



# Examiners' report

F6 Taxation (HUN)

December 2008

## General comments

Overall the quality of the answers was disappointing, although candidates performed well in questions 1 and 2. Contrary to the previous exams when candidates generally performed better in VAT related topics, this time they earned more marks for those questions which focused on corporate tax and personal income tax.

Candidates generally attempted all five questions, although it seemed that questions 1 and 2 were popular. Question 3 appeared to have been a difficult question on tax holiday and no candidate earned the maximum marks. Candidates focused on the easier parts in questions 4 and 5.

In this exam candidates seemed to have focused on calculations and numerical answers, while written explanations and reasoning were absent.

Successful candidates demonstrated a good knowledge of the subject especially in corporate income tax and payroll tax examined in questions 1 and 2 where they earned the majority of their marks. Their answers were well laid out – typically with the main calculations, followed by brief workings, including relevant explanations to support the main calculations.

Many candidates demonstrated poor knowledge of the subject and poor examination technique. It was particularly disappointing that they were unable to deal with core topics. There was much confusion in questions 4 and 5; the VAT treatment of various real estate related transactions were mixed and in question 5, which examined the personal income tax aspects of various payments; many candidates started calculating corporate tax base.

## Question 1

Question 1 for 25 marks was about personal income tax. Candidates were tested in their knowledge of the tax treatment of income of an individual from stock option, benefit in kind and employment income.

The standard answer for this question was generally good. Candidates demonstrated clear knowledge of the taxation of various types of income.

Candidates generally treated the income from exercising the stock option correctly; however in most cases they did not consider that the individual's consolidated income already exceeded the cap for social security contribution in May, and therefore he did not have to pay the 9.5% pension contribution, only the 6% health insurance contribution. Hence the total social security payable by the individual was 6 % instead of the regular 15.5%.

Part c) was about the taxation of various benefits in kind. This part was generally well handled by candidates. Most candidates realised that the 'free of charge' use of the mobile phone generated income at the individual on which the employee had to pay personal income tax at 54 %. Most candidates also knew that the basis of the tax was 20% of the cost of the mobile phone; however many of them applied the 20% rate on the net cost (without VAT) instead of the gross cost. Some candidates did not realise the basis of the social security contribution on the mobile phone cost was the gross cost increased by the personal income tax payable on the benefit in kind. Free internet usage and season ticket were generally treated correctly as tax free benefits in kind; however only a few candidates mentioned the HUF 400,000 cap which applies to certain tax free benefits in kind (including the free internet usage and season ticket).

The last part of this question tested candidates' knowledge about the various deductions from an individual's monthly salary as well as the taxes payable by the employer on the individual's income. This part was solved well by candidates. Candidates had to realise that since the individual's annual income exceeded the cap for social

security contribution, he had to pay the 4% solidarity surtax but not the 9.5 % pension contribution in November 2008.

### Question 2

This question was about corporate income tax and worth the most marks in the paper.

Parts (a) and (b) of the question dealt with loss carry forward rules. In part (a) candidates had to describe the rules that apply if the company wanted to carry forward the losses of 2006. First it had to be identified that a permit of the tax authority was needed due to the fact that losses were incurred in the two prior years and that the pre-tax profit of the company was negative in 2006. While these facts were usually identified by the candidates, they usually forgot to mention the deadline by which the request for such permit has to be submitted and the circumstances under which the permit may be granted by the tax authority.

In part (c) candidates had to calculate the corporate income tax base, which was generally done well. A common mistake was that the write-down of inventory was considered as a non-deductible cost, although this cost is acceptable by the tax law. Many candidates failed to consider the available tax loss carried forward from 2005 and 2006, as calculated under part (b) of the question, as a tax base decreasing item. The corporate income tax rate that had to be used in the calculation was 16 %, since the company was not entitled to utilize the reduced 10 % on the first HUF 5 million of the tax base due to the fact that it had tax allowance. The tax allowance could be deducted from the corporate income tax up to 70 % of the tax.

