
Answers

1 (a) (i) Calculation of 2007 tax base for Novak & syn, s. r. o

	CZK	CZK
Accounting profit		
Income		
Goods and services sold		14,672,900
Interest from a bank account		80,000
Royalty ($142,500/95 \times 100$)		150,000
Price of assigned receivables		17,100
Release accounting provisions to assigned receivables		80,000
Total income		15,000,000
Expenses		
Goods and services purchased	6,848,341	
Salaries and wages	2,500,000	
Social security and health insurance (35%)	875,000	
Statutory representatives' fees	700,000	
Social security and health care insurance (35%)	245,000	
Depreciation charge (Workings 1, 2, 4, 5, 6)	609,548	
Financial lease of Volvo (Working 3)	132,609	
Write off assigned receivables ($80,000 + 11,000$)	91,000	
Provisions created (Working 8)	108,000	
Total expenses		(12,109,498)
Accounting profit		2,890,502
Add back		
Write off receivables (Working 7)	33,900	
Nominal value of the contractual penalty assigned	11,000	
Total		44,900
Less		
Release accounting provision		(40,000)
Tax base adjusted		2,895,402
Less loss		(50,000)
		2,845,402
Tax base rounded		2,845,000
Tax at 24%		682,800
Foreign tax credit		
Foreign income (gross)	150,000	
Expenses related to foreign income	30,000	
Tax paid abroad	$5\% \times 150,000$	7,500
Maximum foreign tax credit	$(150,000 - 30,000)/2,895,402 \times 682,800$	28,299
Actual tax credit	The lower of the Czech tax on foreign income and the tax paid abroad	7,500
Tax liability	$682,800 - 7,500$	675,300

The tax return and tax are due by 28 February 2008.

(ii) Tax prepayments 2007/08	These will be paid quarterly, because $675,300 > 150,000$ $675,300/4$ rounded up to hundreds	168,825
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The 2007/2008 corporate tax prepayments will be due on 15 May 2008, 15 August 2008, 15 November 2008 and 15 February 2009.

Working 1		CZK
Depreciation of rights to breed		
Input price	140,000	
Depreciation period	72 months	
2006/2007 depreciation charge	$140,000/72 \times 5$ months	9,723
Working 2		CZK
Depreciation of Audi		
2005/2006 depreciation charge	$1,400,000/4$	350,000
2006/2007 depreciation charge	$1,400,000 - 350,000 = 1,050,000$ $2 \times 1,050,000/(5 - 1)$	525,000

Working 3		CZK
Financial lease		
Clara, s. r. o. original payment tax deductible amount	$383,999/48 * 25$	199,999
Novak & syn, s. r. o. tax deductible amount	$383,999/48 * 23$	184,000
Novak & syn tax deductible amount > Payment for the assignment, i.e. the payment for the assignments is tax deductible.		
Remaining lease time	23 months	
Total costs	$20,000 * 23 + 150,000$	610,000
Accounting expense – 2006/2007	$610,000/23 * 5 \text{ months (April–August)}$	132,609
Working 4		CZK
Depreciation of a mower		
2006/2007 depreciation charge	$170,000 * 17 \cdot 25/100$	29,325
Working 5		CZK
Depreciation of greenhouses		
2006/2007 depreciation charge (greenhouse not improved)	$200,000 * 10 \cdot 5/100$	21,000
2006/2007 depreciation charge (greenhouse improved)	$(200,000 + 45,000) * 10/100$	24,500
Working 6		CZK
Total 2006/2007 depreciation charge		
$9,723 + 525,000 + 29,325 + 21,000 + 24,500$		609,548
Working 7		CZK
Write off the assigned receivable		
The main receivable nominal value		80,000
Assigned for		16,000
Tax provision created in previous tax years		40,000
Maximum tax deductible amount	$16,000 + 40,000$	56,000
Add back	$80,000 - 56,000$	24,000
Contractual penalty nominal value		11,000
Assigned for = maximum tax deductible amount		1,100
Add back	$11,000 - 1,100$	9,900
Total add back	$24,000 + 9,900$	33,900
Working 8		CZK
Tax deductible provisions		
Mr Kudrna – 24 months due	$66\% * 50,000 - 10,000$	23,000
Mr Holec – 20 months due	$50\% * 70,000$	35,000
Rosana, a. s. – 8 months due	$20\% * 250,000$	50,000
Total tax deductible provisions		108,000

