

Examiner's report

F6 (HUN) Taxation

December 2017

General Comments

There were two sections to the examination paper and all of the questions were compulsory. Section A consisted of 15 multiple choice questions (two marks each) which covered a broad range of syllabus topics. Section B had four questions worth 10 marks each and two longer questions each worth 15 marks, each testing the candidates' understanding and application of Hungarian taxation in more depth. The following paragraphs report on each section and focus on some of the key learning points.

Specific Comments

Section A

It was very pleasing to see that almost all candidates attempted all of the questions. Candidates preparing for the next examination of F6 (HUN) are advised to work through the specimen exam questions and sample questions discussed here and to carefully review how each of the correct answers were derived. Section A questions aim to provide a broad coverage of the syllabus, and future candidates should aim to revise all areas of the F6 (HUN) syllabus, rather than attempting to question spot. The following question is reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific question selected.

Sample Question for Discussion

Example 1

On 10 May 2016 Bende sold his flat (housing purpose real estate) for HUF 18 million. Bende had purchased that flat on 3 September 2013 for HUF 10 million. Costs related to the sale of the flat amounted to HUF 200,000.

What is the personal income tax Bende must pay on the sale of his flat for the year 2016?

- A** HUF 468,000
- B** HUF 702,000
- C** HUF 1,170,000
- D** HUF 1,053,000

This question tested the personal income tax payable on the sale of housing purpose real estate. The taxable income is calculated as the sales proceeds less the purchase price and related costs. The taxable income so calculated is reduced by 40% in the case of a sale in the third year following the year of acquisition. Tax is payable at 15%.

Applying the rule above the personal income tax payable by Bende in 2016 on this transaction is as follows: $\text{HUF } (18,000,000 - 10,000,000 - 200,000) \times 60\% \times 15\% = \text{HUF } 702,000$.

It should be noted that calculation of personal income tax on different types of income of private individuals is a core area of the syllabus so candidates can expect to see questions testing that area on a regular basis.

The correct answer was B.

Section B

Question One

This 10-mark question covered the topic of value added tax (VAT).

This question required candidates to calculate the VAT payable or deductible for the month of October 2016 for a company. Candidates' performance was satisfactory on this question. Many candidates were able to deal with the straightforward items like the VAT payable on sales revenue from VATable activities.

Most candidates were able to identify transactions for which VAT is not payable (sales revenue from VAT exempt activities), and transactions for which VAT suffered is irrecoverable (VAT on fuel purchases and 30% of VAT of the mobile phone invoices). It should be noted that if private and business calls are not required to be separated, and nothing is recharged to employees from the mobile phone expenses then 30% of the VAT is irrecoverable, and not 20% as assumed by a number of candidates (20% is the deemed private usage which is treated as benefit in kind and is taxed accordingly).

This question required candidates to allocate and apportion the input VAT relating to both VATable and VAT exempt activities. Many candidates were able to correctly calculate the deduction ratio and the resulting VAT deductible.

Where candidates failed to score marks this was because they made the following mistakes:

- The deduction ratio had to be calculated twice: once for the nine-month period ended to 30 September 2016 and then for the ten-month period ended 31 October 2016. In both cases, the sales which entitle the entity to deduct VAT and total sales should have been taken on a cumulative basis. Some candidates did not use cumulative figures thus lost marks.
- The calculation of the deductible VAT for the ten-month period included 70% of the VAT on mobile phone invoices, because this service was used for both VATable and VAT exempt activities. Some candidates just ignored this and assumed that 70% of VAT on mobile phone invoices is deductible in full.

It was pleasing to see that most candidates were able to determine the place of performance of translation services (which was Hungary, i.e. the seat of the ordering party in this question) and correctly stated that VAT is payable and deductible in the same VAT period for this item.

Question Two

This 10 mark question covered different aspects of tax payable to local municipalities. Performance on this question was mixed, since computational parts were well answered whereas explanations were poorer.

Part (a) for seven marks required the calculation of the local municipality tax liability of an entity. Candidates also had to identify items referred to in the question which were excluded from the calculation. Most candidates' performance was good in this part of the question. The most common

mistake made by candidates was the inclusion of other income and financial income as well as the cost of labour and other services, and financial and other expenses in the local municipality tax base. These items should be excluded when determining the tax base. Most candidates used the rule of regressive tax base computation correctly.