During the calculation of the solidarity surtax, there were only two tax base adjustments that candidates had to consider, the payment of a supplier's invoice on behalf of the company and the cash received for no consideration. Both items are non-taxable income and therefore reduce the tax base.

### Question 3

Question 3 was as per the study guide about tax allowances and was for 15 marks. This was a rather challenging question and candidates' performance turned out to be disappointing.

In this question candidates had to realize that there are two types of benefits available for companies performing research and development. On the one hand they are eligible to take a deduction for the direct research and development costs they incur from their corporate tax base, and on the other hand they are entitled for a tax credit incentive for salary costs. Almost no candidate managed to identify these two benefits.

Part (a) was dealing with the deduction from the tax base. Candidates had to point out that the benefit derives from the fact that the direct research and development costs can be taken as a deduction twice when calculating the corporate tax base; after they are accounted for in the profit before tax, they also qualify for an additional deduction when calculating the tax base. Candidates had to mention that the double deduction is not available for certain subcontractors' fees and in relation to subsidies received.

In part (b) candidates had to describe the tax credit that is available for companies performing research and development. The main features of the tax credit are that it is 10 % of the salary costs recorded as direct research and development cost and that it can be claimed in equal installments in the year when the costs are incurred as well as in the following three years.

In the last part of the question, candidates had to compare the amount of benefit that is available if the research and development is performed in co-operation with a university with the benefit that is available if it is carried out alone. Candidates had to realize that in the first case, the company is entitled to take a deduction for three times the research and development costs, which is clearly an advantage; however, the deduction is limited to HUF 50 million. This latter restriction makes the co-operation with the university less beneficial in the given situation.

#### **Question 4**

Question 4 was for 15 marks and tested candidates' knowledge of VAT, especially the VAT issues relating to real estate, like land purchase, construction and rental. Candidates were generally confused by the VAT treatment of these three areas. A common mistake was that construction invoices were not identified as being subject to reverse charge VAT - or, even if they were, candidates forgot to mention the requirements that must be fulfilled in order that the reverse charge mechanism can be applied.

In the second part of the question, in part (d), candidates had to calculate the company's VAT balance for the second quarter, which most candidates did well. Besides calculating the VAT payable/deductible of June, the VAT balances of April and May also had to be considered to derive the second quarter VAT balance.

In part (e) candidates had to explain whether the company is eligible to reclaim the second quarter's VAT balance. Candidates had to point out that since the VAT balance (deductible) exceeds the limit of HUF 250,000 – after reducing the VAT balance with the VAT of unpaid invoices – it can be reclaimed.

#### **Question 5**

Question 5 was a mix of VAT and payroll tax related issues. In part (a) candidates had to determine the VAT balance of the company for September considering the invoices received/issued in that month as listed in the example. The most common mistakes were as follows:

- The company issued invoice on royalties to a US company. The deemed place of performance of transfer of rights by the company is at the place where the party ordering the service is resident, which is in the US. Therefore the service is outside the scope of Hungarian VAT.
- On the same logic, in the case of the royalty paid to Germany, the place of performance is in Hungary, and therefore the company has to apply reverse charge VAT on the invoice received.

Part (b) was on personal income taxes and solidarity surtaxes payable/deductible by the company in September. Most candidates calculated the payroll taxes on the rent correctly, although many forgot that the owner has two options for the taxation, he either applies a 25% flat tax on his gross income, or he considers the rent as part of his consolidated tax base and pay tax according to the normal tax rates. In this latter case he can deduct his actual costs or take a lump sum 10% deduction. Besides, he is subject to the 4% solidarity surtax on the part of his income exceeding the threshold.

Candidates generally calculated the taxes on food and drinks correctly. The gross value (including VAT) of such costs should be subject to 54% tax.

The payroll tax effects of the payments made to the translator and the tailor were often left out. The income of the translator is income from independent services, so he can choose to deduct either his actual costs or a lump sum 10% from his income. In addition, if his income is in excess of the cap for social security contributions, he is liable to pay 4% solidarity surtax. In the case of the tailor, candidates had to mention that since he is a private entrepreneur, no personal income tax had to be withheld from his payment.