Note:

Payments to statutory representatives are tax deductible for the company as Mr Jan Novak and Mr Pavel Novak are not members of the board, but sole directors. Social security contributions and health care insurance contributions are paid as from employment income.

(b) Payment to a permanent establishment of a non-resident taxpayer

Novak & syn, s. r. o. is obliged to withhold 10% of the payment when making a payment to a permanent establishment of a non-resident company.

		CZK
Payment to Roses, Inc		140,000
To be withheld	$10\% * 140,000$	14,000

The amount of CZK 14,000 has to be sent to the competent authority of Novak & syn, s. r. o. by 31 March 2007 together with the completed notification form.

2 (a) Calculation of Ms Havlova's 2007 income tax liability, payroll tax and social security and health insurance contributions withheld by her employer

	CZK	CZK
Employment income		
12 * 35,000		420,000
Statutory representative's fee		1,527,000
Pension insurance (Working 1)		21,000
Life insurance (Working 2)		3,000
Social security and health care contributions (Working 3)		(246,375)
Partial tax base		<u>1,724,625</u>
Business income		
Legal services		1,500,000
Lump-sum expenses at 50% (see Note 6)		(750,000)
Partial tax base		<u>750,000</u>
Rental income		
Rent from chalet		25,000
Lump-sum expenses at 30%		(7,500)
Partial tax base		<u>17,500</u>
Tax base 1,724,625 + 750,000 + 17,500		2,492,125
Tax allowance for the interest paid		(43,750)
Tax base after allowances		<u>2,448,375</u>
Tax base rounded down to hundreds		<u>2,448,300</u>
Tax before credits $(2,448,300 - 331,200) * 0.32 + 61,212$		738,684
Personal tax credit	7,200	
Child tax credit	<u>6,000</u>	<u>(13,200)</u>
Tax liability		725,484
Tax prepayments (payroll – see below)		(494,188)
Tax due		<u>231,296</u>
Working 1		CZK
Pension insurance		
10% of salary	10% * 420,000	42,000
Exempt income – maximum 5% of the base	420,000 * 5%	21,000
To be added to employment income	42,000 – 21,000	21,000
Working 2		CZK
Life insurance		
Exempt income life insurance	12,000 per tax year	
To be added to employment income	15,000 – 12,000	3,000
Working 3		CZK
Social security and health care contributions		
Base	420,000 + 1,527,000 + 21,000 + 3,000	<u>1,971,000</u>
Social security contributions	8% * 1,971,000	157,680
Health care contributions	4.5% * 1,971,000	88,695
Total contributions	157,680 + 88,695	<u>246,375</u>
Payroll tax withheld by employer		
Monthly payroll tax January to November		
Salary		35,000
Social security and health care contributions (12.5%)		(4,375)
Base		<u>30,625</u>
Payroll tax before credits	$(30,700 - 27,600) * 0.32 + 5,101$	6,093
Personal tax credit	7,200/12	(600)
Child tax credit	6,000/12	(500)
Payroll tax		<u>4,993</u>

Payroll tax December		
Salary		35,000
Statutory representative's fee		1,527,000
Pension insurance (Working 1)		21,000
Life insurance (Working 2)		3,000
Social security and health care contributions	$(35,000 + 1,527,000 + 21,000 + 3,000) * 12.5\%$	(198,250)
Base		1,387,750
Payroll tax before credits	$(1,387,800 - 27,600) * 0.32 + 5,101$	440,365
Personal tax credit	7,200/12	(600)
Child tax credit	6,000/12	(500)
Payroll tax		439,265
Payroll tax withheld in 2007		
11 * 4,993		54,923
1 * 439,265		439,265
Total		494,188

Notes:

- Travel allowances are tax exempt.
- Profit distribution is subject to final withholding tax.

