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# Answers

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Marks

1 Rose S.A.

(a) Adjustments to accounting profit to reach corporate tax base

The main adjustments made to the accounting profit are:

- subtracting non-taxable revenues;
- adding non-deductible expenses;
- adding elements similar to revenues;
- subtracting elements similar to expenses;
- subtracting tax deductions; and
- covering the tax losses of previous years.

1 mark to be awarded for each answer up to a maximum

3

(b) Corporate income tax for 2012

	Lei	
Total revenues	7,560,000	
Total expenses (W8)	(6,422,500)	
Gross accounting profit	1,137,500	½
Non-taxable revenues		
No reference to dividend revenue		1
Tax depreciation (W1)	(42,000)	2
Legal reserve (W2)	(56,875)	2
Non-deductible expenses	400,295	
Accounting depreciation (W1)	70,000	2
Net value of abandoned investment (W3)	170,000	1½
Tyres for engineer's car	2,000	1
Sponsorship expense	20,000	½
Donation	20,000	½
Withholding tax for non-resident revenue (W4)	6,095	1½
Social expenses (W5)	49,000	1½
Training expenses	0	½
Subscription to professional association (W6)	13,200	1
Provisions for warranties	50,000	1
Taxable income for 2012	1,438,920	
Tax loss carried forward	(87,000)	½
Final taxable income for 2012	1,351,920	
Corporate income tax before sponsorship (16%)	216,307	½
Sponsorship deduction (W7)	(18,690)	1½
Final corporate income tax due	197,617	<u>19</u>

(c) Value of dividends that may be distributed

Net profit = gross profit – corporate income tax

Net profit = 1,137,500 – 197,617 = 939,883 lei

½

Distributable dividends = net profit – legal reserve – accounting loss of 2012

Distributable dividends = 939,883 – 113,750 – 120,000 = 706,133 lei

1½

2

(d) Tax on dividends

(i) Dividends are paid on 8 June 2013

**Bush Co**

Gross dividend = 706,133 x 80% = 564,906 lei

½

Tax on dividend = 564,906 x 16% = 90,385 lei

½

**Romanian individuals**

Gross dividend = 706,133 x 20% = 141,227 lei

½

Tax on dividend = 141,227 x 16% = 22,596 lei

½

The deadline for declaring and paying the tax is 25 July 2013.

1

**(ii) Dividends are paid on 14 December 2014**

As the dividend was not paid before the end of 2013, Rose S.A. would have had to declare and pay the 16% dividend tax by 25 January 2014, even though the dividends were not actually paid.

1½

**Bush Co**

Gross dividend (as in (i) above) = 564,906 lei

Tax on dividend (as in (i) above) = 90,385 lei

½

**Romanian individuals**

Gross dividend (as in (i) above) = 141,227 lei

Tax on dividend (as in (i) above) = 22,596 lei

½

As a result of the tax already paid, when the dividends are actually paid the tax due will be nil.

½

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6

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30**Workings****(1) Accounting and tax depreciation for investment expense**

The building of parking spaces should not be included in the accounting profit as an expense, but it should be capitalised and depreciated over the estimated useful life. Also, when computing the corporate income tax, the tax depreciation of the investment should be determined.

**Accounting depreciation**

Gross value of investment = 240,000 lei

Number of months of depreciation = 40 months (May 2012 to August 2015)

Monthly depreciation in the first year =  $(240,000 \times 50\%) / 12 = 10,000$  lei

Number of months of depreciation in 2012 = 7 (May 2012 to November 2012)

Accounting depreciation in 2012 = 70,000 lei

**Tax depreciation**

Gross value of investment = 240,000 lei

Number of months of depreciation = 40 months (as above)

Monthly depreciation = 6,000 lei

Number of months of depreciation in 2012 = 7 (as above)

Tax depreciation in 2012 = 42,000 lei

**Tutorial note:** As Rose SA should have depreciated the building of parking spaces, total expenses should have been decreased by the value of the investment (240,000) and increased by the value of accounting depreciation (70,000). As the investment was abandoned, total expenses should also be increased by the net accounting value of the investment abandoned (170,000). Thus there will be no impact on the total value of total expenses.