In part (b) for three marks candidates had to identify methods which can be used to apportion the local municipality tax base among local municipalities if an entity carries out permanent business activities in more than one place. Candidates' performance was poor in this part of the question. A number of candidates were not even able to correctly identify the methods available (apportionment in proportion to personnel expenses or in proportion to non-current assets or a combination of the two methods). Many candidates mentioned the sales revenue or other bases that were wrong. But even those who were able to identify the above methods were unable to state that entities can only choose if their tax base in the previous year did not exceed HUF 100 million. If the tax base in the previous year exceeded HUF 100 million, the combination of the two methods must be used.

Question Three

This 10-mark question covered the topics of personal income tax.

Part (a) for eight marks required a calculation of the profit after all taxes of an entity that is registered for taxation for small entrepreneurs (EVA). Despite this area of the syllabus being regularly tested, a significant number of candidates struggled with this question. EVA-qualified entities don't pay corporate income tax at all (as assumed by some candidates); instead they need to pay EVA of 37% on their gross sales revenue (i.e. sales revenue including value added tax (VAT)) while VAT is not payable to the tax authorities. In turn, EVA-qualified entities cannot reclaim VAT on their purchases. The most common mistake was that some candidates treated EVA as an income tax, i.e. they calculated the "profit before tax" of the entity using the standard method and they subtracted EVA (most of the time calculated incorrectly) from the "profit before tax". This approach is completely incorrect in the case of EVA-qualified entities.

Another common mistake related to the calculation of the contribution to professional training funds which equals $1.5\% \times 2 \times$ monthly minimum wage per each individual employed per month.

Part (b) for two marks required a brief explanation of how frequently an EVA-qualified entity needs to make advance tax payments and to state the deadlines for paying these advances. Performance of candidates in this part of the question was poor. Only a minority of candidates were able to gain maximum marks by stating the correct rules, i.e. EVA-qualified entities need to make advance tax payments quarterly for the first three quarters of the year. The deadline for these first three advance tax payments is the 12th day of the month following the end of the quarter. In December EVA-qualified entities need to estimate their expected total tax base and make a top-up payment for which the deadline is 20 December each year.

Where candidates failed to score marks in this part of the question this was because they made the following mistakes:

- Candidates assumed that EVA-qualified entities need to make advance tax payments twice a year (perhaps confused with local municipality tax).
- Candidates stated that the deadline of advance payments is 15th / 20th day of the month following the end of the quarter.

- Candidates ignored the top-up payments.

Question Four

This 10-mark question covered the topic of corporate income tax.

Part (a) for six marks required calculation of the corporate income tax liability of an entity for 2016, taking into account the tax relief for small and medium-sized entities to acquire tangible non-current assets (kis- és középvállalkozások adókedvezménye). Performance on this part of the question was mixed.

Although the requirement of the question (and the question itself) specifically identified the tax relief to be used by candidates, some candidates stated and applied the rules of the development tax relief (although the information provided was insufficient to do so).

Most candidates were able to correctly calculate the accounting and tax depreciation of the non-current assets acquired and capitalised, and to identify them as tax base increasing and reducing items respectively. Those candidates that followed the instruction of the question stated appropriately how the tax relief is calculated, i.e. the lowest of 60% of the interest expenses, or HUF 6 million, or 70% of corporate income tax. Strangely a few candidates had taken the interest paid on the finance lease agreement as a tax base increasing or reducing item; this was not necessary.

Part (b) of the question fell into two sub-parts: in requirement (i) for two marks candidates had to state how the first year and last year of eligibility for the relief for small and medium-sized entities to acquire tangible non-current assets is determined. The majority of candidates were able to identify these years. However, some candidates did not always adequately explain how the first and last year of eligibility is determined. The first year in which the tax relief can be claimed is the year when the interest expense is first recognised in the financial statements in relation to the loan (or finance lease) agreement, and the asset is shown as a non-current asset in the statement of financial position for the year. Some candidates did not mention both criteria of the tax law.

The last year when the tax relief can be claimed is the year when the loan (finance lease) becomes repayable or, if earlier, the year when the non-current asset is still in the books of the entity on the last day of the year. Some candidates only mentioned one of these two dates.

In requirement (ii) for two marks candidates had to state the circumstances in which tax relief becomes repayable. This is the case when the non-current asset is not put into operation within four years following the year of entering into the loan (finance lease) agreement; or the non-current asset is disposed of in the year of capitalisation or in the following three years. Even if the vast majority of candidates were able to mention one of the two cases, only a few could list both.

