Answers

1 Mr Boros

(a) Taxation of consideration for the two-week project

The consideration received for the two-week project will be treated as income from independent sources since Mr Boros carried out the activity outside an employment relationship.

Income from independent sources is part of the consolidated tax base which is taxed at the progressive rates of 18% and 36%. The taxpayer has the right to deduct actual expenses from the income so derived. In the absence of such expenses, a 10% general expense ratio may be used without the need of any supporting invoices.

As there is no information on expenses incurred it is assumed that Mr Boros would opt for the 10% lump sum deduction. This results in a deduction of HUF 50,000.

(b) Income from securities received

Where an individual receives securities for no consideration or at a reduced price, the difference between the price paid and the market price is treated as income of the individual. The legal relationship determines the tax treatment: as the provider is other than Mr Boros' employer it will be classed as other income, part of the consolidated tax base and taxed at the progressive rates of 18% and 36%.

(c) Interest free loan

Where an individual receives an interest free loan or a loan with interest payable below the market level, it qualifies as a benefit in kind. The difference between the interest paid and the market rate will be the income of the individual. The market interest is derived by adding 5% points to the official rate of the National Bank of Hungary (10%) ruling on 31 December in the tax year. The tax on the taxable income is payable at 44%.

		HUF
Deemed interest on the loan	4,000,000 x (10 + 5)% x 10/12	500,000
Interest paid		0
Taxable income		500,000
Tax	44%	220,000

(d) Liability to declare

The tax shall be declared and paid to the tax authorities by Mr Boros in his annual personal income tax return in the case of the income from securities. However, in the case of the interest free loan, the payer (Eger Kft) is obliged to declare and pay the tax on the income.

(e) Sale of securities

When Mr Boros sells the securities for HUF 400,000 he realises a capital gain being income taxed separately. The tax on this type of income is 25%.

		HUF
Sales proceeds		400,000
Acquisition cost		300,000
Taxable income		100,000
Tax	25%	25,000

Tutorial note: Acquisition cost is deemed to be HUF 300,000 and not the actual acquisition cost of HUF 215,000; the difference between the price paid (215,000) and the original market price (300,000) has already been taxed as other income.

(f) Personal income tax liability for 2008

Consolidated tax base	Notes and references	HUF
Non-independent activities		
Salary from Badacsony Kft	(640,000 x 12 – 320,000)	7,360,000
Independent activities		
Two-week project		500,000
Less: 10% lump sum		(50,000)
Other income		
Income from receipt of securities	Note 1	85,000
Total consolidated tax base		7,895,000
Tax on consolidated tax base		
On the first 1,700,000 at 18%		306,000
On the remaining at 36%		2,230,200
		2,536,200
Solidarity surtax	(7,895,000 – 7,137,000) x 4%	30,320
Income taxed separately		
Capital gain on resale of securities	as per part (c)	100,000
Tax on it at 25%		25,000
Sale of moveable property	Note 2	
Selling price		300,000
Less: probate value		(160,000)
Less: fee of 1·5%		(4,500)
Taxable income		135,500
Tax on moveable property sale 25%		33,875
TOTAL PIT LIABILITY		2,625,395

Notes

Note 1:
Income from receipt of securities

Market price	300,000
Price paid	(215,000)
Taxable income	85,000

Note 2: Income from selling a moveable property is income taxed separately at 25%. The taxable income is derived as follows: the sales proceeds are decreased by the original acquisition costs, by any value increasing investments and by any related expenses (charge of the auction house).

(g) Deadline for tax return

The personal income tax return for 2008 should be prepared by 20 May 2009.

2 Tic Zrt

(a) Corporate income tax liability for the year 2008

	Note	HUF '000	HUF '000
Profit before tax			200,000
Increasing items:			
Accounting depreciation	1	1,350	
Debts cancelled	2	4,800	
Tax penalty and default penalty	3	3,000	
Inventories stolen	4	10,000	
Thin capitalisation and interest paid	8	18,000	
			37,150
Decreasing items:			
Tax depreciation	1	2,000	
Capital gain	5	900	
Dividend received	6	0	
Local business tax	7	2,000	
			(4,900)
Tax base			232,250

Notes:

1. Accounting depreciation is a tax base increasing item. Tax depreciation is allowable for tax purposes. Since HUF 18 million out of HUF 20 million was financed from the development reserve created in 2007 and the tax base was reduced in that year by HUF 18 million, only the excess amount of HUF 2 million can be depreciated for tax purposes. However, the base of tax depreciation is still HUF 20 million.

