Examiner's report

F6 (HUN) Taxation
June 2016

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 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 pilot paper 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

Joja Kft recognised the following two items as an expense in its financial statements for the year ended 31 December 2015.

1. Impaired debt: An impairment loss of HUF 3,500,000 on a trade receivable from Zanzi Kft. The original amount of the receivable was HUF 20,000,000 and it was outstanding for 370 days.
2. Debt written off: A trade receivable of HUF 7,000,000 from Bar Kft was written off in full. Bar Kft went bankrupt in 2014 and in 2015 the court notified Joja Kft officially that the debt was definitely irrecoverable. Joja Kft had not impaired this receivable in the year ended 31 December 2014.

What is the net adjustment (the sum of the tax base increasing and reducing items) Joja Kft should make to its corporate income tax base for the year 2015?]

A Increase by HUF 3,500,000
B Reduce by HUF 7,000,000
C NIL (no adjustment)
D Reduce by HUF 500,000

This question tested one of the core areas of the F6 (HUN) syllabus, namely the determination of the corporate tax base of entities. In the case of impaired debts, the impairment recognised in the accounting records is a tax base increasing item. Tax base reducing item is the lower of 20% of receivables outstanding for more than 365 days (i.e. HUF 20 million x 20% = HUF 4 million) or the

impairment loss actually recognised, i.e. HUF 3.5 million. So Joja Kft must increase its tax base by 3.5 million and can reduce it by 3.5 million. Net impact is zero.
Bad debts written off that are truly irrecoverable are allowable expenses without tax base adjustment.

Candidates must be able to identify correctly tax base increasing and decreasing items and calculate the net impact of them on the corporate tax base.

The correct answer was C.

Section B

Question One

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

Part (a) for 8 marks required candidates to calculate the VAT payable or deductible for a company. This part of the question was generally well answered. Most candidates were able to deal with the more straightforward items, e.g. VAT payable on disposal of tangible non-current asset or place of performance of German legal services, which was Hungary, so VAT is payable and deductible in the same return.

The most complex part of this question involved the allocation and apportionment of input VAT relating to both VATable and VAT exempt activities. Deduction ratios needed to be calculated for both the six-month period ended 30 June 2015 and the seven-month period ended 31 July 2015. Using these ratios candidates had to calculate the VAT deducible for July 2015. Most candidates were able to correctly calculate the ratios. For candidates who were not able to do so the most common mistake was to use the sales relating to VAT exempt activities in the numerator of the ratio (and not the sales which entitle the entity to deduct VAT). Also some candidates failed to use the cumulative VAT to be allocated and apportioned for the seven-month period, which was the sum of the cumulative VAT to be allocated and apportioned for the six-month period and the VAT relating to both VATable and VAT exempt activities of HUF 40 million as given by the question (and for which there is no systematic and reliable method that could be used to allocate and apportion the input VAT).

Part (b) for 2 marks required candidates to state the conditions a taxpayer must meet in order to be able to opt for 'tax exempt business' status. For clarity the Hungarian version was also given: 'alanyi adómentesség felételei'. Most candidates were able to state the two conditions for this: the taxpayer has its seat in Hungary, and its actual sales revenue in the preceding tax year and expected sales revenue for the current tax year are both below HUF 6 million. Some candidates stated a wrong threshold (HUF 8 million or 5 million), or they listed the types of activities that are exempt from VAT. This was not required. Candidates are strongly advised to read the requirement carefully and answer the question actually set.

Question Two

This 10-mark question addressed the area of company car tax.

Part (a) for 3 marks required candidates to state any three situations in which a car is not subject to company car tax. Many candidates were able to gain all three marks here providing valid examples of situations where no company car tax is payable.

Part (b) of the question for 6 marks required a calculation of the company car tax payable by a company for two company cars. The requirement also stated that candidates need to identify the dates and amounts of payments to be made. Most were able to calculate the correct amount payable on each car monthly, however some candidates had difficulty identifying the start and end of obligations. Obligation starts in the month following the month of gaining ownership or entering into a finance lease agreement. The last day of the obligation is the last day of the month of disposal. Applying these rules the company had to pay 10 x HUF 33,000 in case of car 1 and 7 x HUF 22,000 in case of car 2. The dates of payments, however, were stated incorrectly by many candidates. Payments should be made quarterly (and not monthly as assumed by many), and date of payment is the 20th day of the month following the quarter end (and not the 12th day). Also quite a few candidates simply ignored the requirement to identify the dates of payments. Future candidates should aim to provide an answer to all requirements in each question.

Part (c) was a 1-mark requirement where candidates needed to state when car capacity tax is deductible from the company car tax. The vast majority of candidates knew correctly the 2 conditions, namely that the tax obligation existed for both the company car tax and car capacity tax, and the taxpayer paid the company car tax within the legal deadline. Some candidates stated that this deduction right always exists which is clearly not the case.

Question Three

This 10-mark question covered the topics of the simplified system of taxation for small entrepreneurs (egyszerűsített vállalkozói adó – EVA) and foreign dividend income of private individuals.

Part (a) for 6 marks required a calculation the net dividends distributable to the owners of an EVA-qualified entity. To arrive at this number candidates had to apply the special rules applicable to EVA-qualified entities, i.e. those entities need to pay EVA on their gross sales revenue (sales revenue including VAT) at a rate of 37%. Also, these entities cannot deduct input VAT so purchases including VAT will decrease their profits. The calculation of tax payable to local municipalities is also special, namely it is calculated as sales revenue including VAT x 2% x 50%.