**(2) Deductible legal reserve**

According to the shareholders' decision, the legal reserve shall be constituted in the amount of 10% x gross profit, but not exceeding 20% of share capital.

In 2011, there was no allocation to the legal reserve as there was an accounting loss.

In 2012, the allocation to the legal reserve will be:

Allocation to the legal reserve =  $\min(10\% \times \text{gross profit}; 20\% \text{ share capital}) = \min(1,137,500 \times 10\%; 20\% \times 1,000,000) = \min(113,750 \text{ lei}; 200,000 \text{ lei}) = 113,750 \text{ lei}$

But, for tax purposes only, a maximum of  $(5\% \times \text{gross profit} - \text{non-taxable revenues} + \text{expenses related to non-taxable revenues})$  may be deducted.

Maximum tax deductible legal reserve =  $5\% \times 1,137,500 = 56,875 \text{ lei}$

So, only 56,875 lei of the legal reserve is deductible for tax purposes.

**(3) Net value of the abandoned investment****Accounting depreciation**

Gross value of investment = 240,000 lei

Accounting depreciation in 2012 = 70,000 lei

Net accounting value =  $240,000 - 70,000 = 170,000 \text{ lei}$

**Tax depreciation**

Gross value of investment = 240,000 lei

Tax depreciation in 2012 = 42,000 lei

Net tax value =  $240,000 - 42,000 = 198,000 \text{ lei}$

As the investment was abandoned and no revenue was received, the net tax value cannot be deducted.

**(4) Withholding tax for non-resident revenue**

As the Hungarian company provides consultancy services and it has not provided Rose S.A. with a certificate of tax residence, Rose S.A. should withhold income tax on the non-resident revenue. As Rose S.A. paid the full invoiced amount, it should compute the income tax by grossing-up the net amount of 32,000 lei.

Net revenue = gross revenue – tax

Net revenue = gross revenue – 16% x gross revenue

Gross revenue = net revenue/(1 – 0.16) = 32,000/0.84 = 38,095 lei

Tax = 16% x 38,095 = 6,095 lei.

This tax should be paid to the state budget and treated as tax non-deductible.

**(5) Social expenses**

The subscription of 4,000 lei per month to the sports club and of 25,000 lei for the health spa are social expenses. They may be deducted up to 2% of the gross salary expense.

Limit of deductibility of social expenses = 2% x 1,200,000 = 24,000 lei

Social expenses = 73,000 lei

Non-deductible social expenses = 49,000 lei

**(6) Subscription to professional association**

Subscriptions to professional associations may be deducted up to €4,000 per year.

Subscription paid = 30,000 lei

Limit of deductibility = 4,000 x 4.2 lei/euro = 16,800 lei

Non-deductible subscription = 13,200 lei

**(7) Sponsorship deduction**

Sponsorship contributions may be deducted from the income tax up to 20% of the corporate income tax, but not more than 3‰ of sales revenue.

Sponsorship expense = 20,000 lei

20% of income tax = 20% x 216,307 = 43,261 lei

3‰ x sales revenue = 3‰ x 6,230,000 = 18,690 lei

The maximum possible deduction for sponsorship is 18,690 lei.

