
Answers

1 (a) (i) Nautica PE's 2008 tax base and tax liability

	CZK	CZK
Accounting profit		
Income		
Sold boats		6,385,000
Sold services		1,650,000
Compensation from insurance company		365,000
Sold land		12,000,000
Total revenues		20,400,000
Expenses		
Services purchased	888,250	
Goods and materials purchased	4,955,650	
Management fees to Swedish parent	530,000	
Fine	25,000	
Salaries and wages inclusive of mandatory social security and health care insurance contributions	3,105,000	
Pension scheme of employees 5 * 50,000	250,000	
Life insurance 5 * 10,000	50,000	
Corresponding social security and health care insurance contributions (Working 1)	63,000	
Meal vouchers	55,600	
Bonuses 5 * 70,000	350,000	
Corresponding mandatory social security and health insurance contributions 350,000 * 35%	122,500	
Yacht club membership 5 * 9,000	45,000	
Contractual penalty paid	20,000	
Depreciation charge	620,000	
Entertainment costs (a party)	320,000	
Acquisition costs of sold land	12,800,000	
Gift to Bariery	200,000	
Total expenses		24,400,000
Accounting loss		(4,000,000)
Add back		
Non-deductible expenses		
Fine	25,000	
Yacht club memberships	45,000	
Entertainment costs	320,000	
Loss on sold land	800,000	
Gift	200,000	
Meal vouchers (Working 2)	25,020	
Adjustment for unpaid debts (Working 3)	584,980	
Total amount to be added back		2,000,000
Tax base (loss)		(2,000,000)
Tax		0
Tax advances paid		750,500
Tax overpayment		750,500

- (ii) The 2008 corporate tax return is due by 30 June 2009. It should be submitted or sent to the competent authority of Nautica PE which is the local financial office in Prague 2.

The tax overpaid may be claimed back on the tax return form and should be paid back to Nautica PE within 30 days from the day of application (filing of the tax return).

Working 1

Social security and health care insurance contributions due by employer on pension and life insurance payments:

Contribution per employee	50,000 + 10,000	60,000
Non-exempt part per employee	60,000 – 24,000	36,000
SH contributions	36,000 * 35% * 5	63,000

Note: contributions to pension and life insurance schemes are exempt up to CZK 24,000 per employee per year.

Working 2

Non-deductible part of meal vouchers

Tax deductible part – 55% of the value of the meal voucher not more than CZK 69 per voucher	$55,600 * 55\%$	30,580
Non-deductible expense	$55,600 - 30,580$	25,020

Working 3

Unpaid debts		Add back
Timber Ltd	44 months overdue	584,980
Uklid, s. r. o.	26 months overdue	0
Mr Kolar	16 months overdue	0
TransEurope, s. r. o.	9 months overdue	0
Total amount to be added back		584,980

Notes:

1. The collection for Bariery (CZK 800,000) should be accounted for through asset and liabilities accounts.
2. The dividend distributed to Nautica International is subject to 15% withholding tax $CZK 3,000,000 * 15\% = CZK 450,000$.
3. Relief for the gift to Bariery is not possible as Nautica PE incurred a loss also, the relief for this gift cannot be carried forward to the following tax years.
4. Unpaid debts due for more than 36 months have to be added back to the taxable profit.

(b) Carry forward of loss following a transfer of assets

The following conditions have to be fulfilled for Yacht Club, a. s. to be able to deduct the loss carried forward by Nautica PE:

1. The transfer has to be between companies which are tax resident in the Czech Republic or another member state of the European Union (EU), with qualifying legal forms and subject to corporate income tax in the Czech Republic or another member state of the EU. These conditions would be met in the outlined situation if Nautica Co, a tax resident of Sweden, has a prescribed legal form and is subject to corporate income tax in Sweden. Yacht Club, a. s. fulfils all the conditions (a Czech tax resident, legal form of a. s. and subject to corporate income tax in the Czech Republic).
2. The assets transferred have to create a distinct business, that is they have to form a separate organisational and functional part of the business capable of functioning separately.

Provided these conditions are met, the acquiring company is allowed to carry forward the remaining part of the loss for a maximum of five years from the year in which the loss was incurred by the transferring company. Thus, Yacht Club, a. s. would be able to carry forward the 2005 Nautica PE's tax loss to 2010 at the latest.

However, the acquiring company is only able to use that part of the loss relating to the business transferred. This part should be calculated based on real economic criteria, that is the loss generated by the business that is being transferred can be documented, or it can be calculated based on the proportion of assets transferred in relation to the overall assets of the company before the transfer (decreased by the value of any transferred liabilities).