   Depreciation for tax and accounting purposes is summarised below:

   Accounting depreciation

	HUF '000	HUF '000
Depreciable amount	20,000 – (4 x 500)	18,000
Rate of depreciation		10%
Depreciation in 2008	18,000 x 10% x 9/12	1,350

   Tax depreciation

	HUF '000	HUF '000
Depreciable amount		20,000
Rate of depreciation		20%
Depreciation in 2008	20,000 x 20% x 9/12	3,000

   From the theoretical HUF 3 million the company can only effect HUF 2 million as tax depreciation since this is the amount not coming from the development reserve.

2. Expenses accounted for as a consequence of debts cancelled are not deductible for tax purposes. Therefore, the company must add back the HUF 4 million to its corporate tax base increased by VAT of HUF 800,000.

3. Consequences of tax audits and the fines so charged are not recognised expenses for tax purposes. The only exception is the self-revision surcharge. Therefore the HUF 3 million (2 million + 1 million) is a tax base increasing item; however, the HUF 350,000 will not modify the tax base.

4. The value of missing assets is only a recognised expense if the taxpayer did everything in his powers to prevent the loss. From the scenario in the question it is obvious that the company did not repair the electronic lock system of the store-house. As a result, the value of inventories stolen must be added back to the corporate tax base.

5. 50% of the capital gain realised on a recognised stock exchange is a tax base reducing item. As the total gain realised is HUF 1·8 million, the deduction amounts to HUF 900,000.

6. Dividend received is a tax base reducing item as per the main rule. However, if the dividend is paid by a company that qualifies as a controlled foreign corporation, the dividend received cannot be deducted from the tax base.

   The subsidiary located in Jersey appears to be a controlled foreign company (CFC), since no corporation tax is payable in Jersey and Tic Zrt holds shares in that company during the year. Since there is no double tax treaty between Hungary and Jersey the burden of proof as to whether the subsidiary in Jersey carries out real business activities lies with Tic Zrt.

7. Local tax is deductible from the tax base provided that the company has no overdue liabilities as at the end of the tax year. Furthermore, the company must be profit making.

8. Where a company receives a loan (bank loans are excluded from this rule) and the average daily balance on the loan exceeds three times the average equity, the interest on the exceeding part is a tax base increasing item. Average equity is equity of the company at the end of the previous tax year excluding the revaluation reserve.

	HUF '000
Average daily balance on loan	600,000
3 x average equity (3 x 130 million)	390,000
Exceeding part	210,000
Disallowed interest (210 million x 6%)	12,600

   If there is net interest payable by a company in relation to related parties, then 50% of the interest is a tax base increasing item. The same amount is a tax base reducing item for the other party (although in this case the Swedish company cannot reduce the tax base; the increase in the Hungarian company is compulsory).

   Interest paid during the year: 600 million x 6% x 50% = HUF 18 million.

   If both the thin capitalisation rule and the rule re 50% of the net interest expense is applicable then only the higher of the two adjustments will increase the tax base. For Tic Zrt this means an increase of HUF 18 million in 2008.

(b) Rules for progressive rate and calculation of corporate tax for the year 2008

(i) Companies can pay 10% corporate tax on the first HUF 50 million of the positive tax base provided that the following conditions are met:

- The company does not apply for any tax relief.
- The company ties up 6% of the tax base (max. HUF 50 million) and uses this tied-up reserve as a resource for investments in the next four tax years.
- The average number of employees in the tax year is at least one.

- The corporate tax base in the current and previous tax years is greater than or equal to the minimum tax base.
- The pension and health contribution paid in the tax year is greater than or equal to double the minimum wage as at the beginning of the year multiplied by the average number of employees.
- The difference between the 16% and 10% rate qualifies as a '*de minimis*' support.