Gross dividend	$425,000/85 * 100$	500,000
Tax withheld (15%)	$500,000 * 0.15$	75,000
- Non-monetary income from the apartment rented in Belgicka is exempt as Ms Havlova has her permanent home in Pribram.
- Gym membership is exempt.
- Income from the sale of paintings (movable asset not included in business assets) is exempt.
- Lump-sum expenses of 40% may also be applied if assumed Ms Havlova was a barrister.

(b) Calculation of Ms Havlova's 2007 social security and health insurance contributions (legal services)

Health care contributions		CZK
Business income		1,500,000
Expenses		(750,000)
Difference between income and expenses		750,000
Base	$50\% * 750,000$	375,000
Health care contributions	$13.5\% * 375,000$	50,625
Social security contributions		
Base	$50\% * 750,000$	375,000
Social security contributions	$29.6\% * 375,000$	111,000

(c) Calculation of Ms Havlova's 2007 tax liability if Petr Havel acted as cooperating person

Ms Havlova		CZK
Tax base	$1,724,625 + 750,000 - 180,000 + 17,500$	2,312,125
Tax allowance for interest paid		(43,750)
Tax base after allowances		2,268,375
Tax base rounded down to hundreds		2,268,300
Tax before credits	$(2,268,300 - 331,200) * 0.32 + 61,212$	681,084
Personal tax credit		(7,200)
Tax liability		673,884
Petr Havel		CZK
Tax base	30% of 750,000 maximum 180,000	180,000
Tax before credits	$(180,000 - 121,200) * 0.19 + 14,544$	25,716
Personal tax credit		(7,200)
Student tax credit		(2,400)
Tax liability		16,116

It would be more advantageous if Ms Havlova and her son acted as cooperating persons.

The difference between the tax liability of Ms Havlova (alone) and total tax liability if her son acts as a cooperating person is CZK 35,484 (CZK 725,484 – (673,884 + 16,116)).

3 (a) Registration

Two possible alternative answers:

- (i) Investment, a. s. exceeded the threshold of CZK 1,000,000 of turnover in November 2006 and therefore should have registered for value added tax purposes by 15 December 2006. Investment, a. s. became a VAT payer as of 1 February 2007. Invoices for financial services and rents for buildings are excluded from the calculation as financial services and rents are exempt supplies and it is assumed that rental income was occasional.

Investment, a. s. will use a quarter as its tax period as the turnover did not exceed CZK 10,000,000 (exclusive of exempt supplies) in the last calendar year.

- (ii) Investment a. s. exceeded the threshold of CZK 1,000,000 of turnover in May 2006 and therefore should have registered for VAT purposes by 15 June 2006. Rental income is included in the calculation of turnover assuming that it was not occasional. Taxable period would be a month in this case as expected turnover inclusive rental income would exceed CZK 10,000,000 per year.

(b) Calculation of VAT liability

(i) Tax return for the first period (1 February to 31 March 2007)

Input supplies	CZK tax base	CZK tax (deduction)
Initial deduction for the assets excluding the car	2,250,000 * 19%	427,500
Electricity in let buildings (2 months)	54,000	linked to exempt supply – no deduction
Gas in let buildings (2 months)	74,000	linked to exempt supply – no deduction
Water in let buildings (2 months)	28,000	linked to exempt supply – no deduction
Legal services from Luxembourg – reverse charge	1,200,000 * 19%	228,000
Services linked to financial services	850,000	no claim for deduction
Services linked to advisory services (220,000 + 80,000)	300,000 * 19%	57,000
Allowable deduction for goods and services linked to taxable supplies (Working 1)		15,136
Total allowable deduction		<u>727,636</u>