If the change of ownership exceeds 25% of the capital of the company (a major change in ownership) the company may continue to carry forward the loss only if it can be proved that at least 80% of the revenues are generated from the same type of activities after the major change as before the major change.

A company can apply for and obtain an advance ruling on whether the loss may be carried forward after a major change in an individual case.

2 (a) (i) Mr Mares's 2008 income tax liability

		CZK	CZK
Business income			
Share in Maja, v. o. s. (Working 1)			
Partial tax base			4,000,000
Capital income			
Interest income		120,320	
Kosmetyka Naturalna share			
of gross dividend	50% of (360,000/90 * 100)	200,000	
Naturalia share on gross dividend	50% of 200,000	100,000	
AXM gross dividend	90,000/90 * 100	100,000	
Partial tax base			520,320
Rental income			
Partial tax base (Working 3)			198,000
Other income			
Toyota	1,200,000 – 950,000 = 250,000		
Porsche	Exempt as Mr Mares owned it for more than 12 months.		
Partial tax base			250,000
Tax base			4,968,320
Tax base rounded	Down to hundreds		4,968,300
Tax before credits	4,968,300 * 15%		745,245
Personal tax credit		24,840	
Spouse tax credit	24,840 * 2	49,680	(74,520)
Total tax liability			670,725
Foreign tax credit (Working 4)		30,000	
Tax prepayments	4 * 130,000	520,000	(550,000)
Final tax due			120,725
Working 1			
Calculation of Maja's accounting profit			
Accounting income			25,125,230
Accounting expenses		14,652,745	
Depreciation charge (Working 2)		2,472,485	(17,125,230)
Accounting profit			8,000,000
Mr Mares share (50%)			4,000,000
Working 2			
Calculation of Maja's depreciation charge			
Building			
Input price	16,000,000		
Year	Depreciation charge		Tax book value
2004	16,000,000/50 = 320,000		15,680,000
2005	2 * 15,680,000/(51 – 1) = 627,200		15,052,800
2006	2 * 15,052,800/(51 – 2) = 614,400		14,438,400
2007	2 * (14,438,400 + 4,000,000)/50 = 737,536		17,700,864
2008	2 * 17,700,864/50 – 1 = 722,485		
Licence			
Input price	(1,800,000 + (10 * 310,000)) = 4,900,000		
2008 depreciation charge			
(calculated per 12 months)	(4,900,000/120) * 12 = 490,000		490,000
Plant			
Input price	4,500,000		
Year	Depreciation charge		Tax book value
2007	(4,500,000/5) + 10% * 4,500,000 =		
	900,000 + 450,000 = 1,350,000		3,150,000
2008	2 * 3,150,000/(6 – 1) = 1,260,000		
Total depreciation charge	1,260,000 + 490,000 + 722,485 = 2,472,485		

Working 3			
Rental income			1,720,000
Income			
Related maintenance expenses		230,000	
Depreciation charge	$38,000,000 \times 3.4/100$	1,292,000	
Total documented expenses		<u>1,522,000</u>	
Lumpsum expenses	30% of 1,720,000	516,000	
			198,000

Documented expenses are higher than lumpsum expenses; therefore Mr Mares should be advised to use documented expenses.

Working 4			
Calculation of foreign tax credit (per state)			
Kosmetyka Naturalna	50% of $(360,000/90 \times 100)$		200,000
Connected expenses		0	
Tax paid abroad		20,000	
Maximum credit capacity in CR	$(200,000/4,968,320) \times 100 = 4.03\%$ $670,725 \times 0.0403 = 27,030$		
Tax credit	Lower of 20,000 and 27,030		<u>20,000</u>
Naturalia			100,000
Tax paid abroad		0	
Maximum credit capacity in CR	$(100,000/4,968,320) \times 100 = 2.01\%$ $670,725 \times 0.0201 = 13,482$		
Tax credit	Lower of 0 and 13,482		<u>0</u>
AXM gross dividend			100,000
Tax paid abroad		10,000	
Maximum credit capacity in CR	$(100,000/4,968,320) \times 100 = 2.01\%$ $670,725 \times 0.0201 = 13,482$		
Tax credit	Lower of 10,000 and 13,482		<u>10,000</u>
Total foreign tax credit	$20,000 + 0 + 10,000$		<u>30,000</u>

Note:

The income from Chilli&Pepper, s. r. o. would have been subject to final withholding tax at 15%.

