b>Lei</b>       |
|          | Total revenues (W1)  | 19,660,000       |
|          | Total expenses (W1)  | (15,972,400)     |
|          | Non-taxable revenues   | (660,000)        |
|          | Revenue from investment  | (560,000)        |
|          | Revenue from provisions (W2)   | (100,000)        |
|          | Elements similar to revenues   | 0                |
|          | Tax depreciation (W2)  | (15,000)         |
|          | Non-deductible expenses  | 1,789,668        |
|          | No reference to interest expenses  | –                |
|          | Protocol expenses (W3)   | 5,268            |
|          | Social expenses (W4)   | 23,600           |
|          | Subscription to a non-profit organisation (W5)   | 7,000            |
|          | No reference to office expenses  | –                |
|          | Fuel expenses  | 9,600            |
|          | Service expenses   | 27,200           |
|          | Depreciation expense   | 10,000           |
|          | Corporate income tax expenses  | 1,707,000        |
|          | Taxable income   | 4,802,268        |
|          | Income tax at 16%  | 768,363          |
|          | Tax credit for the permanent establishment (W6)  | (16,000)         |
|          | Income tax after tax credit  | 752,363          |
|          | Minimum tax due for the year ( $8/12 \times 22,000$ )  | 14,667           |
|          | Final income tax due   |                  |
|          | – normal income tax  | 752,363          |
|          |  | <u><u>1</u></u>  |
|          |  | <b><u>21</u></b> |
|          | <b>(c) Settlement of corporate income tax</b>  |                  |
|          | The corporate income tax due for the year 2009 will be settled in 2010, offset by the quarterly prepayments made, resulting a difference to be paid to/refunded by the state. The settlement is made through Circle SA's annual tax return.      | ½                |
|          | The settlement must be made by 15 April 2010, at the latest.   | ½                |
|          | Corporate income tax due for 2009 = 752,363 lei  |                  |
|          | Prepayments of corporate income tax made during the year = 1,688,000 lei   |                  |
|          | Corporate income tax to be refunded by the state = $1,688,000 - 752,363 = 935,637$ lei   | <u>1</u>         |
|          |  | <b><u>2</u></b>  |
|          | <b>(d) Tax on dividends</b>  |                  |
|          | Mathematics SA has held 55% of Circle SA's shares since May 2007.  |                  |
|          | In April 2008 Circle SA allocated dividends from the profits of the year 2007. Mathematics SA did not cash in these dividends in 2008 but only in 2009.  | ½                |
|          | Thus Circle SA had to pay withholding tax on these dividends at the latest on 31 December 2008.  |                  |

On 31 December 2008 Mathematics SA has held a participation in Circle SA for less than two years, thus Circle SA had to pay withholding tax of 10% on the dividends to the state budget.

1

In June 2009, Mathematics SA cashes in the dividends for which the tax was already paid on 31 December 2008. Therefore, no further tax on the dividends is payable to the state budget in 2009.

1

In June 2009 both the conditions for exempting the dividends from taxation were fulfilled, i.e. (i) Mathematics SA had held more than 10% of Circle SA's equity and (ii) for an uninterrupted period of more than two years. However, as the tax on the dividends had already been paid, Mathematics SA could now request a refund of the tax withheld.

1½430

## WORKINGS

### (1) Total revenues and expenses

Total revenue = Total revenue from Romania + Total revenue of the permanent establishment  
 Total revenue = 18,660,000 + 1,000,000 = 19,660,000

Total expenses = Total expenses from the profit and loss account + Prepayments of corporate income tax made during the year + Total expenses of the permanent establishment

Expenses before including prepayments of corporate income tax = 13,365,400 lei  
 Prepayments of corporate income tax (as calculated in (a)) = 422,000 x 4 = 1,688,000 lei  
 Total expenses of the permanent establishment = 750,000 + 150,000 + 19,000 = 919,000 lei  
 Total expenses = 13,365,400 + 1,688,000 + 919,000 = 15,972,400 lei

### (2) The tax depreciation and revenue from provision

The net tax value of the asset before revaluation = 300,000 lei  
 The amount of the revaluation = -100,000 lei

As this revaluation will decrease the value of the asset below its cost, the expenses generated by the revaluation in December 2008 are non-deductible when computing the corporate income tax for 2008. However, the tax value of the asset will remain at the cost level. As this is the first revaluation ever, the net tax value of the assets after the revaluation remains unchanged.

