

Examiner's report

F6 Taxation (HUN)

December 2014

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General Comments

The examination consisted of five compulsory questions, question 1 for 30 marks, question 2 for 25 marks and three further questions of 15 marks each.

The vast majority of candidates attempted all five questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure. Candidates who passed the exam typically attempted all five questions.

Candidates performed particularly well on questions 1(a)(i), 1(a)(ii), 2(b), and question 5. The questions candidates found most challenging were questions 1(b)(ii), 2(a), and 3. This is mainly due to a lack of technical knowledge and also due to a failure to read question requirements carefully.

A number of common issues arose in candidate's answers:

- Failing to read the question requirement carefully and therefore providing irrelevant answers which scored few, if any, marks.
- Not learning lessons from earlier examiner's reports and hence making the same mistakes.
- Illegible handwriting and poor layout of answers.
- Providing workings that are very difficult to follow with a lot of corrections where it was unclear what the final answer to a particular question was.

Specific Comments

Question One

This 30-mark question examined a number of areas in relation to personal income tax.

Part (a) for 18 marks was split into 3 sub-requirements. Part (i) required candidates to explain how the taxable income derived from the sale of immoveable assets is calculated for Hungarian personal income tax purposes. Many candidates were able to provide a good answer to this question. The rules of this area are long to describe, but many of the candidates could find a reasonable method to explain the taxation of income from selling immoveable assets.

Part (ii) for 5 marks required an application of the principles described in the previous part and it was a calculation of the personal income tax payable by the private individual on selling a piece of land and a flat. Those candidates who gave a great answer to part (i) applied their knowledge here perfectly, reaching maximum marks at the calculations. Others who had difficulties in answering part (i) struggled with the calculations as well.

In part (iii) candidates had to calculate the personal income tax of an individual for the year 2013. Although a number of candidates were able to achieve great scores in this part of the question, there were some common mistakes including the following:

- A wrong classification of the rental income. Rental income (if the private individual is not a private entrepreneur) is taxed as independent income, part of the consolidated tax base.
- Many candidates were unable to calculate the family allowance available to Mr Somorjai in the question. The question clearly stated that Mr Somorjai has three children and that he is entitled to the family allowance, so the rate of HUF 206,250 per month per child is the right rate to be used.
- Some candidates were confused how to classify the gain on the regulated market transaction. It should be classified as income taxed separately with a flat rate of 16%.

Part (b) (i) was a question addressing three items of benefit in kind. Candidates had to calculate the personal income tax and health care contributions payable by the employer on them. Surprisingly, some candidates assumed that Mr Somorjai, the private individual has to pay the taxes and they considered these items as part of the consolidated tax base. Candidates are strongly advised to read the requirements carefully. On the other hand, these items of benefit in kind cannot be taxed as non-independent income, so this approach was totally false. Candidates who knew the rules of taxation of this sort of income received very high marks. One common mistake made by several candidates was missing the point that assumed private usage in case of mobile phones is 20% if business and private calls are not separated.

Part (b) (ii) required candidates to give any three examples of situations in which the rules of interest rate discount on outstanding amounts will not be applied. It was surprising to see how few candidates were able to do so. Even those who could give relevant examples, gave one or two only. Others did not read the question carefully enough and they gave examples where no personal income tax is payable on interest income. This is a completely other issue in the Hungarian tax legislation. Once again, candidates should answer the question set and not the question they would like to see.

Question Two

This 25-mark question focused on the corporate income tax and consequences of non-compliance.

Part (a) for 6 marks required candidates to name and briefly explain the six methods that can be used when determining customary market prices in transfer pricing scenarios between related parties. This was a very straightforward question but still fairly poorly answered. Very few candidates could name all six methods. Most were only able to mention one or two of them. Some candidates were trying to be creative and made up some rules they thought would make sense. The Hungarian tax law clearly states which methods can be used. Using only common sense instead of technical knowledge is not a good strategy for a taxation paper, so revision of the full syllabus is required.

In part (b) candidates had to carry out a calculation of the corporate income tax liability of a Hungarian business entity. This sub-question included a lot of easy marks. Surprisingly, a number of candidates had difficulties with calculating the accounting and tax depreciation of a company car. They failed to recognise value added tax (VAT) as part of the cost of the asset, and time-apportioning of depreciation was also frequently missing from the calculations. It was also a common mistake that candidates were unable to calculate the accounting carrying value and the tax written down value of the car at sale. This is one of the most common tax base adjustments in case of Hungarian companies so incorrect calculation was rather unexpected. Other mistakes included the following:

- An incorrect treatment of the donation to National Cultural Fund: only 50% of the donation is decreasing the tax base, and many took a 100% of it as an adjustment.
- The allowed impairment of bad debts is only 20% if the debt is outstanding for more than 365 days. The accounting impairment of bad debts is a tax base increasing item in full. These rules were unknown to many candidates.

