Examiner's report

F6 Taxation (HUN)
December 2010

General Comments

The examination consisted of five compulsory questions (Question 1 for 25 marks, Question 2 for 30 marks and three further questions of 15 marks each) with an approximate 1:1 split requirement for computation and narrative.

Most candidates attempted all five questions although there was some evidence of poor time management, particularly affecting Question 2. Where not all questions were attempted, Question 3 was the most frequently omitted.

Excellent answers were presented by many for all five questions and high marks were achieved by several candidates.

A number of candidates showed a good balance in their answers between narrative and calculations and pleasingly, many candidates provided concise explanations.

On the other hand, many candidates displayed knowledge that was out of date, for example, being unaware of changes to the tax laws relating to entertainment expenses (Question 2), controlled foreign corporations (Question 2) and company car tax (Question 5).

Workings were generally shown but were at times difficult to follow. Too many candidates continue to display their answers poorly, with a lack of clear labelling to indicate which questions are being attempted. Candidates are encouraged to start each question on a new page, and to plan the layout and organisation of their answers.

Specific Comments

Question One

This 25-mark question tested candidates' ability to cope with various aspects of personal income tax. A few candidates used a poor layout. Whilst candidates need not answer the sub-parts of a question in order, in this case the requirements were ordered so as to help candidates to present a logical answer.

Part (a) required candidates to state the circumstances that evidence Hungarian tax residency. This was a straightforward question, with many candidates showing good knowledge and gaining maximum marks. A common mistake amongst candidates was to attempt to establish whether or not the private individual in the question was resident in Hungary for tax purposes. This was not necessary for two reasons: the requirement did not request this, and more importantly the question explicitly stated that the taxpayer was resident in Hungary for tax purposes. This demonstrates the importance of reading the requirements carefully so as to be able to answer the question set and not the question one would like to see.

In part (b) candidates had to state the two ways in which rental income may be taxed. Although many candidates stated the two options accurately, some were not able to calculate the resulting tax liabilities as they ignored the fact that, if rental income is part of the consolidated tax base, the uplift of 27% is applicable as well.

In part (c) a net salary calculation needed to be carried out. A significant number of candidates missed the information in the question stating that the net salary was to be calculated for the month of December 2010 and not for the whole year, which in turn meant that they did not calculate the cap for the pension contribution and so could not be awarded the marks allocated to that element of the question.

The personal income tax implications of dividend and stock options in part (d)(i) was answered well in most cases. Some candidates thought that a dividend from a CFC ought to be taxed at 25%, when a dividend from a CFC should in fact have been classified as part of the consolidated tax base.

Similarly a significant proportion of candidates did not recognise that the stock options were exercisable only in 2011, so had no tax implications in 2010.

To determine the personal income tax liability for part (d)(ii), candidates needed to consolidate their workings for parts (b), (c) and (d)(i) of the question, and calculate the capital gain which most candidates performed correctly.

Question Two

This question, focusing on corporate income tax, was frequently a well answered question on the paper.

Part (a) tested the adjustment of profit before tax of an organisation. This part was the least well answered, with many candidates citing the old rules whereby the tax free portion of entertainment expenses can be calculated as 1% of sales revenue. In 2010, entertainment expenses did not have a personal income tax implication as they are not tax deductible expenses when arriving at the corporate tax base.

Other benefits in kind, however, were correctly identified and taxation calculated correctly.

In part (b) candidates showed consistently good performance. Increasing and decreasing items of the corporate income tax base were identified properly by most.

Few candidates knew that impairment of slow moving inventory is recognised by the tax law, or how to treat interim and final dividends for accounting and tax purposes (interim dividends are not recorded as income until they become final, when the financial statements of the parent company are prepared).

In part (c) a computation of the corporate income tax liability for the year had to be done, which most candidates found straightforward.

In part (d) the definition of controlled foreign corporations had to be given. Many candidates knew and stated the rules, but a minority did not.

Question Three

This question was on the subject of corporate tax relief available on research and development (R&D) expenditure.

There were candidates who wrote excellent answers to this question, but the majority did not. Incorrect answers confused R&D relief with development relief.

In part (a) the R&D tax credit had to be identified. This was done reasonably by most.

In part (b), few candidates could prepare a forecast of the expected corporate tax liability. Common mistakes were to miss the tax relief that is calculated as 10% of the total direct salary cost; to forget to add the 15% tax relief that is available on the direct salary cost of software development; or to attempt a simple addition of 10% + 15% of the total direct salary cost. A number of candidates tried to discount the relief available at the rate of the development relief.

Part (c) examined the double deduction right of R&D expenses from the corporate tax base.

Question Four

This question focused on value added tax (VAT) and was the best answered question overall.

In part (a) the most typical mistake was that many candidates were confused about the difference between an event outside the scope of the Hungarian VAT law and a so-called import service. The former was examined in this question, and does not have an impact on the VAT return of a Hungarian entity; the latter results in VAT payable and deductible at the same time but was not examined in this question.

Although the majority of candidates were aware of the fact that 30% of the VAT of a 'phone invoice is not deductible, some of them also explained the personal income tax consequences of private phone usage. This explanation was not required meaning marks could not be awarded, and that candidates will have wasted time.

Other events were correctly assessed by most candidates.

The conditions for a cash refund of deductible VAT in part (b) were listed accurately by most candidates.

Question Five

There were two main subject areas examined in question five.

Part (a) tested the taxation issues relating to an EVA-qualified company. Some candidates did not know that EVA replaces most taxes including VAT and dividend tax. EVA must be paid on the gross revenue, however, and not on the profit of the company. Those who were aware of the rules gained high marks in this question.

Almost all candidates forgot that EVA-qualified companies must pay tax to local municipalities on 1% of gross revenue. This also reduces the amount of cash distributable to owners.

Candidates' performance was disappointing in part (b). This part examined company car tax, a topic that is examined regularly and had been the subject of an article published in Student Accountant.

In part (b)(i), few candidates knew that a private individual is subject to company car tax because he/she deducts expenses in relation to the car in the personal income tax return. It is not relevant whether private and business use is or is not separated, nor that the car is registered in another state than Hungary. Many candidates thought that the mere fact that a private individual is tax resident automatically means that he/she is subject to company car tax, but this is not true.

In part (b)(ii) candidates needed to calculate the total personal income tax and company car tax liability of a private individual. Most answers were completed correctly.