Calculation of coefficient for the reduction of the deduction

Output supplies	CZK tax base	CZK tax
Rent for apartments (2 months)	1,100,000	exempt
Rent for offices (2 months)	700,000	exempt
Financial services 32/2007	5,200,000	exempt
Advisory services 38/2007	650,000 * 19%	123,500
Advisory services 43/2007	200,000 * 19%	38,000
Financial services 49/2007	4,200,000	exempt
Legal services from Luxembourg – reverse charge	1,200,000 * 19%	228,000
Import from India	1,600,000 * 19%	304,000
Total		<u>693,500</u>

Working 1

Calculation of estimated coefficient for the reduction of the deduction

(Candidates may estimate the coefficient based on a different criterion; they have to give appropriate reasoning in any case).

Goods and services linked to both taxable and exempt supplies	1,130,000	214,700
(650,000 + 200,000)/((650,000 + 200,000) + (1,100,000 + 700,000 + 5,200,000 + 4,200,000))		0.0705
Coefficient rounded		0.0705
Reduction of the deduction	0.0705 * 214,700	15,136
VAT liability	693,500 – 727,636	–34,136

Investment, a. s. had to submit the VAT return by 25 April 2007.

Investment, a. s. will be able to claim a VAT refund of CZK 34,136. The deduction will be sent to Investment, a. s. within 30 days from the assessment date. Investment, a.s. does not need to apply for the refund.

(ii) Tax return for August**Input supplies**

Electricity in let buildings

CZK
tax base
 27,000

CZK
tax (deduction)
 linked to exempt
 supply – no deduction
 linked to exempt
 supply – no deduction
 linked to exempt
 supply – no deduction

Gas in let buildings

37,000

Water in let buildings

14,000

Output supplies

Rent for apartments

CZK
tax base
 550,000

CZK
tax
 exempt

Rent for offices

350,000

Total

900,000

exempt

VAT liability

0

4 (a) Calculation of Mr Jirout's 2007 income tax liability**Tax liability before exemption**

Income from employment

CZK
 1,500,000
 (195,000)

Social security and health care contributions

Partial tax base

1,305,000

Income from sale of wine

60,000

Expenses (Working 1)

(48,000)

Partial tax base

12,000

Other income

Income from sale of shares in Bianca 10 x 18,000

180,000

Expenses 10 x 14,000

(140,000)

Payment to the adviser

(10,000)

Partial tax base

30,000

Tax base 1,305,000 + 12,000 + 30,000

1,347,000

Tax base rounded

1,347,000

Tax liability (1,347,000 – 331,200) * 0.32 + 61,212

386,268

Exemption with progression

Average tax rate on world wide income

386,268/1,347,000

28.68%

Exempt income (1,500,000 – 195,000)

(1,305,000)

Tax base after exemption (1,347,000 – 1,305,000)

42,000

Tax before personal credit 42,000 * 28.68%

12,046

Personal tax credit

(7,200)

Add tax on separate tax base

0

Tax liability (rounded up to whole CZK)

4,846

Mr Jirout will pay no advances in 2008 as his 2007 income tax liability does not exceed CZK 30,000.

Working 1 – Expenses related to production of wine

Documented – 35,000

Lump-sum – 80%, i.e. 48,000

Mr Jirout should apply lump-sum expenses as they are higher than documented.