**2 The Iris Family****(a) Exempt income**

The following incomes are exempt:

- |   |   |
|---|---|
| – the inheritance received by Mrs Iris;                         | ½ |
| – Andrei's scholarship;   | ½ |
| – the revenue received by Andrei from selling the computer; and | ½ |
| – the prize won by George at the Mathematics National Contest.  | ½ |

2

**(b) Income tax****(1) Income tax due by Mrs Iris**

	January to February AND April to May AND September to December 2012	March and June to August 2012	
	(lei/month)	(lei/month)	
Base salary	2,200	2,200	½
Social security contribution (10.5%)	(231)	(231)	½
Healthcare contribution (5.5%)	(121)	(121)	½
Unemployment contribution (0.5%)	(11)	(11)	½
Net income	1,837	1,837	
Personal deduction (W1)	(140)	(100)	2½
Taxable income	1,697	1,737	
Income tax (16%)	272	278	1
Total income tax due by Mrs Iris for 2012 = 272 x 8 + 278 x 4 = 2,176 + 1,112 = 3,288 lei			½

**(2) Income tax due by Mr Iris**

**For his self-employed activity**

Prepayments:

$$16\% \times 49,000 = 7,840 \text{ lei}$$

1/2

Final tax:

	Lei	
Gross revenue	189,000	1/2
Deductible expenses	(88,600)	
Materials	(78,000)	1/2
Equipment (W2)	(600)	1 1/2
Others	(10,000)	1/2
Net income	100,400	
Final income tax (16%)	16,064	1/2

**For the investment activity**

Prepayments:

Quarter 2, 2012 (April to June 2012)

$$\text{Total revenues} = 3,000 \times 4 = 12,000 \text{ lei}$$

1/2

$$\text{Total expenses} = 3,000 \times 3 = 9,000 \text{ lei}$$

1/2

$$\text{Gain} = 12,000 - 9,000 = 3,000 \text{ lei}$$

$$\text{Income tax due for the second quarter} = 16\% \times 3,000 = 480 \text{ lei}$$

1/2

Quarter 4, 2011 (October to December 2011)

$$\text{Total revenues} = 7,000 \times 3.5 + 3,000 \times 4 = 36,500 \text{ lei}$$

1/2

$$\text{Total expenses} = 7,000 \times 3 + 3,000 \times 3 = 30,000 \text{ lei}$$

1/2

$$\text{Cumulative gain} = 36,500 - 30,000 = 6,500 \text{ lei}$$

1/2

$$\text{Cumulative income tax} = 16\% \times 6,500 = 1,040 \text{ lei}$$

1/2

$$\text{Income tax due for the fourth quarter} = 1,040 - 480 = 560 \text{ lei}$$

1/2

Final tax

$$\text{Cumulative annual gain} = 6,500 \text{ lei}$$

$$\text{Tax loss carried forward} = 4,000 \text{ lei}$$

$$\text{Cumulative annual taxable gain} = 6,500 - 4,000 = 2,500 \text{ lei}$$

1/2

$$\text{Final income tax} = 16\% \times 2,500 = 400 \text{ lei}$$

1/2

$$\text{Total final income tax due by Mr Iris for 2012} = 16,064 + 400 = 16,464 \text{ lei}$$

1/2

**(3) Income tax due by Paul**

Prepayments:

The payer of the income must withhold social contributions and income tax monthly.

$$\text{Gross monthly revenue} = 14,000 \text{ lei}$$

$$\text{Tax base for social contributions} = 14,000 - 20\% \times 14,000 = 11,200 \text{ lei}$$

1/2

$$\text{Maximum tax base for social contribution} = 5 \times 2,022 = 10,110 \text{ lei}$$

1/2

$$\text{Social security contribution withheld} = 10.5\% \times 10,110 = 1,062 \text{ lei}$$

1/2

$$\text{Unemployment contribution withheld} = 0.5\% \times 10,110 = 51 \text{ lei}$$

1/2

$$\text{Monthly prepayment of income tax withheld} = 10\% \times (14,000 - 1,062 - 51) = 1,289 \text{ lei}$$

1/2

Final tax:

	Lei	
Annual gross revenue (14,000 x 12)	168,000	1/2
Deductible expenses		
Lump-sum expenses (20%)	(33,600)	1/2
Social contributions (W3)	(20,748)	1
Taxable income	113,652	
Final income tax (16%)	18,184	1/2

**(4) Income tax due by Andrei**

Andrei does not have any liability to pay income tax as all the revenue he earns is exempt (see part (a)). 1/2

**(5) Income tax due by George**

For each prize the income payer has to withhold income tax at 16% on the value of the prize which exceeds 600 lei.