Gross income	300,000	
Tax withheld	$15\% \times 300,000$	45,000
Net income received by Mr Mares	$300,000 - 45,000$	255,000

(ii) Taxation of dividend income received by partnership

A dividend received by a partnership is taxed at the level of the partners (transparent taxation). A general partnership is not considered to be a beneficial owner of a dividend. Tax residence is also assessed at the level of the partner (beneficial owner).

- (iii)** The partnership is obliged to keep double entry book-keeping and Mr Mares will calculate his share of profit based on the accounting profit. As regards the other income of Mr Mares, double entry book-keeping is not required and Mr Mares is obliged to document income and expenses for income tax purposes on a cash basis.

(b) Income subject to final withholding tax when received by an individual

Any SIX of the following:

- Income received when a contract of pension insurance is abolished
- Income received when a contract of life insurance is abolished
- Income from pension insurance with a state contribution (the part which is not exempt)
- Interest income other than interest on loans (e.g. Czech bank deposits)
- Prizes in lotteries and sports competitions (those which are not exempt)
- Capital gains on sale of share in UCITs (podílový list)
- Profit distributions other than dividends of cooperatives, limited liability companies
- The share paid out when a company is being dissolved and liquidated
- The share of a silent partner
- Employment income paid based on a contract on the work done basis (dohoda o provedení práce) not exceeding CZK 5,000 a month
- Income of authors for articles not exceeding CZK 7,000 per calendar month.

3 (a) Stella, a. s. May 2008 VAT return

	Tax base CZK	Tax CZK
Input supplies		
Purchased materials (90% of 380,000)	342,000	64,980
Purchased goods and services	950,000	180,500
Personal car	820,000	no deduction
Insurance premiums	VAT not applicable	
Software	53,000	10,070
Total	<u>1,345,000</u>	<u>255,550</u>
Output supplies		
Supplies to Czech customers	1,640,000	311,600
Supplies to Japanese customers (Export)	2,800,000	exempt
Supplies to German customers (Supply of goods to a person from another EU Member State)	720,000	exempt
Advance payment (10% of 36,000)	3,600	684
Total	<u>1,643,600</u>	<u>312,284</u>
VAT due by 25 June 2008	312,284 – 255,550 = CZK 56,734	

- (b)** Stella, a. s. will be charged interest for late payment from 26 June to 25 July 2008, i.e. for 30 days.

Calculation of the interest:

Repo rate + 14 %points * 30 days

$(56,734 * (3.5 + 14) * 0.01) / 365 * 30 = \text{CZK } 817$ (rounded up to the next whole CZK).

The interest due will be assessed separately by the competent tax authority.

- (c)** Stella, a.s. would not be able to claim an input deduction for the software in the taxable period of May based on its ordinary tax return, as this was due by 25 June 2008 i.e. before the invoice was received. To claim a deduction in such a situation Stella, a. s. would have to submit a supplementary tax return and it would be able to file this supplementary tax return at any time before the end of July 2008.
- (d)** (i) Jarní 35, Desná
(ii) Černokostelecká 251, Prague 10
(iii) Bonn and Mannheim, respectively
(iv) Jarní 35, Desná
(v) Jarov, Prague 3
(vi) Jarní 35, Desná

- 4 (a)** In compliance with the Czech tax legislation it is possible to claim a research and development relief against the corporate tax base where a company incurs expenses linked to the realisation of qualifying projects. The maximum relief is 100% of such expenses and the relief is given in addition to the ordinary deduction of these expenses against the tax base, i.e. such costs are effectively deducted twice.

To qualify for relief, a project needs to include experimental, theoretical, project or construction activities, calculations, technological concepts, development of functional samples or prototypes and certification of results of the research and development.

Also, separate documentation needs to be kept for these expenses.

The relief is only available in respect of tax deductible expenses. A claim is not possible for expenses which are incurred for services, tax non-deductible expenses, royalties or any costs which have already been financed by state aid.

Written documentation has to be prepared before the beginning of the project, which includes the following information:

- identification of the taxpayer's business and the activity connected with research and development;
- identification of the taxpayer (name, registered seat, tax identification number);
- the objectives of the project;
- the estimated overall costs of the project;
- the estimated costs for the individual years of the project;

- the names of the individuals responsible for the project, their qualifications and competences, and their relationship to the company (the form of contract);
- the means of control and evaluation of the project and its results; and
- the date, place and name of the person who approved the project on behalf of the company.

An advanced ruling on whether the particular expenses qualify for the relief can be obtained from the competent tax authority.

Where it is not possible to claim the relief in the first year because there is a tax loss, the relief may be carried forward to the three tax years following the tax year in which the entitlement to a deduction first arose.