(ii) Corporate tax liability

	HUF '000
On the first HUF 50 million	5,000
On the remaining amount (232,250,000 – 50,000,000) x 16%	29,160
Total:	34,160

(c) Solidarity surtax liability for the year 2008

	HUF '000	HUF '000
Profit before tax		200,000
Increasing items:		
Tax penalty and default penalty	3,000	
		3,000
Decreasing items:		
Dividend received	0	
		0
Tax base		203,000
Tax at 4%		8,120

(d) Tax advance payments for the year 2009

Corporation tax:
If the taxpayer in a certain year has a final corporate tax liability over HUF 5 million then in the next year it has to pay tax advances monthly. This is obviously the case for Tic Zrt so the company will pay advances in every month. The deadline for that payment is 20th of the current month (e.g. the deadline for the March advance payment is 20 March).

As the final tax liability of 2008 is only established and declared to the tax authorities by 31 May 2009 in the first six months of 2009 the advance payments will be based on the 2007 final tax liability. The amount of the advance payments from January to June will be 1/12 of the final liability of 2007, i.e. HUF 34,500,000/12 = HUF 2,875,000 per month.

From 1 July 2009, by which date the final 2008 liability will be available, tax advances will be based on that. As computed in part (b) of the question, the final tax liability will be HUF 34,160,000 thus advances of HUF 34,160,000/12 = HUF 2,846,667 per month will have to be paid from July until November.

By 20 December 2009 the company must assess the final tax liability for the year 2009 and any difference between the forecast and the advances paid from January to November must be paid.

After calculating the final tax liability for the year 2009 (which is done on 31 May 2010) any remaining liability must be paid or any overpaid amount can be recovered.

Solidarity tax:
The system is the same as for corporation tax with the distinction that payments shall be made only quarterly. The deadline for such advance payments is the 20th of the month following the quarter for the first, second and third quarter. The deadline for the fourth quarter advance payment is 20 December 2009.

The amount so paid will be:

- On 20 April 2009: HUF 7,650,000/4 = HUF 1,912,500
- On 20 July 2009: HUF 7,650,000/4 = HUF 1,912,500
- On 20 October 2009: HUF 8,120,000/4 = HUF 2,030,000
- On 20 December 2009: as forecast by Tic Zrt.

3 (a) Conditions to qualify for development tax relief

A company is entitled to claim development tax relief provided it has:

- Invested more than HUF 3 billion in net present value terms.
- The investment started after 31 December 2002.
- The whole project involves investment in new assets.
- The assets are operated for at least five years after they are put into operation.
- The annual average number of employees must exceed, by at least 150, the average number of employees in the year prior to the commencement of the investment. This condition only applies from the second year in which relief is claimed.

(b) Limit calculation for Nagyhal Kft

The limit can be calculated by taking the net present value (NPV) of the investment to which three factors are then applied:

1. Location of the investment: Pest County has a ratio of 30%.
2. Size of the investment: see below.
3. Industrial factor: not applicable here (certain industries only).

Intensity ratio

NPV of the relief in HUF million	31,050		
NPV of the relief in EUR million	115		
Location		30%	
	€		€
For the first €50 million	50,000,000	100%	15,000,000
between €50 million and €100 million	50,000,000	50%	7,500,000
above €100 million	15,000,000	34%	1,530,000
Total limit			24,030,000

This equates to HUF 6,488 million in net present value terms

(c) Forecast of expected tax liability for Nagyhal Kft

All numbers in HUF million

Relief calculation

	2008	2009	2010	2011	2012	2013
Corporate tax base	11,000	11,900	12,960	14,040	15,300	16,540
Tax at 16%	1,760	1,904	2,074	2,246	2,448	2,646
Relief (80% of tax)	1,408	1,523	1,659	1,797	1,958	2,117
Discount factor at 8·59%	1	0·92	0·85	0·78	0·72	0·66
Present value of the relief	1,408	1,401	1,410	1,402	1,410	1,397
Cumulative PV of the relief	1,408	2,809	4,219	5,621	7,031	8,428
Available relief (in PV terms)	1,408	1,401	1,410	1,402	867*	
Limit of relief	6,488					