June 2012: Income tax =  $16\% \times (1,000 - 600) = 64$  lei

July 2012: Income tax =  $16\% \times (2,800 - 600) = 352$  lei

August 2012: Income tax =  $16\% \times (4,000 - 600) = 544$  lei

Total income tax due by George =  $64 + 352 + 544 = 960$  lei

1/2

1/2

1/2

1/2

2325**Workings****(1) Personal deduction**

Mrs Iris has three sons, but they may not be always in her care:

- Paul cannot be considered in Mrs Iris's care as he earns more than 250 lei/month;
- Andrei cannot be considered in Mrs Iris's care as his income exceeds 250 lei/month;
- George is considered to be in Mrs Iris's care, except in the months when he won prizes in the television shows and in the Mathematics National Contest.

Thus, during January to February and April to May and September to December 2012, Mrs Iris has a person under her care, so the personal deduction computes as follows:

Personal deduction =  $350 \times [1 - (2,200 - 1,000)/2.000] = 140$  lei

In March and during June to August 2011 Mrs Iris has no person under her care, so the personal deduction computes as follows:

Personal deduction =  $250 \times [1 - (2,200 - 1,000)/2.000] = 100$  lei

**(2) Equipment expense**

The equipment should be depreciated on a straight-line basis over ten years.

Gross value = 12,000 lei

Number of months of depreciation =  $10 \times 12 = 120$  months

Monthly depreciation =  $12,000/120 = 100$  lei/month

Number of months of depreciation in 2012 = 6 (July to December 2012)

Depreciation in 2012 =  $6 \times 100 = 600$  lei

**(3) Social contributions**

The payer of the income of intellectual property withheld the monthly social security contribution and unemployment contribution. Thus the total contributions withheld by the income payer are:

Total contributions withheld by the payer of the income =  $12 \times (\text{social security contribution} + \text{unemployment contribution}) = 12 \times (1,062 + 51) = 13,356$  lei

Paul also has the obligation to pay the healthcare contribution.

Healthcare contribution =  $5.5\% \times (14,000 - 20\% \times 14,000) \times 12 = 7,392$  lei

Total contributions due =  $13,356 + 7,392 = 20,748$  lei

**3 Tulip SRL****(a) Place of supply and value added tax (VAT) amount**

Service	Invoiced to	Place of supply	
Transport of goods within the EU, from Romania to France	Grass SARL, a company established and registered for VAT purposes in France	France	1/2
Transport of goods from the EU (Italy) to outside the EU (North Africa)	Leaf SA, a company established and registered for VAT purposes in Romania	Romania	1/2
Transport of goods in Romania from Bucharest to Pitesti	Flower Co, a company established in Russia	Romania	1
Transport of goods in Romania from Bucharest to Iasi	Strain Ltd, a company established and registered for VAT purposes in Hungary	Hungary	1/2
Transport of goods from Russia (non-EU) to China (non-EU)	Pestle SRL, a company established and registered for VAT purposes in Romania	Outside EU	1