- (b) The maximum relief for research and development available in 2008, based on the estimated costs to be incurred, is CZK 43,070,000 made up as follows:

	CZK	Research and development relief implication
Acquisition of land	45,000,000	Acquisition costs of land have to be capitalised for income tax purposes.
Acquisition of depreciable assets	65,000,000	Acquisition costs of depreciable assets have to be capitalised.
Corresponding tax depreciation charge	9,750,000	Can be used for the relief.
Salaries and wages	12,320,000	Can be used for the relief.
Directors fees	6,800,000	Relief is not possible as this is not a tax deductible expense.
Goods purchased (all tax deductible)	21,000,000	Can be used for the relief.
Services purchased (all tax deductible)	18,500,000	Relief is not possible for services costs.
Royalties	5,500,000	Relief is not possible for royalties.
Representation and entertainment costs	750,000	Relief is not possible as this is not a tax deductible expense.
Maximum available relief (9,750,000 + 12,320,000 + 21,000,000)	CZK 43,070,000	

5 (a) Payroll tax due by Design, s. r. o. for December 2008

	CZK	CZK
Salary		25,000
Pension scheme		3,000
Life insurance		8,000
Skiing weekend	26,500 – 20,000	6,500
Total taxable income		42,500
Social security contributions due by the employer	35% * 42,500	14,875
Base (rounded up to hundreds)	42,500 + 14,875	57,400
Tax	15% * 57,400	8,610

The payroll tax due by Design, s. r. o. for Ms Kratka for December 2008 will amount to CZK 8,700.

Note: recreational benefits provided to employees and their families are exempt up to CZK 20,000 per year.

Social security and health care insurance contributions to be withheld by Design for December 2008

	CZK	CZK
Base (as above)	25,000 + 3,000 + 8,000 + 6,500	42,500
Social security contributions	8% * 42,500	3,400
Health care insurance	4.5% * 42,500	1,913
Design, s. r. o. is obliged to withhold CZK 3,400 for Ms Kratka's social security contributions and CZK 1,913 for her health care insurance contributions in December 2008.		

(b) Ms Kratka's 2008 income tax base

	CZK	CZK
Employment income		
Charles University	12*15,000	180,000
Design, s. r. o.	12*25,000	300,000
Bonus		64,000
Contributions to pension scheme and life insurance	36,000 + 8,000 – 24,000	20,000
Skiing weekend (as in (a) above)	26,500 – 20,000	6,500
Total taxable income subject to employer's share of social security and health care insurance contributions		570,500
Social security and health care insurance contributions paid by employers	35% * 570,500	199,675
Contract with the municipality of Hostivice		80,000
Member of supervisory board fee		50,000
Health care insurance contributions	9% * 50,000	4,500
Partial tax base		904,675
Business income		
Contract with family Staringer	420,000	
Lumpsum expenses at 40% (higher than documented expenses)	(168,000)	
Partial tax base		252,000
Tax base	904,675 + 252,000	1,156,675
Tax base rounded	Down to hundreds	1,156,600

Notes:

1. Deduction of expenses relating to the contract for Hostivice is not possible because a dohoda o provedeni prace is a form of employment contract.
2. Tickets to the theatre and to concerts paid from social and cultural fund are exempt.
3. Contributions to pension and life insurance schemes are exempt up to 24,000 per year per employer. The Charles University pension contributions of CZK 500 per month are within the exempt limit ($500 * 12 < 24,000$).
4. The social security and health care insurance contributions paid during 2008 are no longer a tax deductible expense.
5. The income from the articles published in the Bulletin of Architects is subject to final withholding tax at 15%, i.e. CZK 225 should be withheld by the publisher of each CZK 1,500 and the income of CZK 1,275 net of the tax sent to Ms Kratka.

	<i>Marks</i>
1 (a) (i) Accounting loss calculation	
Compensation from insurance company included	1/2
Both revenue and expense for sold land included	1/2
Management fees deductible	1/2
Fine deductible	1/2
Pension insurance deductible	1/2
Life insurance deductible	1/2
Corresponding social security and health care insurance deductible	1
Meal vouchers deductible	1/2
Bonuses deductible	1/2
Corresponding social security and health insurance	1/2
Yacht Club membership deductible	1/2
Contractual penalty deductible	1/2
Entertaining costs deductible	1/2
Gift to Bariery deductible	1/2
Add back	
Yacht club membership	1
Fine	1
Meal vouchers	1
Unpaid debts	2
Entertainment costs	1
Loss on sold land	1
Gift	1
Tax loss rounded	1/2
Advances paid	1/2
Dividend excluded (subject to withholding tax)	1
Tax overpayment identified	1/2
	<hr/> 18
(ii) Due date for the return	1
Where to submit the tax return	1
How to claim the overpayment	1
	<hr/> 3
(b) Available for transfers within EU only	1/2
Conditions (tax residence, legal form, subject to tax)	1 1/2
Distincts business	1
Five years rule (2010)	1
Loss relating to the business being transferred	1
Method of calculation	1
Major change in ownership effect	1
80% of revenues rule	1
Advance ruling possible	1
	<hr/> 9
	<hr/> 30

