

# Examiner's report

## F6 (HUN) Taxation

### June 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 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 questions and sample question 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

In 2016 the profit before tax and the corporate income tax base of Minim Kft were both negative. The following information is extracted from the financial records of Minim Kft for 2016:

	HUF
Sales revenue	3,000,000,000
Other income	40,000,000
Financial income	20,000,000
Cost of goods sold	(2,400,000,000)
Other costs and expenses	<u>(800,000,000)</u>
Profit before tax	<u>(140,000,000)</u>

**What is Minim Kft's corporate income tax liability for the year 2016 using the minimum tax base method (elvárt adóalap)?**

- A HUF 6,120,000
- B HUF 6,000,000
- C HUF 1,320,000
- D HUF 1,200,000

This question tested the calculation of corporate income tax if the minimum tax base method is used to determine the corporate income tax liability. The minimum tax base is calculated as total income (sales revenue, other income, financial income and extraordinary income) x 2% (it should be noted the total income needs to be

adjusted for items related to preferential transformation and preferential asset transformation, but those topics are out of scope of the F6 (HUN) syllabus, and for the increase in the average daily balance of loans from owners, which was not included in this particular question). The corporate income tax should be then calculated on the amount so determined under the usual rules, ie 10% is payable on first HUF 500 million of the corporate tax base, and 19% is payable on the tax base in excess of HUF 500 million.

Applying the above rule the corporate income tax liability for the year 2016 is as follows:  $(3,000 \text{ million} + 40 \text{ million} + 20 \text{ million}) \times 2\% \times 10\% = \text{HUF } 6,120,000$ .

Candidates are expected to know the rules of calculating the corporate income tax liability as it is a core area of the syllabus.

The correct answer was A.

## **Section B**

### **Question One**

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

This question required candidates to calculate the VAT payable or deductible for the month of March 2016 for a company. Many candidates were able to deal with the straightforward items like the VAT payable on sales revenue.

This question included a number of issues where the place of performance of different services had to be determined in order to decide if VAT is payable or deductible for the entity. Many candidates had difficulties with identifying transactions which are outside the scope of Hungarian VAT law, eg the services provided electronically to Polish private individuals (who are not subject to VAT) or the sports exhibition organised for a French company in France. VAT is a core area of the syllabus and candidates are expected to be able to identify the place of performance of different types of services.

It was pleasing to see that most of the candidates were able to identify the transactions where input VAT is irrecoverable, namely in the case of VAT on purchases of goods used for renovation of residential property of the entity or the VAT of restaurant invoices.

Most candidates were able to apply the rule that advance payments include any applicable VAT and they were able to correctly calculate the base of VAT and the related VAT as well. However, some candidates classified VAT on advance payment made as VAT payable although the opposite is true.

Another problem for a number of candidates related to the treatment of VAT of mobile phone invoices (where employees are not required to separate private and business calls in the phone invoice). The rule is clear: 30% of VAT of such invoices is irrecoverable in this situation. Most candidates stated and applied the rule correctly, others, however, assumed that 70% of VAT is irrecoverable. Deductibility of VAT is a regularly tested part of the syllabus, and candidates are encouraged to learn the detailed rules relating to this core topic.

### **Question Two**

This 10-mark question covered different aspects of company car tax. Performance of candidates on this question was mixed. Many candidates showed a clear understanding of the company car tax rules thus achieving very high marks. A number of candidates were, however, confused about those rules.

Part (a) for eight marks included scenarios relating to three company cars, and required candidates

- to state, with reasons, who is responsible for paying any company car tax;
- to state when the tax obligation commences and ceases; and
- to calculate the car tax payable and state the dates of payment.

Car 1 was an environmentally-friendly car, so no company car tax obligation arises. Most candidates did not have a problem with this scenario.

Car 2 was owned by a private individual who did not deduct expenses in respect of his car. Then the private individual transferred the right of usage to a company that recognised expenses in relation to car 2. The vast majority of candidates stated correctly that the private individual is responsible to pay company car tax. Only a minority of candidates assumed that the company should pay the tax. Those who applied the correct rule were also able to determine the start and end of obligation (the first day of the month following the month in which expenses were first deducted and the last day of the month in which expenses were deducted, respectively).