The net tax value of the asset after revaluation = 300,000 lei  
 The remaining depreciation period = 20 years  
 The tax depreciation in 2009 = 300,000/20 = 15,000 lei

As the impairment expenses were non-deductible in 2008, their reversal through revenue from provisions in 2009 will be non-taxable revenue.

### (3) Protocol expenses

The deductibility of protocol expenses is limited to 2% x (Taxable revenues – Expenses related to taxable revenues less protocol and corporate income tax expenses)

|   | Lei              |
|---|------------------|
| Taxable revenues (19,660,000 – 660,000)             | 19,000,000       |
| Expenses related to taxable revenues                | (15,972,400)     |
| Protocol expenses                                   | 102,000          |
| Corporate income tax expense (1,688,000 + 19,000)   | 1,707,000        |
|   | <u>4,836,600</u> |
| Deductibility limit for protocol expenses (2%)      | 96,732           |
| Deductible protocol expenses                        | 96,732           |
| Non-deductible protocol expenses (102,000 – 96,732) | 5,268            |

### (4) Social expenses

Both the nursery school expenses and the gift voucher expenses are social expenses. The deductibility of social expenses is limited to 2% of salary expenses.

Total social expenses = 36,000 + 2,000 = 38,000 lei  
 Deductibility limit for social expenses = 2% x 720,000 = 14,400 lei

Deductible social expenses = 14,400 lei  
 Non-deductible social expenses = 38,000 – 14,400 lei = 23,600 lei

**(5) Subscription to a non-profit organisation**

Subscriptions to non-profit organisations such as professional organisations connected to the taxpayers' activity may be deducted up to 4,000 euro per year.

Deductibility limit for subscription = 4,000 eur x 4.2 lei/eur = 16,800 lei

Deductible subscription = 16,800 lei

Non-deductible subscription = 23,800 – 16,800 = 7,000 lei

**(6) Tax credit for the permanent establishment**

Circle SA may have a tax credit for the corporate income tax paid by the permanent establishment in Hungary. This tax credit may not exceed the value of the corporate income tax that would have been paid by the permanent establishment in Romania if it had been an independent company in Romania.

Corporate income tax paid in Hungary = 19,000 lei

Taxable income of the permanent establishment according to Romanian laws = 1,000,000 – 750,000 – 150,000 = 100,000 lei

Corporate income tax that would have been paid by the permanent establishment in Romania = 16% x 100,000 lei = 16,000 lei

This is less than the tax actually paid in Hungary, so the tax credit in Romania = 16,000 lei

**2 Mrs Rhombus**

**(a) Income tax due in 2008**

The annual income quota established by the tax authorities for Mrs Rhombus in 2008 is 30,000 lei. As Mrs Rhombus started her activity in July, her income quota will be reduced to reflect the actual period in which Mrs Rhombus worked. The taxable base shall be computed by dividing the annual income quota by 365 and then multiplying by the number of days of activity.

The taxable base in 2008 = The income quota x 184/365

The taxable base in 2008 = 30,000 x 184/365 = 15,123 lei

1

Total income tax = 16% x 15,123 lei = 2,420 lei

1/2

This income tax is payable in two equal instalments on 15 September and 15 December 2008.

1

The amount of tax to be paid at each deadline = 2,420/2 = 1,210 lei

1/2

3

**(b) Prepayments of tax for 2009**

The prepayments of tax are based on the estimated taxable base, which equals the estimated gross revenue less the estimated deductible expenses.

1

Estimated taxable base = 120,000 – 110,000 = 10,000 lei

Prepayments of income tax = 10,000 x 16% = 1,600 lei

1/2

The prepayments will be made in four equal quarterly instalments by the 15th of the final month of each quarter, i.e. 15 March, 15 June, 15 September and 15 December.

1

Quarterly prepayment = 1,600/4 = 400 lei

1/2

3

**(c) Final income tax due for 2009**

|   | lei       |           |
|---|-----------|-----------|
| Gross income  | 144,000   |           |
| Sale income (100 x 120 x 12)                              | 144,000   | 1         |
| Deductible expenses                                       | (100,518) |           |
| Cash register   | (800)     | ½         |
| Salary (W1)   | (6,480)   | 1         |
| Social contributions for salary (W1)                      | (1,798)   | 1         |
| Rent (1890 x 12 x 70%)                                    | (15,876)  | 1         |
| Electricity and water (250 x 12 x 70%)                    | (2,100)   | 1         |
| Materials (6,000 x 12)                                    | (72,000)  | ½         |
| No reference to income tax for 2008 and related penalties | –         | ½         |
| Interest expenses (12,000 x 10% x 2/12)                   | (200)     | 1         |
| Depreciation expenses                                     | (0)       | 1         |
| Protocol expenses (W2)                                    | (369)     | 1½        |
| Subscription expenses (W3)                                | (895)     | 1         |
| No reference to social contributions due for herself      | –         | ½         |
| Tax base  | 43,482    |           |
| Final income tax due for 2009 at 16%                      | 6,957     | ½         |
|   |           | <u>12</u> |