It was surprising to see that there is still a significant proportion of candidates who don't know the difference between the companies under the scope of corporation tax and those under the scope of EVA. Corporation tax is payable on the pre-tax profit of the entity after making relevant adjustments, whereas EVA is payable on the sales revenue including VAT as explained above. Also quite a few candidates assumed that personal income tax is payable on the 'dividend' paid by the EVA-qualified company to its owners; this is false, because EVA-qualified entities are exempted from paying personal income tax on the dividend base. Still, salary-related taxes and contributions are payable in the same way for both types of entities.

Another common mistake related to calculation of the tax payable to local municipalities (local tax). Some candidates subtracted the cost of purchases from the sales revenue to derive the tax base for the local tax. This approach demonstrated a lack of knowledge in this area.

Part (b) for 4 marks required a calculation of the personal income tax payable by a private individual on foreign dividend income.

Where candidates did not tend to score well this was because they misunderstood the question and thought that Hungarian personal income tax is payable on the net (after tax) amount received by Ms Hadas; this was not the case. The question was very clear in stating that Ms Hadas received after tax dividend income, and tax had been paid to the foreign tax authorities. So the US$ 6,000 received after paying tax of 25% means a dividend income of US$ 8,000 on which the Hungarian tax is payable. Candidates should ensure that they read the question requirements carefully prior to writing anything.

In addition some candidates confused the rules of personal income tax on dividend income and those of foreign tax credit on the consolidated income. As for personal income tax applicable in question 3 (b) if a Hungarian tax resident receives dividend income from abroad, in the absence of double tax treaties, the foreign tax paid may be deducted from the Hungarian tax, but at least 5% tax is payable in Hungary. This was frequently confused with the rules relating to income that forms part of the consolidated tax base and in relation to which tax has been paid abroad, and where a foreign tax credit is available (being the lower of 90% of foreign tax payable or the Hungarian tax calculated on the foreign pre-tax income, using the Hungarian tax rate).

Question Four

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

Part (a) for 5 marks required a calculation of the corporate income tax liability of an entity that has been incurring research and development (R&D) expenses. This entity carried out the R&D activities jointly with a Hungarian university based on a written contract. All R&D activities related to its business activities. In this case the maximum potential R&D incentive is 3 times the tax base reducing items including services purchased from foreign taxpayers, material costs and labour costs. Non-allowable expenses included services purchased from Hungarian taxpayers and from private entrepreneurs. The tax base reducing item is limited to HUF 50 million. Some candidates were unclear on which expenses qualify as a tax base reducing items in this case.

Part (b) for 5 marks required (bi) a calculation of the corporate income tax base for a company creating development reserve and (bii) stating the deadline by which a development reserve created in 2015 must be used up, and explaining the consequences of not using the reserve by this deadline.

In part (bi) the majority of candidates computed the tax base increasing item correctly, i.e. the accounting depreciation of the asset acquired on 1 January 2015. However, many candidates failed to correctly calculate the tax base reducing item in 2015. The most common mistake was to calculate the tax depreciation of the new asset. This is incorrect because the tax base had already been decreased in 2014 when the development reserve had been created so the entity cannot reduce its tax base once again. Secondly the tax base reducing item relating to creating a development reserve in 2015 should be the lowest of the actual reserve created, or 50% of profit before tax or HUF 500 million. This rule was used by many candidates.

In part (bii) the majority of candidates knew correctly that there are four years available for companies to acquire new non-current assets from a development reserve created in 2015, although some candidates stated five years being an out-of-date rule.

Question Five

This 15-mark question was focused on corporate income tax regulation.

Part (a) for 4 marks required a calculation of the self-revision surcharge and default penalty on two items and the revision of the profit before tax figure for a company.

It was pleasing to see that most candidates were able to correctly calculate the self-revision surcharge and default penalty and the resulting revised profit before tax thus scoring maximum marks. Those who failed to do so made a mistake mostly in relation to self-revision surcharge which is 50% of the default penalty.

Part (b) represented a comprehensive calculation of the corporate income tax liability of an entity after identifying the tax base increasing and decreasing items. This type of question regularly comes up because it addresses core areas of corporate income tax. Most candidates achieved high marks in this part of the question. One common mistake made by many was that the self-revision surcharge was added back as a tax base increasing item. This is not the appropriate treatment, because the self-revision surcharge is an allowable expense for tax purposes unlike a default penalty or tax penalty.

In part (c) for 3 marks candidates had to state the circumstances in which a foreign entity is considered to be a controlled foreign corporation (CFC) for Hungarian tax purposes. Some candidates stated an out of date definition of CFCs. Other candidates started to explain the circumstances in which a foreign entity is not considered to be a CFC. This was not required. Again candidates are reminded to read the question requirements carefully.

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

Part (a) for 5 marks required an explanation of the treatment of income in the form of securities for Hungarian personal income tax purposes and to state three exemptions from the general rule. Many candidates stated correctly that the classification of income depends on the legal relationship between the buyer and the seller. However, fewer candidates were able to name three exemptions from the general rule.

Part (b) for 6 marks involved a calculation of personal income tax of a private individual.

Common mistakes made by candidates in part (b) were:

- classifying income in the form of securities as income taxed separately;
- classifying income from long-term deposits and dividend income as income being part of the consolidated tax base;
- calculating family allowance incorrectly, e.g. using HUF 62,500 per dependant instead of HUF 206,250 per dependant; and
- applying the general 16% rate on income from long-term deposits. The long-term deposit in question 6 was a 3-year deposit on which 10% personal income tax is payable.

Part (c) for 4 marks required a calculation of the contributions to State Health Fund and State Pension Fund which is deducted from the private individual's remuneration. Performance on this question was unsatisfactory. Only a few candidates were able to calculate the unused family allowance from part (b) of this question, 16% of which reduces the calculated contribution to State Health Fund. Another common mistake was that quite a few candidates did not know what the base for contribution payment was for both types of contribution.