Corporate tax liability forecast

	2008	2009	2010	2011	2012	2013
Tax base	11,000	11,900	12,960	14,040	15,300	16,540
Tax at 16%	1,760	1,904	2,074	2,246	2,448	2,646
Relief at 80% (in absolute terms)	1,408	1,523	1,659	1,797	1,204**	
Tax payable	352	381	415	449	1,244	2,646

*The last year the company can claim the relief is 2012 where only a fraction of the theoretical relief is available as the company reaches the limit in net present value terms (HUF 6,488 – HUF 5,621 million). After this point of time, no relief may be claimed.

**867/0·72 = 1,204

4 Calculation of VAT position of Lee Kft for December 2008

Output VAT (payable)

	Notes	Base for VAT	Rate of VAT	HUF
Tea sales		230,000	20%	46,000
Health services			Exempt	0
Invoice Y	Note 2	900,000	20%	180,000
VAT payable	Note 4			1,836
Total VAT payable				227,836

Input VAT (deductible)

	Notes	Base for VAT	Rate of VAT	HUF
Invoice X	Note 1	80,000	20%	0
Invoice Y	Note 2			0
				0

Net VAT position in December 2008: HUF 227,836 payable less HUF 0 deductible = HUF 227,836 payable.

Notes:

1. In the case of telephone bills the date of obligation is determined by the due date of the invoice, consequently the November invoice with a due date of 12 December 2008 is relevant to the December VAT return. 30% of input VAT on phone invoices is not deductible if private usage is not re-invoiced to employees. VAT on the invoice of: HUF 80,000 x 20% = HUF 16,000 out of which 30% is irrecoverable: HUF 16,000 x 30% = HUF 4,800. The remaining portion of HUF 11,200 must be allocated and apportioned (see note 4).
2. The place of performance of legal services is the place of the seat of the ordering party i.e. Lee Kft. This invoice is thus within the territorial scope of the Hungarian VAT law, it is a so called 'import service'. Lee Kft has to self-assess the VAT of this service based on the invoice received from Smith Ltd. As per base case VAT is payable and receivable at the same time in the same VAT return. However, since Lee Kft used this legal service only in respect of its VAT exempt activity (health services) VAT cannot be deducted, but still it remains payable. VAT payable: 900,000 x 20% = 180,000.
3. 'Other invoices' worth HUF 300,000 are used for general business purposes so allocation and apportionment of the input VAT on them of: HUF 300,000 x 20% = HUF 60,000 is necessary (see note 4).
4. Lee Kft carries out both VATable (selling tea) and VAT exempt (health services) activities. It has to separate the purchases related to both activities. VAT related to only health services cannot be deducted whereas VAT related to only tea sales can be deducted in full. The firm has to allocate and apportion the VAT receivable on purchases that relate to both activities.

The deduction is calculated as follows:

$$\textit{deduction portion} = \frac{\textit{sales that entitle the entity to deduct VAT}}{\textit{total sales}}$$

The ratio must be calculated to two decimal places and rounded up. This must be done on a cumulative basis throughout the year in every VAT period of the firm (monthly).

For the first 11 months Lee Kft had the following deduction ratio:

$$\frac{1{,}700{,}000}{1{,}700{,}000 + 4{,}800{,}000} = 0{\cdot}2615 \text{ which means a deduction ratio of 27\%.}$$

Consequently, the deductible portion of the unallocated input VAT in November 2008 was HUF 350,000 x 27% = HUF 94,500.

The same ratio must be calculated for the whole year as well including December sales figures.

$$\frac{1{,}700{,}000 + 230{,}000}{1{,}700{,}000 + 4{,}800{,}000 + 2{,}500{,}000} = 0{\cdot}2144 \text{ so this is 22\%.}$$

Cumulative unallocated input VAT: HUF 350,000 (first 11 months) + 11,200 (note 1) + 60,000 (note 3) = HUF 421,200.