**(d) Settlement of final income tax**

The final income tax due for 2009 will be settled in 2010 offset by the prepayments of income tax made during the year. ½

Mrs Rhombus has to submit her income declaration to the tax authorities by 15 May 2010. 1

Based on this declaration the tax authorities will compute the difference of tax to be paid and send Mrs Rhombus a decision as regards the amount to be paid. ½

Mrs Rhombus must pay this amount to the state budget within 60 days of receiving the decision. 1

3

**(e) The possibility of continuing to use the income quota system**

The income quota system can only be used by taxpayers who do not employ anyone. 1

As Mrs Rhombus employed one person from 1 March 2009 it would have not been possible for her to continue to use the income quota system for paying income tax in 2009 and she would have had to switch to the real system. 1

2

**(f) Hired hairdresser's monthly social security and income tax liabilities for 2009**

Employment income of 720 lei/month.

Social contributions:

– social security fund:  $720 \times 10.5\% = 76$  lei

– health care fund:  $720 \times 5.5\% = 40$  lei

– unemployment fund:  $720 \times 0.5\% = 4$  lei

Total =  $76 + 40 + 4 = 120$  lei 1

Income tax:

$16\% \times (720 - 120) = 96$  lei 1

2

25

**WORKINGS****(1) Salary and social contribution expenses**

From 1 March 2009, Mrs Rhombus has an employee. Thus, in 2009 her employee works for 10 months. The gross salary is 720 lei/month, but it is payable on the 25th of the month following the one for which it is due. Thus only 9 months will be considered as a salary expense in 2009.

Salary expense =  $9 \times 720 = 6,480$  lei

Social security contributions paid by Mrs Rhombus for her employee are:

Social security fund =  $20.8\% \times 6,480 = 1,348$  lei

Health care insurance fund =  $5.2\% \times 6,480 = 337$  lei

Unemployment fund =  $0.5\% \times 6,480 = 32$  lei

Work accident fund =  $0.159\% \times 6,480 = 10$  lei

Health insurance indemnities fund =  $0.85\% \times 6,480 = 55$  lei

Fund for guaranteeing salary payments =  $0.25\% \times 6,480 = 16$  lei

Total contributions paid = 1,798 lei

**(2) Protocol expenses**

The deductibility limit for protocol expenses =  $2\% \times (\text{Gross income} - \text{deductible expenses, other than protocol, sponsorship and subscriptions to non-profit organisations})$

Deductibility limit for protocol expenses =  $2\% \times (144,000 - (800 + 6,480 + 1,798 + 15,876 + 2,100 + 72,000 + 200)) = 2\% \times (144,000 - 99,254) = 895$  lei

Protocol expenses paid in 2009 = 369 lei

Deductible protocol expenses = 369 lei

**(3) Subscription expenses**

As these are expenses for subscription to a professional organisation which are not compulsory for Mrs Rhombus they will only be deductible up to  $2\% \times (\text{gross income} - \text{deductible expenses, other than protocol, sponsorship and subscriptions to non-profit organisations})$

Deductibility limit subscription expenses (as in working (2)) =  $2\% \times (144,000 - 99,254) = 895$  lei

