Fundamentals Level – Skills Module

Taxation (Hungary)

Monday 6 December 2010

Paper F6 (HUN)

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are on pages 3–4.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

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The question paper begins on page 3.

SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need to be made to the nearest HUF except where stated otherwise in the question.
2. All apportionments should be made to the nearest month.
3. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates and allowances applicable to 2010 are to be used in answering the questions.

Corporate tax

On the first HUF 50 million of the corporate tax base	10%
On the remaining tax base	19%

Note: the lower band of 10% may only be taken advantage of if the company meets the criteria specified in the law on corporate tax. If not, the corporate tax rate is 19% on the entire tax base.

Value added tax (VAT)

Tax rate	25%

Personal income tax

On the consolidated tax base	
On the first HUF 5,000,000	17%
On the remaining tax base	32%
On dividends	
General rate	25%
On dividends from companies listed on a stock exchange (operating within the European Economic Area)	10%
On interest	20%
On capital gains	
General rate	25%
On capital gains realised on the stock exchange (operating within OECD)	20%
On rents	25%

Benefits in kind

Tax rate	54%

Social security contributions

Employer's contributions	
Pension contributions	24%
Health insurance contributions	3%
Employee's contributions	
Pension contributions	9·5%
Health insurance contributions	7·5%

Cap for social security contributions – HUF 7,453,300

Company car tax

Cubic capacity of car	Monthly amount HUF
Below 1600 cm^3	7,000
1600 cm^3 and over	15,000

Support and subsidies – development tax relief

The limits applying to subsidies given in the form of tax relief or other subsidies in respect of investments are defined by the following intensity ratios.

1. Regional factors.
   - Budapest: 35%
   - Pest County: 30%
   - Western Transdanubia: 45%
   - Other regions: 50%
2. For companies which qualify as being small and medium sized, 15% is added to the regional factor.
3. The maximum support is calculated by applying the following to the initial investment:
   - On the first €50 million of the investment: 100% of the intensity ratio.
   - On the portion between €50 million and €100 million: 50% of the intensity ratio.
   - On the portion over €100 million: 34% of the intensity ratio.

The reference rate to be used in the present value calculations is 8·59%.

Qualifying limits for small and medium sized companies

A company qualifies as small or medium if:

- the company has no state or local government members; and
- the number of employees is less than 250; and
- total assets are less than €43 million; or
- total revenues are less than €50 million

Exchange rates

Euro: €1 = 270 HUF

USD: $1 = 200 HUF

Official rate of interest

National Bank of Hungary (Magyar Nemzeti Bank – MNB) – 6·25%

ALL FIVE questions are compulsory and MUST be attempted

1 Mr Klein is a German citizen, who has been employed by Gross Kft for several years and is resident in Hungary for tax purposes. The following items are relevant when determining his personal income tax liability for 2010.

Mr Klein owns a flat in Budapest, which he bought many years ago. The flat was rented out for a period of ten months in 2010, for a monthly fee of HUF 90,000.

Mr Klein receives a salary of HUF 700,000 per month from Gross Kft.

As a part of his remuneration package, on 1 August 2010 Mr Klein received an option from Gross Kft to buy 1,000 shares of Giant Inc (the parent company of Gross Kft) for HUF 30,000 per share. Giant Inc is listed on the New York Stock Exchange. On 1 August 2010 the shares of Giant Inc were trading at the equivalent of HUF 50,000 per share. The earliest date that the option can be exercised is 1 April 2011.

Mr Klein regularly buys and sells shares on the Budapest Stock Exchange. During 2010 he realised capital gains of HUF 2,000,000 and capital losses of HUF 1,200,000 on different transactions.

Mr Klein received a dividend of HUF 5,000,000 from a company that qualifies as a controlled foreign corporation (CFC) in 2010.

Required:

(a) State the circumstances in which a private individual is considered to be a tax resident in Hungary, in the absence of an applicable double tax treaty. (5 marks)

(b) State the options available to Mr Klein concerning the taxation of his rental income and determine which option is the more advantageous to him. (6 marks)

(c) Calculate the net salary received by Mr Klein from Gross Kft in December 2010 after deducting the personal income tax and social security contributions payable from his gross salary. Support your answer with brief explanations. (6 marks)

(d) (i) Explain the personal income tax implications of the dividend and stock options received by Mr Klein. (4 marks)

(ii) Calculate the total personal income tax liability of Mr Klein for the year 2010. (4 marks)

(25 marks)

2 Recovery Rt is a wholesaler company trading in pharmaceutical products. Its parent company, Get-well Plc, is incorporated in the United Kingdom. Recovery Rt has its domicile in Budapest and an accounting year ending 31 December.