Working 2 – Dividend received from UK – Separate tax base

Dividend received (5,950/0.85)

CZK
 7,000

Tax liability in CZ at 15%

1,050

Tax withheld in UK

(1,050)

Tax due

0

- (b) Mr Jirout should be advised to apply for a prolongation of the statutory deadline for submission of his tax return. The application has to be sent to his competent tax authority by 30 June 2008. The competent tax authority can put the deadline for submission of the tax return off until 30 October 2008 (10 months after the end of the tax year), because he had income from abroad.
- (c) (i) 31 December 2008, if no action towards a reassessment of the tax base was made by the competent tax authority. The statutes of limitation will expire once and for all on 31 December 2015.
- (ii) The statutes of limitation for the tax year in which a tax loss was incurred expires when the statutes of limitation for the last tax year in which the tax loss may be deducted from the tax base expire, i.e. the statutes of limitation for the tax year 2004 will expire once and for all on 31 December 2020.

5 Subject: Tax deductibility of employees' benefits

From: Tax Adviser

To: Directors of Maxima, a. s

Date: 3 June 2008

Labour costs related to work and social conditions and the health care of employees are tax deductible only if certain statutory conditions are met. The general condition that such expenses have to be incurred in earning, maintaining or securing taxable income has to be met in all cases.

The costs of the language courses are tax deductible as expenses on the further education of employees related to their duties, similarly for the costs of the MBA courses if the selected employees' tasks correspond with the course content.

As regards the meal vouchers, 55% of the costs are tax deductible up to 70% of CZK 69 (maximum statutory meal allowance for a business trip between 5 and 12 hours), i.e. CZK 48.30 per employee per working day. This means that CZK 1,944,000 (Working) will have to be added back when calculating the 2007 tax base.

A financial contribution for employees' holidays is generally tax non-deductible, and costs of influenza vaccination are not generally tax deductible either as it is not a mandatory treatment prescribed by the special law. These could only be deducted against the tax base if the employees' right to such benefits follows from a Union agreement or similar internal document. In the case of a contribution for holidays the maximum exempt amount is CZK 20,000 per employee per tax year.

Costs of gym membership and kindergarten/school fees are tax deductible to the extent to which they are taxable income for the employees. Such income is exempt for employees if the sums are paid out of the employer's profit after tax.

If Maxima decides to pay for the employees' gym membership and kindergarten/school fees as employees' taxable (not exempt) income, the costs can be deducted against Maxima's taxable income only if the employees' right to such benefits follows from an employment contract, Union agreement or a similar internal agreement. If these benefits are granted in addition to the employees' claims following from such agreement they are not tax deductible and will have to be added back when calculating the 2007 tax base.

Costs of transportation of employees to/from Maxima's premises would only be tax deductible if the employees are transported by a vehicle for a minimum of 10 passengers owned or rented by Maxima.

Costs of a new coffee machine and wrist rest mouse pads are fully tax deductible.

Pension insurance premiums are tax deductible up to 3% of an employee's assessment base for the purposes of social security contributions, if paid directly to a pension fund.

Life insurance premiums are tax deductible up to CZK 8,000 per employee per tax year if the benefits from the life insurance contract are not due before the end of the 60th month after concluding the contract or before the employee reaches the age of 60.

Blackberries and subscriptions will be tax deductible similarly as for the costs of the new cars, if they are provided in relation to the performance of the work tasks of the employees. However, while the costs of the new cars are tax deductible, they have to be capitalised and depreciated in accordance with an appropriate tax depreciation scheme.

Yours sincerely,

Tax Adviser

Working

$55\% \times \text{CZK } 60 = \text{CZK } 33 < \text{CZK } 48.30$

55% of total cost is tax deductible and 45% has to be added back.

Total cost	CZK 4,320,000
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45% * CZK 4,320,000	CZK 1,944,000
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	<i>Marks</i>
1 (a) (i) Royalty	1
Release provision to the assigned receivable	1
Social security and health insurance contributions (both)	1
Statutory representatives' fees tax deductible	1
Depreciation of rights to breed	1
Depreciation of Audi	1½
Financial lease of Volvo	3
Depreciation of a mower	1
Depreciation of not improved greenhouse	½
Depreciation of improved greenhouse	1
Write off of assigned receivables (accounting)	½
Remaining accounting profit items	2
Write off of receivables (tax addback)	3
Nominal value of penalty assigned	1
Bad debts provisions	1½
Loss relief	1
Tax base adjusted	½
Tax	½
Foreign tax credit	2
Due date for the tax return	1
Subtotal	<u>25</u>
(ii) Tax prepayments quarterly	½
Tax prepayments calculation	½
Due dates for prepayments	1
Subtotal	<u>2</u>
(b) Obligation to withhold at 10% when making a payment to a permanent establishment of a company resident outside the EU	2
Due date	1
Subtotal	<u>3</u>
Total marks	<u>30</u>