Subscription expenses paid in 2009 = 1,200 lei

Deductible subscription expenses = 895 lei

3 Oval SRL

(a) Value added tax (VAT) arising from 2009 transactions

| No. | Type of VAT | Amount                         | Explanation  | Marks     |
|-----|-------------|--------------------------------|--|-----------|
| 1.  | Output VAT  | 250,000 x 19% = 47,500 lei     | Taxable activity   | 1/2       |
| 2.  | Output VAT  | 0                              | Exempt without deduction right activity  | 1/2       |
| 3.  | Output VAT  | 0                              | Exempt without deduction right delivery because on acquisition the right of deduction was limited  | 1         |
| 4.  | Input VAT   | 113,000 x 19% = 21,470 lei     | Acquisition used only for taxable activities   | 1/2       |
| 5.  | Input VAT   | 0                              | Acquisition used only for exempt without deduction right activities  | 1/2       |
| 6.  | Input VAT   | 80,000 x 19% x 45% = 6,840 lei | Acquisition used for mixed activities which cannot be separated, so pro-rata mechanism applies   | 1         |
| 7.  | Input VAT   | 0                              | Acquisition used only for exempt without deduction right activities  | 1/2       |
| 8.  | Input VAT   | 24,000 x 19% x 45% = 2,052 lei | Acquisition used for mixed activities, which cannot be separated, so pro-rata mechanism applies  | 1         |
| 9.  | Input VAT   | 0                              | This acquisition has a mixed usage, so, in principle, VAT should be deducted through the pro-rata mechanism. However, for car acquisitions there is an express limitation of the deduction right after 1 May 2009. So, even if the car has a mixed usage, the VAT is all non-deductible        | 1 1/2     |
| 10. | Input VAT   | 0                              | This acquisition has a mixed usage, so, in principle, VAT should be deducted through the pro-rata mechanism. However, for fuel there is an express limitation of the deduction right after 1 May 2009. So, even if the fuel was used for a car with mixed usage, the VAT is all non-deductible | 1         |
| 11. | Input VAT   | 3,600 x 19% x 45% = 308 lei    | Acquisition has a mixed usage, so VAT will be deducted through the pro-rata mechanism. For leasing there is no explicit limitation of deduction as there is for buying cars.   | 2         |
| 12. | Input VAT   | 0                              | Acquisition has a mixed usage, so, in principle, VAT should be deducted through the pro-rata mechanism. However, for fuel there is an express limitation of the deduction right after 1 May 2009. So, even if the fuel was used for a car with mixed usage, the VAT is all non-deductible.     | 1         |
|     |             |                                |  | <u>11</u> |

(b) VAT adjustment in December 2009

During 2009, input VAT was deducted based on an estimation of pro-rata. Thus, in December 2009, the company has to determine the final pro-rata percentage and adjust the deducted VAT in 2009 (positive or negative adjustment accordingly).

1

Final VAT pro-rata =  $250,000 / (250,000 + 350,000) = 41.6\% \approx 42\%$  (VAT pro-rata should be rounded up to the nearest whole percentage).

1

VAT deducted during the year using estimated pro-rata =  $107,600 \times 19\% \times 45\% = 9,200$  lei

1/2

VAT that should be deducted using final pro-rata =  $107,600 \times 19\% \times 42\% = 8,586$  lei

1/2

Thus, a negative adjustment of deducted VAT has to be made in December 2009. This means that in December 2009 614 lei ( $9,200 - 8,586$ ) should be recorded as non-deductible VAT.

1

4

15

## 4 Mrs Triangle

## (a) The tax treatment of the gift

For corporate income tax purposes, the gift is considered a social expense. So its deductibility will be limited to 2% of salary expenses.

1

For personal income tax purposes, the gift is considered a benefit in kind to the extent that it exceeds the threshold of 150 lei. Thus, 350 lei will be taxable.

12

## (b) Personal deduction for 2009

Mrs Triangle's son will be considered as a person under her care no matter how much revenue he receives, because he is a juvenile.

1

Mrs Triangle's father will also be considered as a person under her care, as he has no revenue and no property at all.

1

Therefore, there are two persons under her care, so the personal deduction =  $450 \times (1 - (2,200 - 1,000)/2,000) = 180$  lei

13

## (c) Prepayments of tax for her income from intellectual property for 2009

Income received from the University of Economics Revue:

- Prepayment of tax =  $10\% \times 2,500$  lei = 250 lei 1/2
- The University of Economics Revue must withhold this amount from the gross income of Mrs Triangle and pay it to the state budget 1/2
- The deadline for paying the tax is 25 March 2009 1/2
- Mrs Triangle shall cash in:  $2,500 - 250 = 2,250$  lei 1/2

Income received every month from the Teachers in Economics Revue:

- Prepayment of tax on a monthly basis =  $10\% \times 700 = 70$  lei 1/2
- Monthly, the Teachers in Economics Revue must withhold this amount from the gross income of Mrs Triangle and pay it to the state budget 1/2
- The deadline for paying the tax is the 25th of the month following the month in which the tax is deducted. 1/2
- Mrs Triangle shall cash every month  $700 - 70 = 630$  lei 1/2

4

## (d) The final tax liability for her income from intellectual property

The annual gross income =  $2,500 + 700 \times 12 = 10,900$  lei

The lump-sum expenses =  $10,900 \times 40\% = 4,360$  lei 1/2

The taxable base =  $10,900 - 4,360 = 6,540$  lei 1

The final income tax =  $6,540 \times 16\% = 1,046$  lei

Pre-payments of tax withheld =  $250 + 70 \times 12 = 1,090$  lei 1/2

So, Mrs Triangle will be able to recover the difference of  $1,090 - 1,046 = 44$  lei from the state budget.