In the year ending 31 December 2010 Recovery Rt had a preliminary profit before tax of HUF 800 million before accounting for the items below relating to the month of December 2010:

– Entertainment expenses incurred of HUF 2 million.
– Payments of taxable benefits in kind of HUF 3 million.

Both the entertainment expenses and the benefit in kind payments are stated excluding value added tax (VAT) and before any other relevant taxes payable on them.

Included in the preliminary profit before tax of HUF 800 million are the following items:

1. HUF 8 million expensed as an impairment of Recovery Rt's non-current assets. This impairment expense was necessary because the market value of the non-current assets affected was materially and durably lower than their book value.

2. An allowance has been made in accordance with Recovery Rt's accounting policy, on all accounts receivable balances over 180 days. The balance of Recovery Rt's receivables and the amount of the allowance as at 31 December 2010 were :

Age of receivables	**Outstanding receivables HUF '000**	**Allowance %**	**Allowance HUF '000**
Less than 180 days	2,100,000	0%	0
More than 180 days but less than 365 days	20,000	25%	5,000
More than 365 days	45,000	50%	22,500
Total	**2,165,000**		**27,500**

There was no similar allowance at the start of the year 2010 in the accounting records of Recovery Rt.

In addition to the allowance of HUF 27,500,000 (as above), Recovery Rt wrote off bad debts of HUF 10 million in 2010 since these receivables had lapsed.

3. Dividends received from Recovery Rt's two subsidiaries: Pills Kft and Softmed Kft, which are highly profitable and pay dividends to Recovery Rt on a regular basis. Both subsidiaries are located and incorporated in Hungary.

The amounts and dates of declaration and payment of the subsidiaries' interim and final dividends for the year 2010 are as follows:

	HUF '000	**Date of declaration**	**Date of payment**
Pills Kft			
Interim dividend	100,000	31 August 2010	11 December 2010
Final dividend	50,000	12 March 2011	31 May 2011
Softmed Kft			
Interim dividend	70,000	28 July 2010	1 December 2010
Final dividend	10,000	22 January 2011	To be paid later

In the case of both Pills Kft and Softmed Kft the date of declaration of the final dividend was also the date of their annual general meeting for the year 2010. The date of preparation of the financial statements of Recovery Rt is 28 February annually (*mérlegkészítés időpontja*).

4. During the inventory count at the end of the year 2010 inventories of HUF 20 million were classified as slow-moving by Recovery Rt's management. A write down of 50% was booked for these items.

5. All the non-current assets of Recovery Rt are depreciated at the same rate for accounting and tax purposes except for asset X, which was acquired for and capitalised in its books at HUF 45 million in July 2010. Recovery Rt started depreciating asset X on 1 July 2010 at an annual rate of 20%. Asset X qualifies for tax depreciation at a rate of 14·5% and is deemed to have negligible residual value.

6. A debt of HUF 95 million was assumed by Recovery Rt in May 2010. This debt was originally owed by a company resident in a state with which Hungary does not have a double tax treaty.

In 2009 Recovery Rt had a negative corporate tax base (tax losses) of HUF 4,500,000.

Required:

(a) Calculate the profit before tax of Recovery Rt for the year 2010 after making adjustments for the entertainment and benefit in kind expenses and related contributions. Support your calculations with relevant explanations. (6 marks)

(b) Calculate the corporate income tax base of Recovery Rt for the year 2010. Support your calculations with relevant explanations. (17 marks)

(c) Calculate the 2010 corporate income tax liability of Recovery Rt assuming that it is eligible for the progressive tax rate. (1 mark)

(d) (i) Explain the circumstances in which an entity will and will not qualify as a controlled foreign corporation (CFC). (4 marks)

(ii) State the corporate income tax consequences of having a business relationship with a controlled foreign corporation. (2 marks)

(30 marks)

3 Kutfej Kft is a company that has been engaged in the research and development of new communications technology. During the year 2010, the company spent HUF 800 million on an applied research project. The amount spent included the following items:

Type of cost/expense	Amount HUF millions
Material costs	80
Salary costs	700
Cost of subcontractors	20
Total	800

Of the salary costs of HUF 700 million, HUF 120 million related to the salary costs of the software development staff.

The corporate tax base of Kutfej Kft for 2010 and for the next three tax years is forecast to be as follows:

	2010	2011	2012	2013
Corporate tax base (HUF millions)	158	163	169	179

Kutfej Kft qualifies as a medium sized entity.

Required:

(a) Identify and explain the corporate tax relief(s) by which Kutfej Kft can reduce its corporate tax liability when calculating its 2010 corporate income tax. (6 marks)

(b) Prepare a forecast of the expected corporate tax liability (in HUF millions) of Kutfej Kft for the projection period 2010 to 2013 inclusive. (7 marks)

(c) Briefly explain how research and development expenses are treated when calculating the corporate tax base.