	Marks
2 (a) Employment income	$\frac{1}{2}$
Statutory representative's fee	$\frac{1}{2}$
Pension insurance premiums	1
Life insurance premiums	1
Social security and health care contributions	$1\frac{1}{2}$
Business income	$\frac{1}{2}$
Lump-sum expenses	1
Rental income	$\frac{1}{2}$
Lump-sum expenses	1
Allowance for the interest paid	1
Rounded tax base	$\frac{1}{2}$
Tax before credits	$\frac{1}{2}$
Personal tax credit	$\frac{1}{2}$
Child tax credit	$\frac{1}{2}$
Monthly payroll January–November	$1\frac{1}{2}$
Monthly payroll December	$1\frac{1}{2}$
Minus total payroll tax withheld	$\frac{1}{2}$
Travel allowance exempt	$\frac{1}{2}$
Profit distribution subject to withholding tax	1
Rent in Belgicka exempt	$\frac{1}{2}$
Gym membership exempt	$\frac{1}{2}$
Income from sale of paintings exempt	$\frac{1}{2}$
Subtotal	<u>17</u>
(b) Base calculation	2
Health care contributions	1
Social security contributions	1
Subtotal	<u>4</u>
(c) Share of Ms Havlova	$\frac{1}{2}$
Tax base and tax calculation	1
Share of Petr Havel	
30%	$\frac{1}{2}$
Maximum 180,000	$\frac{1}{2}$
Tax calculation	$\frac{1}{2}$
Tax credits	$\frac{1}{2}$
Calculation of the difference	$\frac{1}{2}$
Subtotal	<u>4</u>
Total marks	<u>25</u>

	Marks
3 (a) Only advisory services are taxable supplies	1
Registration obligation by the correct date	1
VAT payer as of the correct date	1
Taxable period quarterly	1
Subtotal	<u>4</u>
(b) Input supplies:	5
No deduction on services linked to exempt supplies	1
Output supplies:	5
Subtotal	<u>11</u>
(1 mark for each correct point in both alternatives – maximum 11 marks)	
Total marks	<u>15</u>
4 (a) Tax liability before exemption	
Employment income	1/2
Social security and health care contributions	1/2
Business income	1/2
Lump-sum expenses	1
Other income	1/2
Expenses	1/2
Tax base and tax	1
Average tax rate	1
Exempt income	1
Tax at average tax rate	1
Personal credit	1/2
No advances + reasoning	1
No additional tax on dividend	1
Subtotal	<u>10</u>
(b) Application for prolongation of a statutory deadline and due dates	<u>2</u>
(c) (i) 31 December 2008	1
31 December 2015	1
Subtotal	<u>2</u>
(ii) 31 December 2020	<u>1</u>
Total marks	<u>15</u>
5 (a) Condition of earning, maintaining and securing income	1
Language course	1/2
MBA	1/2
Meal vouchers	2
Contribution for holidays	1
Influenza vaccination	1/2
Gym membership	1/2
Kindergarten/school fees	1/2
Exempt for employees if paid out of after-tax profits	1/2
Tax deductible if granted under internal rules	1
Transportation	1
Coffee machine	1/2
Wrist rest mouse pads	1/2
Pension insurance	1
Life insurance	1
Blackberries and subscriptions	1
Cars	1
Layout/clarity	1
Total marks	<u>15</u>