<b>Service</b>	<b>VAT Amount</b>	<b>Marks</b>
Transport of goods within the EU, from Romania to France	Tulip SRL will not charge VAT as this is an intra-community transaction having a place of supply in France, for which Grass SARL is the taxable person liable to charge VAT	1
Transport of goods from the EU (Italy) to outside the EU (North Africa)	Tulip SRL may not charge VAT as this is a transport ancillary to an export of goods, which is exempt from VAT. However, if Tulip SRL does not hold all necessary documents to support the exemption, it will have to charge Romanian VAT at 24%, i.e. $3,000 \times 2.5 \times 24\% = 1,800$ lei	1 $\frac{1}{2}$
Transport of goods in Romania from Bucharest to Pitesti	$130 \times 2.5 \times 24\% = 78$ lei	$\frac{1}{2}$
Transport of goods in Romania from Bucharest to Iasi	Tulip SRL will not charge VAT as this is a transaction having a place of supply in Hungary and Strain Ltd is the taxable person liable to charge VAT	1
Transport of goods from Russia (non-EU) to China (non-EU)	Tulip SRL will not charge VAT as this is a service having its place outside the VAT territory	$\frac{1}{2}$
		<hr/> <b>9</b>
<b>(b) Transport services not invoiced</b>		
(i) For transporting its own assets to another business location, Tulip SRL should not issue an invoice (as the service was not performed for another person) nor a self-invoice (as the services were performed in connection with its own activity).		1
(ii) For transporting the personal goods of its shareholders without receiving payment, Tulip SRL should issue a self-invoice, as this is considered a self-service.		1
(iii) For the services performed for Ground S.A., Tulip SRL should issue an invoice as this is a service receiving payment, i.e. fuel. Tulip SRL should issue an invoice for the value of the transport performed to Ground S.A. and Ground S.A. should invoice Tulip SRL for the full amount of the fuel. Any compensation should be made on a cash basis.		1
		<hr/> <b>3</b>
<b>(c) VAT returns and statements</b>		
<b>VAT declaration</b>	<b>Deadline</b>	
VAT return for January 2012	25 February 2012	$\frac{1}{2}$
VAT return for February 2012	25 March 2012	$\frac{1}{2}$
VAT return for March 2012	25 April 2012	$\frac{1}{2}$
Recapitulative statement for intra-EU transactions for January 2012	25 February 2012	$\frac{1}{2}$
Recapitulative statement for intra-EU transactions for February 2012	25 March 2012	$\frac{1}{2}$
Statement for supplies/acquisitions made within Romania in the first semester of 2012	25 July 2012	$\frac{1}{2}$
		<hr/> <b>3</b>
		<hr/> <b>15</b>

#### 4 Daffodil SARL

##### (a) Permanent establishment

A permanent establishment may be defined as a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Thus:

- it has to exist as a place of business that is at the disposal of the person;  $\frac{1}{2}$
- this place of business has to be fixed, i.e. last more than six months; and 1
- the person has to carry on business activities through this place of business.  $\frac{1}{2}$

Daffodil SARL fulfils all the above conditions, thus its activity in Romania does constitute a permanent establishment.

1  

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**3**

**(b) Corporate income tax 2012**

	Lei	
Total revenues (18,400 x 4 + 20,500 x 7)	217,100	1
Total expenses (W1)	202,900	1
Gross accounting profit	14,200	
Non-taxable revenues	0	
Non-deductible expenses	7,852	
– Protocol (W2)	2,852	1½
– Fine	5,000	1
Taxable income	22,052	
Income tax (16%)	3,528	½
		<u>5</u>

**(c) Tax residence of an individual**

An individual is considered a tax resident in Romania if at least one of the conditions below is fulfilled:

- |  |   |
|--|---|
| (1) has his/her domicile in Romania; or  | ½ |
| (2) his/her centre of vital interest is considered to be in Romania; or  | ½ |
| (3) he/she is present in Romania for a period or multiple periods which exceed 183 days during a 12-month period which ends in the respective tax year; or | 1 |
| (4) he/she is a Romanian citizen working abroad as an employee of Romania in a foreign country.  | ½ |

As Daffodil SARL's employees do not fulfil any of the above conditions, they cannot be considered resident in Romania.

½

3**(d) Personal income tax**

Personal income tax is due in Romania by non-residents from the first day they obtain the revenue related to an activity performed in Romania, should no double tax treaty apply.

2

The employees have the obligation to pay and declare the income tax in Romania personally.