Note: No calculations are required in this part of the question. (2 marks)

(15 marks)

4 Self-made Kft is a Hungarian company, with its seat in Budapest. The company manufactures wooden furniture and all of its business activities attract the standard rate of value added tax (VAT). The company prepares VAT returns monthly.

Self-made Kft self-constructed a new workshop, which it capitalised in December 2010. The total capitalisation value of the non-current assets relating to this workshop was HUF 200 million.

Self-made Kft's net sales revenue in December 2010 amounted to HUF 5 million.

The following invoices are relevant to the December 2010 VAT return of Self-made Kft:

– In December 2010 the managing director of Self-made Kft went on a three-day business trip in Austria. The invoice of the Austrian hotel amounted to €600 plus 10% VAT. This invoice was paid in cash.

– Self-made Kft has paid the last two months mobile phone bills late. The invoice for November 2010 of HUF 80,000 (due date 20 December 2010) was only paid on 22 January 2011. The invoice for October 2010 of HUF 100,000 (due date 20 November 2010) was paid on 23 December 2010. Private and business calls on the mobile phone invoices are not separated by the company. The invoiced amounts are stated excluding any applicable VAT.

– In December 2010 the company participated in a furniture fair in France. The organiser of the fair, a French company, issued an invoice of €8,500 (excluding VAT) to Self-made Kft. The standard rate of VAT in France is 19·6%. The invoice was received on 18 December 2010; its due date was 31 December 2010, and it was paid on that day.

– On 12 December 2010 Self-made Kft made an advance payment of HUF 2 million to one of its suppliers, a Hungarian entity.

Self-made Kft is not registered for VAT purposes in any EU country except Hungary.

Required:

(a) Calculate Self-made Kft's value added tax (VAT) liability/refund for the month of December 2010. Support your computations with relevant explanations. (13 marks)

(b) Briefly describe the conditions to be fulfilled by a taxpayer in order to obtain a cash refund from the tax authorities in cases where the balance on the VAT return shows an amount owing to the taxpayer. (2 marks)

(15 marks)

5 (a) Lehel and his wife founded a small family business (Lehel Kft) in 2000. In 2005 they qualified for the simplified taxation for small entrepreneurs (*egyszerűsített vállalkozói adó – EVA*).

Lehel Kft has two employees: Ada and Babett. They are paid a monthly gross salary of HUF 160,000 and HUF 170,000 respectively.

Lehel Kft generated domestic sales revenue of HUF 15,000,000 (net of value added tax (VAT)) during the year 2010. The domestic sales of Lehel Kft attract the standard rate of VAT.

Lehel Kft also earned sales revenue of €7,500 (net of VAT) from marketing services carried out in Morocco.

As well as the salary costs, Lehet Kft incurred costs and expenses in addition to local taxes, of HUF 4,000,000 (net of VAT) during the year 2010. All these costs and expenses attracted the standard rate of VAT.

Required:

(i) Calculate the net cash dividend distributable to Lehel and his wife by Lehel Kft for the year 2010. Ignore the contribution payable to professional training funds; (6 marks)

(ii) State the revenue-related condition for a company to hold an EVA-licence and explain the consequences, if any, of exceeding the annual revenue limit. (2 marks)

(b) Karl is a business advisor. He is an Austrian citizen but is resident in Hungary for tax purposes. Karl has no employment contract with any Hungarian legal entity; instead he carries out his business advisor activity independently by entering into short-term service contracts as regulated by the Civil Code (*megbízási szerzödés*).

When preparing his 2010 personal income tax return all Karl's income is classified as independent income. He has chosen to deduct expenses based on an itemised list to determine his taxable income for personal income tax purposes.

Karl has a car registered in Austria under his own name that he uses for business as well as private purposes. The car has an engine capacity of 2,000 cm^3. Karl has collected invoices in relation to his business activities during the year 2010 as follows:

Type of expense	Date	HUF
Fuel invoice	1 March 2010	15,000
Fuel invoice	29 March 2010	12,000
Fuel invoice	3 April 2010	10,000
Fuel invoice	5 August 2010	15,000
Fuel invoice	11 November 2010	14,000
Other invoices	During the year 2010	2,000,000
Total		2,066,000

Karl generated revenue of HUF 6,000,000 during the year 2010 from his business activity.

Required:

(i) State, giving reasons, whether Karl will be subject to company car tax in Hungary; (3 marks)

(ii) Assuming Karl is subject to company car tax in Hungary, calculate his total personal income tax and company car tax liability for 2010. (4 marks)

(15 marks)

End of Question Paper