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## (e) VAT Registration

For both of the activities undertaken as an employee, Mrs Triangle is not a taxable person according to the VAT legislation, as the activities are not independent ones, but dependent ones. Thus, she will have no obligation to register for VAT purposes. 1

The transfer of intellectual property rights is a taxable activity according to the VAT legislation. Thus, Mrs Triangle should register for VAT purposes for this activity. 1

However, this obligation can be avoided where the special scheme for small enterprises is applied. Mrs Triangle may opt to apply this scheme as her income from intellectual property is below 35,000 euro and if she does so she will not have an obligation to register for VAT. 1

1315

5 Rectangle SRL

(a) Corporate income tax for 2008

|  |  |          |
|--|--|----------|
| For the trade activity:  |  |          |
| Taxable income = 120,000 – 75,000 = 45,000 lei   |  | ½        |
| Corporate income tax = 16% x 45,000 lei = 7,200 lei  |  | ½        |
| For the discotheque activity:  |  |          |
| Taxable income = 260,000 – 215,000 = 45,000 lei  |  | ½        |
| Corporate income tax = 16% x 45,000 lei = 7,200 lei  |  | ½        |
| However, for this activity, the corporate income tax may not be below 5% of revenue              |  |          |
| 5% x Revenues = 5% x 260,000 = 13,000 lei  |  | 1        |
| Thus, for the discotheque activity, Rectangle SRL's corporate income tax liability is 13,000 lei |  | ½        |
| Total corporate income tax = 7,200 + 13,000 = 20,200 lei   |  | ½        |
|  |  | <u>4</u> |

(b) The minimum tax applicable for 2009

|   |  |          |
|---|--|----------|
| Minimum tax is not applicable to the discotheque activity.  |  | 1        |
| Thus, in establishing the minimum tax for 2009, only the revenues from the trade activity should be considered. |  |          |
| Revenues from trade activity in 2008 = 120,000 lei  |  |          |
| Minimum tax on revenues of 120,000 lei = 4,300 lei/year.  |  | 1        |
|   |  | <u>2</u> |

(c) Registration of the discotheque

|   |  |          |
|---|--|----------|
| The discotheque is a secondary establishment.   |  | 1        |
| Thus, Rectangle SRL will have to complete the following registration procedures:                                  |  |          |
| – file a declaration regarding the secondary establishments of the company;                                       |  | 1        |
| – within 30 days of the secondary establishment (discotheque) being created, i.e. no later than 11 December 2008; |  | 1        |
| – with the tax authorities where the discotheque was established, i.e. in Ploiesti.                               |  | 1        |
|   |  | <u>4</u> |

(d) Penalties paid and due on 1 March 2009

|   |               |           |
|---|---------------|-----------|
|   | lei           |           |
| VAT due for December 2008   | 12,000        | ½         |
| VAT due for January 2009  | 10,000        | ½         |
| Penalties for non-payment, established by tax authorities' decision (W1)                          | 416           | 3         |
| Total amount actually paid on 1 March 2009  | <u>22,416</u> |           |
| The tax due = 22,000 lei  |               |           |
| Number of days for which penalties are still due = 2 days (28 February to 1 March 2009 inclusive) |               |           |
| Outstanding penalties due = 22,000 x 2 x 0.1% = 44 lei.   |               | 1         |
|   |               | <u>5</u>  |
|   |               | <u>15</u> |

WORKINGS

(1) Penalties due for non-payment established by the tax authorities' decision

For the VAT registered in December 2008  
 The amount of VAT due for December 2008 = 12,000 lei  
 Deadline for paying VAT registered in December 2008: 25 January 2009  
 Date until when penalties were computed: 27 February 2009  
 Number of days of delay (26 January to 27 February 2009): 33 days  
 Late penalties = 12,000 x 33 x 0.1% = 396 lei.

For the VAT registered in January 2009

The amount of VAT due for January 2009 = 10,000 lei

Deadline for paying VAT registered in January 2009: 25 February 2009

Date until when penalties were computed: 27 February 2009

Number of days of delay (26 February to 27 February 2009): 2 days

Late penalties =  $10,000 \times 2 \times 0.1\% = 20$  lei.

Total penalties due until 27 February 2009 inclusive =  $396 + 20 = 416$  lei