Allocation and apportionment of input VAT in December 2008

		HUF
Cumulative deductible VAT based on Dec portion	421,200 x 22%	92,664
Already deducted in November	350,000 x 27%	(94,500)
Payable in December 2008		(1,836)

Based on the calculation above Lee Kft has VAT payable as a result of the decrease of the deduction ratio from November to December 2008.

5 (a) Conditions to be fulfilled for simplified taxation (EVA)

A company such as AVE Bt may become an EVA taxpayer only if, in the year of registration (2007) and the previous tax year (2006) the following conditions are met:

(1) The company did not reorganise into another company form (including demerger and merger by acquisition) and no new member acquired voting shares in the company (except from inheritance) in excess of 50%.
(2) The tax authority did not order to impose definitely any default fine on the company at issue for repeated failure to meet the obligation to issue invoices and receipts.
(3) The company was not obliged, according to the Act on Value Added Tax, to be subject to taxation based on price margin or to apply any special rules of taxation (reverse taxation).
(4) The company accounted for its sales revenue in accordance with the Act on Accounting.
(5) The company had a total revenue, on an annual basis, of not more than HUF 25 million in the tax year preceding the year of registration under the EVA system (2006), and it will have a total revenue, reduced to a reasonably expected annual level, of not more than HUF 25 million for the tax year of registration (2007). The company's reasonably expected total revenue will not exceed HUF 25 million in the tax year and under the EVA system (2008). Total revenue means sales revenue including value added tax (VAT).

(b) Calculations of net dividend receivable from AVE Bt for the year 2008

(i) If the company does not apply EVA-taxation, the net dividend that can be paid to Mr Fazekas is:

		HUF
Sales revenue net of VAT		18,000,000
Costs and expenses excluding salaries		(3,000,000)
Salary expense (12 x 200,000)		(2,400,000)
Contribution to state pension fund	24%	(576,000)
Contribution to state health fund	5%	(120,000)
Contribution to unemployment fund	3%	(72,000)
Total costs and expenses		(6,168,000)
Profit before tax		11,832,000
Corporate tax	16%	(1,893,120)
Solidarity surtax	4%	(473,280)
Profit after tax (gross distributable profits)		9,456,600
Dividend tax	25%	(2,366,400)
Net dividend that can be paid		7,099,200

(ii) If the EVA-rules are applied, the following net dividend can be paid to Mr Fazekas:

		HUF
Sales revenue net of VAT		18,000,000
Sales revenue including VAT		21,600,000
Costs and expenses excluding salaries (+20%)	Note	(3,600,000)
Salary expense (12 x 200,000)		(2,400,000)
Contribution to state pension fund	24%	(576,000)
Contribution to state health fund	5%	(120,000)
Contribution to unemployment fund	3%	(72,000)
Total costs and expenses		(6,768,000)
EVA	25%	(5,400,000)
Net distributable profits – dividend (gross revenue – costs – EVA)		9,432,000

Note: The net dividend is calculated after paying the EVA and the salary expenses as well as social contributions and other expenses. As an EVA-qualified company cannot reclaim VAT the expenses incurred should be increased by 20%.

			Marks
1	(a)	**Taxation of consideration for the two-week project**	
		Treatment as independent income	0·5
		Part of consolidated tax base/progressive rates	0·5
		Deduction opportunities (0·5 mark each)	1
			2
	(b)	**Income from securities**	
		Determining the income	1
		Classification as other income	0·5
		Part of consolidated tax base/progressive rates	0·5
			2
	(c)	**Benefit in kind – interest free loan**	
		Classification as benefit in kind	1
		Determination of income	1
		Calculation of taxable income	1
		Personal income tax: 44%	1
			4
	(d)	Income from securities – Mr Boros is liable	1
		Interest free loan – the payer (Eger Kft) is liable	1
			2
	(e)	**Capital gain**	
		Classification as capital gain (income taxed separately)	1
		Right calculation of income	1·5
		Calculation of tax	0·5
			3
	(f)	**PIT liability of Mr Boros**	
		Salary classification	0·5
		Calculation of salary income	0·5
		Independent activities – classification	0·5
		Net of deduction of 10%	0·5
		Other income – classification	0·5
		Calculation of other income	1
		Consolidated tax base	0·5
		Tax on consolidated tax base using the progressive rates	1
		Solidarity surtax calculation	1
		Income from capital gain on securities – classification	0·5
		Income from sale of moveable property – classification	1
		Deduction of probate value	1
		Deduction of auction house fee	1
		Tax re moveable property and securities at 25%	1
		Total personal income tax	0·5
			11
	(g)	**PIT tax return deadline**	
		Right deadline	1
			1
			25