Question Five

This 15-mark question focussed on the corporate income tax regulations.

Part (a) for four marks required an explanation of how the corporate income tax base will be adjusted if the profit before tax is lower or higher due to the transfer prices used in related party transactions. Many candidates were able to state that if profit before tax is higher than the corporate tax base must be decreased if:

- the related party is a domestic entity or a foreign entity (other than a controlled foreign corporation) that is subject to corporate tax in its country of tax residence; and
 - the taxpayer can exhibit a document signed by the other party declaring the price difference.
- Some candidates, however, did not add these two additional criteria as required by the tax law.

The fact that the tax base must be increased if the profit before tax is lower than it would be if customary market prices had been used was recognised by almost all candidates.

Part (b) for seven marks involved a comprehensive calculation of the corporate income tax liability of an entity for the year 2016. Many candidates were able to identify the tax base increasing and decreasing items. Common mistakes in this part of the question were as follows:

- Quite a few candidates considered the development reserve as a tax base decreasing item. This was because these candidates overlooked the fact that this reserve had been created in 2015 (previous year) so it was a tax base decreasing item in 2015.
- Many candidates considered tax depreciation of asset X as a tax base reducing item. This would be true if the main rule applied; but since this asset was acquired using the development reserve created in 2015 no tax depreciation is allowed in 2016 (the tax base was already reduced in 2015).
- Self-revision surcharge is NOT a tax base increasing item, but many candidates considered it as one.

Part (c) for four marks required the calculation of the corporate income tax advances the entity should have made during the year 2016 and stating the deadlines for such advance payments. Most candidates were able to score very high or maximum marks by stating that advances are payable monthly and the deadline for those payments is the 20th day of the current month. Also a balancing payment is required on 20 December. However, some candidates incorrectly stated that quarterly advances are payable, or they calculated the accurate monthly advance payment but took the 20th day of the following month as a deadline.

Question Six

This 15-mark question tested the areas of personal income tax and social security contributions.

Part (a) (i) for four marks required an explanation of how the income from rights to purchase securities is taxed for personal income tax purposes, and candidates had to determine the classification of Rudolf's (a private individual) income from the rights to purchase securities granted to him by his employer. Although most candidates were able to explain the right method of calculating the income (i.e. the difference between the customary market price of the securities at the date of exercising the option (when the securities are transferred) and the actual purchase price reduced by any expenses related to the acquisition), many made mistakes when classifying the income. Since the party providing the rights was the employer of Rudolf, this income is to be classified as income from non-independent sources. A lot of candidates classified this income as other income or as income taxed separately, which is wrong.

Part (a) (ii) included the calculation of Rudolf's personal income tax liability for the year 2016. Candidates providing a correct answer to (i) were able to carry forward their findings to (ii) and apply the rules stated previously.

Common mistakes made by candidates in part (a) (ii) were:

- Being confused about how interest income from a country of low tax rate and dividend income from a Hungarian company need to be classified. Interest income from a country of low tax rate is other income, part of the consolidated tax base, whereas dividend income from a Hungarian entity is income taxed separately. It should be noted that the tax rate is 15% in both cases.
- Taking family allowance on a monthly rather than annual basis.
- Calculating the capital gain on securities sold incorrectly. The capital gain is the difference between the sales proceeds and the acquisition cost (which is the customary market price in this question). Candidates taking the price paid when calculating the capital gain included the gain on acquisition twice in the personal income tax computation.

Part (b) for five marks involved a calculation of the personal income tax and health care contributions payable by the employer on two types of benefits in kind.

In the case of private use of mobile phones most candidates were able to state that the personal income tax is payable at 15% and health care contributions are payable at 27%, but some had difficulty determining the tax base (deemed private usage is 20% of the gross value of the total value of the service and not 30%, and this must be multiplied by 1.19 rather than 1.18 in the year 2016).

In the case of vouchers for catering services at the workplace the tax base is the value of the vouchers x 1.19, on which personal income tax of 15% and health care contribution of 14% are payable. This latter rate was frequently confused with the 27% rate thus resulting in lost marks for candidates. Taxation of benefits in kind are regularly tested so future candidates should be prepared to deal with similar issues of taxation of benefits in kind.