1

The deadline for paying and declaring the tax is the 25th of the month following the month when the revenue was obtained.

1

415**Workings****(1) Total expenses**

$$\begin{aligned} \text{Total expenses} &= \text{rent} + \text{utilities} + \text{meals} + \text{salaries} + \text{social contributions} + \text{fine} \\ &= (4,000 \times 11) + (500 \times 11) + 3,200 + (5,100 \times 2 \times 11) + (1,500 \times 2 \times 11) + 5,000 \\ &= 44,000 + 5,500 + 3,200 + 112,200 + 33,000 + 5,000 = 202,900 \text{ lei} \end{aligned}$$

**(2) Deductibility of protocol expenses**

$$\begin{aligned} \text{Limit for protocol expenses} &= 2\% (\text{gross profit} + \text{corporate income tax} + \text{protocol expense}) \\ &= 2\% (14,200 + 3,200) = 348 \text{ lei} \\ \text{Non-deductible protocol expenses} &= 3,200 - 348 = 2,852 \text{ lei} \end{aligned}$$

**5 Mr Snowdrop****(a) Prepayments and final income tax**

$$\text{Prepayments of income tax} = 16\% \times 8,400 = 1,344 \text{ lei}$$

½

Prepayments of income tax have to be paid in four equal instalments of 336 lei by the 15th of the last month of each quarter.

1

When income quotas are used, the final tax is equal to the sum of the tax prepayments. Therefore, there is no obligation to declare or pay anything as final tax.

½

2



**(b) Additional income tax as calculated by the tax inspectors**

Gross income established by the tax authorities = $12,000 \times 12 = 144,000$ lei	1/2
Net income established by the tax authorities = gross income = 144,000 lei	1/2
Income tax established by the tax authorities = $144,000 \times 16\% = 23,040$ lei	1/2
Additional income tax to be paid according to the tax inspectors = $23,040 - 1,344 = 21,696$ lei	1/2
	<u>2</u>

**(c) (i) Value added tax (VAT) to be paid for 2012**

The VAT registration threshold = $\text{€}35,000 \times 3.3817$ lei/euro = 118,360 lei $\approx$ 119,000 lei	1/2
Monthly revenue = 12,000 lei	
Number of months to reach the threshold = $119,000/12,000 = 9.92$	1/2
$\Rightarrow$ Mr Snowdrop exceeded the threshold during October 2012.	1/2
$\Rightarrow$ He should have requested registration for VAT purposes by 10 November 2012.	1
$\Rightarrow$ Mr Snowdrop should have been registered for VAT purposes from 1 December 2012.	1
The VAT that should have been charged by Mr Snowdrop and paid to the state budget for 2012 = $12,000 \times 24\% = 2,880$ lei	1/2
	<u>4</u>

**(ii) Interest and penalties**

Value of additional VAT set by the tax inspectors = 2,880 lei	
The deadline for paying the VAT is 25 January 2013.	1/2
The actual date of payment is 10 July 2013.	
Number of days of late payment = 166 days (26 January to 10 July 2013 inclusive)	1/2
Interest = $2,880 \times 0.04\% \times 166 = 191$ lei	1/2
Penalties = $2,880 \times 15\% = 432$ lei	1/2
	<u>2</u>

**(d) Appeal**

Mr Snowdrop may appeal against the tax inspectors' decision within 30 days after the decision was received.	1
In the first stage of the appeal, the competent authority for making the appeal is the authority that issued the tax decision.	1
Arguments for an appeal:	
(i) The decision to compute additional income tax was wrong. According to the tax legislation, taxpayers who use the income quota system have to pay income tax based on that income quota, without considering the real revenues.	1
(ii) As the decision to compute additional income tax was wrong, the decision to compute interest and penalties for not paying this income tax in due time was also wrong.	1
No appeal is possible in the case of VAT as the decision made was correct.	1
	<u>5</u>
	<u>15</u>