			Marks
2	**(a)**	**Tax base calculation**	
		Accounting depreciation	1
		Debts cancelled including VAT	1
		Tax penalty and default penalty	1
		Self revision surcharge allowable	0·5
		Inventories stolen	1
		Tax depreciation	1
		Recognising limit from development reserve	1
		Capital gain	1
		Dividend received and CFC rules	2
		Local business tax allowable	1
		Thin capitalisation rules	1
		Calculation of daily averages	2
		Disallowed interest	1
		Rule re 50% of net interest expense	1
		Calculation of adjusting item	0·5
		Rule of higher of both adjustments	1
			17
	(b)	**Corporate tax calculation**	
		(i) Rules for 10% band (0·5 each)	3
		(ii) Tax calculation	1
	(c)	**Solidarity surtax**	
		PBT as starting point	0·5
		Penalties as increasing item	1
		Dividend – non-decreasing (as from CFC)	1
		Tax at 4%	0·5
			3
	(d)	**Advance payment rules**	
		Rules re advance monthly payment of corporate tax	2
		Amounts calculated correctly for January to November	1
		Position re December and remaining liability payments	1
		Rules re advance payment of solidarity surtax	1
		Amounts calculated correctly	1
			6
			30

			Marks
3	**(a)**	**Conditions to qualify for the relief**	
		Criteria (1 mark each)	5
	(b)	**Limit calculation**	
		Right application of regional factor	1
		Right application of size factor	1·5
		Conversion to HUF	0·5
			3
	(c)	**Forecast of expected tax liability**	
		Relief calculation	
		Tax rate at 16%	1
		Relief limited to 80% of tax	1
		Calculation of tax relief in present value terms	1
		Cumulative present value of the relief	0·5
		The last year when relief is available	1
		Corporate tax liability forecast	
		80% adjustment in absolute terms	0·5
		Calculation of relief in 2012	1
		Actual tax payable 2008 to 2012	1
			7
			15

4	**Calculation of VAT position**	
	VAT on tea sales in December	0·5
	Phone bill – date of performance	1
	Phone bill – non-recoverable portion (rule + amount)	2
	Phone bill – fact that it forms part of general input VAT	1
	Legal services – place of performance	1
	Legal services – treatment of import service	2
	Legal services – treatment of exempt activity	1
	Other invoices	1
	Allocation and apportionment rules	1
	Deduction ratio and deductible amount for the first 11 months	1·5
	Deduction ratio and deductible amount for the whole year	1·5
	VAT payable as a result of decrease in deduction ratio	1
	Net VAT position in December	0·5
		15

			Marks
5	**(a)**	**Conditions to be met**	
		Criteria 1 to 4 (1 mark each)	4
		Criteria 5 – total revenue	2
			6
	(b)	**Net dividend**	
	(i)	**Without EVA**	
		Sales revenue/cost of sales expenses	0·5
		Salary expense	0·5
		Contribution to state pension fund	0·5
		Contribution to state health fund	0·5
		Contribution to unemployment fund	0·5
		Corporation tax and solidarity tax on PBT	1
		Dividend tax	1
		Net dividend	0·5
			5
	(ii)	**With EVA**	
		Using gross sales revenue (including VAT) as basis for calculation	1
		Costs and expenses increased by 20%	1
		Salary expense plus on costs as in (i)	0·5
		Application of 25% EVA on gross revenue	1
		Right calculation of distributable profits after EVA	0·5
			4
			15