In part (c) candidates had to define the term 'registered intangible asset' and explain how such an asset would impact the corporate tax base. Many candidates provided good answers to this question, but some of them were confused whether expenses and gains are tax base increasing or decreasing items. If registration occurs within the time period prescribed in the tax law, losses in relation to a registered intangible asset are a tax base increasing item, and gains are tax base reducing items.

Part (d) included three consequences of non-compliance. Most candidates successfully computed the default penalty, tax penalty and self-revision surcharge payable in these cases. One common mistake was in case of self-revision surcharge, which is 50% of the default penalty and not 100% of it.

Question Three

This 15-mark question addressed the corporate income tax reliefs. This time it covered the relief available for small and medium-sized entities related to interest paid on loans taken out to finance the acquisition of new non-current assets.

In part (a) candidates had to identify and explain the relief available. Although most candidates identified the relief correctly and in this case they were able to put down the criteria to be met in order to qualify for the relief including the limitations as well, others tried to write down as much as they know about tax reliefs in general. This was a result of lack of knowledge. It was quite clear from the case the development tax relief was not an option here.

In part (b) candidates were required to calculate the corporate income tax liability of Optic Kft after applying the relief identified in part (a). Candidates who performed well in part (a) scored very well in part (b) as well. It was surprising though that even if some candidates described the right relief in the first part of the question, they decreased the corporate tax base rather than the corporate tax liability with the relief available.

Question Four

This 15-mark question focused on value added tax (VAT).

Part (a) included the explanation of the VAT treatment of partial payment and fixed term settlement. Most candidates knew correctly that in both cases the date of performance is the due date of the invoice. However, only a few candidates were able to explain when VAT becomes payable if the contract is longer than 12 months.

Part (b) involved the calculation of the VAT liability of Fresh Bt for September 2013. This computation included the allocation and apportioning of input VAT relation to both VATable and VAT exempt activities. This calculation presented difficulties to a number of candidates which was rather surprising especially because allocation and apportioning of input VAT is a frequently examined area. Some candidates only calculated the deduction ratio once (although it needs to be recalculated in every VAT period), others did not take into account the VAT already deducted in previous VAT periods. Apart from this the VAT treatment of other items was reasonably well addressed by most candidates.

Question Five

This 15-mark question was split into three parts, examining three different types of taxes.

Part (a) included the calculation of the net distributable dividend to the owners of a small company registered under simplified taxation for small entrepreneurs, i.e., EVA. The following common mistakes have arisen:

- Some candidates assumed that EVA is payable on the profit of the company. This is not the case though. EVA is payable on the gross sales revenue (i.e. revenue increased by value added tax).
- EVA is payable (among others) instead of personal income tax payable on dividend received by the private individual. Some candidates calculated EVA correctly, but they also calculated how much the personal income tax payable would be. This step is unnecessary and wrong.
- A few candidates considered VAT on purchases as recoverable which not the case is. EVA-qualified companies don't have to pay VAT but in turn they cannot reclaim VAT either.
- Some candidates were confused how much local municipality tax is payable by the EVA-qualified company. The correct rate is 50% of the 'standard rate', i.e. 50% of 2% of the gross revenue.

In part (b) the company car tax was examined. The total company car tax liability of a company had to be computed. Most candidates were able to use the tables provided to them to calculate the monthly company car tax liability, but some of them did not know when the obligation commences and ceases. The tax obligation commences on the first day of the month following acquisition and ceases on the last day of the month of



disposal. It was pleasing to see that the vast majority of candidates knew that car capacity tax is deductible from the total company car tax payable.

In part (c) candidates had to calculate the local municipality tax liability of a Hungarian entity with the standard method and with the simplified tax base method. With the simplified method tax is payable on 80% of the sales revenue if it is more advantageous to the tax payer. A number of candidates confused the simplified tax base calculation with the regressive weighting of cost of goods sold and mediated services. This latter rule was not applicable in this case since Tiny Bt's sales revenue was below HUF 500 million.