	Marks
2 (a) (i) Share in Maja, v. s. o., including depreciation adjustment (business income)	1
Depreciation of the building	2
Amortisation of the license	1½
Depreciation of the plant	1½
Interest income	½
Dividend from Kosmetyka Naturalna	1
Dividend from Naturalia	1
Dividend from AXM	1
Rental income using documented expenses	1
Depreciation of the house	1
Cars	2
Silent partnership share, subject to final withholding	1
Tax base rounded	½
Tax at 15%	½
Personal tax credits	1
Foreign tax credit done state by state	2
Tax advances paid	½
	<u>19</u>
(ii) At the level of the partners (transparent taxation)	<u>1</u>
(iii) Partnership share based on double entry book-keeping	1
Other income on a cash basis documentation possible	1
	<u>2</u>
(b) Any SIX items – ½ mark each, maximum	<u>3</u>
	<u>25</u>
3 (a) Input supplies	
Purchased materials	½
Purchased goods and services	½
Personal car	½
Insurance premiums	½
Software	½
Output supplies	
Supplies to Czech customers	½
Supplies to Japanese customers	½
Supplies to German customers	½
Advance payment	½
VAT due (net)	½
Due date 25 June 2008	1
	<u>6</u>
(b) Number of days overdue	1
Calculation of interest	1
Interest will be assessed by the tax authority separately	1
	<u>3</u>
(c) No deduction as invoice not received before 25 June	1
Supplementary tax return	1
By the end of July	1
	<u>3</u>
(d) Six items – ½ each	<u>3</u>
	<u>15</u>

	Marks
4 (a) R&D relief against tax base	$\frac{1}{2}$
Maximum relief 100% of expenses linked to R&D project	1
In addition to ordinary expense deduction	$\frac{1}{2}$
R&D qualifying project (main features)	$1\frac{1}{2}$
Separate documentation of concerned expenses	$\frac{1}{2}$
Expenses excluded from the relief	2
Written documentation	$\frac{1}{2}$
Obligatory parts of the written documentation – $\frac{1}{2}$ mark per item, maximum	3
Carry forward in case of loss	1
Advance ruling possible	$\frac{1}{2}$
	<u>11</u>
(b) Calculation of maximum relief	
Land	$\frac{1}{2}$
Depreciable assets	$\frac{1}{2}$
Salaries and wages	$\frac{1}{2}$
Directors' fees	$\frac{1}{2}$
Goods	$\frac{1}{2}$
Services	$\frac{1}{2}$
Royalties	$\frac{1}{2}$
Representation and entertainment	$\frac{1}{2}$
	<u>4</u>
	15
5 (a) December payroll tax due by Design	
Salary and pension scheme contributions	$\frac{1}{2}$
Life insurance contributions	$\frac{1}{2}$
Skiing weekend (son)	1
Tax base (inclusive employer's share on social security contributions)	1
Tax	$\frac{1}{2}$
Rounding up to hundreds	1
Social security contributions and health care insurance to be withheld by Design	
Base	$\frac{1}{2}$
Social security contributions	$\frac{1}{2}$
Health care insurance contributions	$\frac{1}{2}$
	<u>6</u>
(b) Tax base calculation	
Employment income	
Salary from University	$\frac{1}{2}$
Pension contributions by University excluded	$\frac{1}{2}$
Salary from Design	$\frac{1}{2}$
Bonus	$\frac{1}{2}$
Pension and life insurance payments by Design	1
Skiing weekend (from (a))	$\frac{1}{2}$
Social security and health care contributions at 35%	$\frac{1}{2}$
Tickets exempt	$\frac{1}{2}$
Contract on work to be done (gross)	1
Remuneration of supervisory body member	$\frac{1}{2}$
Business income	
Stanger revenue	$\frac{1}{2}$
Expenses – lump sum basis	$\frac{1}{2}$
Social security and health care contributions not deductible	$\frac{1}{2}$
Articles taxed by final withholding	1
Tax base rounded	$\frac{1}{2}$
	<u>9</u>
	15