Car 3 was a special case because the car was not registered by the Hungarian tax authorities but it was owned by a German individual. Still, a Hungarian company recognised expenses relating to car 3. This resulted in a tax obligation of the Hungarian entity.

One common mistake made by many was that some candidates were confused about how to calculate and when to pay the company car tax. The tax is calculated on a monthly basis, but payment is required quarterly only. Also, the due date of payments is relevant, ie it is to be done on 20<sup>th</sup> day of the month following the quarter.

Company car tax has been and will be examined on a regular basis, so candidates should be familiar with the rules of company car tax in more depth.

Part (b) for two marks required candidates to state two circumstances when a car is exempted from company car tax. A very high proportion of candidates were able to give two exemptions from the main rule thus gaining maximum marks on this part of the question.

### **Question Three**

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

Part (a) for seven marks required a calculation of net dividends that an EVA-qualified entity can distribute to its owners for 2016 (EVA – simplified taxation for small entrepreneurs).

Most were able to correctly identify the base of EVA, ie the sales revenue including VAT. However, many had difficulties with the export sales revenue which involved data processing services for a Spanish company. The place of performance of data processing services is the registered seat of the party ordering the services, ie Spain. So this transaction was outside the scope of the Hungarian VAT law and thus no VAT is charged on the invoice.

Also most candidates stated correctly that purchases should be considered including VAT since an EVA-qualified entity cannot reclaim VAT.

Part (b) for three marks required a calculation the personal income tax payable by a private individual on the income from sales of a moveable asset. Very few candidates were able to score maximum marks here. This is because the acquisition cost of the moveable asset could not be determined reliably in which case the taxable gain is 25% of the sales proceeds. Many candidates confused this rule with the rules relating to income from independent sources, eg rental income where a lump sum deduction of 10% of income is allowable. Income from sale of moveable and immovable assets is regularly tested so candidates are expected to know the detailed rules in respect of these items. Also the Hungarian tax law states that the first HUF 30,000 of personal income tax on sales of moveable assets is not payable, and this was missed by many in answering this question.

### **Question Four**

This 10-mark question covered the topics of corporate income tax, namely the development relief.

Part (a) for three marks required a brief explanation of how the limit for development relief is calculated and the calculation the maximum development relief available to the entity. Although the majority of candidates were able to calculate the correct amount of the relief available, many ignored the requirement to explain how the limit is calculated. Candidates are strongly advised to read the requirements carefully in order to avoid losing marks.

Part (b) for seven marks involved the calculation of the corporate income tax liability for two years, taking into consideration the development relief. This area has been tested in previous sittings as well and candidates historically provided poor answers on this. It was pleasing to see that a significant improvement has been observable although some candidates still struggle with incorporating reliefs into corporate income tax calculations. The most typical mistake was that many decreased the tax base with the tax relief and not the tax itself. Also a number of candidates incorrectly stated that the relief is limited to 70% of the tax calculated before the relief. The correct percentage to be applied here is 80%.

#### **Question Five**

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

Part (a) for five marks required a calculation of the local municipality tax liability of an entity. Many candidates achieved maximum marks in this part of the question, because they were able to apply the rules of regressive calculation of the local municipality tax.

Part (b) for four marks required candidates to state the circumstances in which an intangible asset is treated as a registered intangible asset, and explain how a registered intangible asset impacts on the tax base of a corporation. Performance of candidates was unsatisfactory in this part of the question. Only a few could define a registered intangible asset, very few could state that such an asset must be registered with the tax authority within 60 days from acquisition or creation.

Even fewer candidates could explain how a registered intangible asset impacts on the tax base. Those who could recall the logic of the impact of registered intangible assets on the tax base were uncertain when the tax base may be reduced by the gain on disposal of such assets (namely the asset has been held for at least one year before disposal, and the entity did not create a tied-up reserve in the year preceding the registration of the asset in respect of the same intangible asset). Although this paper is a mainly computational one candidates should not ignore explanations required in exam questions. The knowledge of tax rules is inevitably important to make correct calculations as well.

Part (c) for six marks required candidates to calculate the corporate tax base of the entity. One common mistake made by many candidates was to incorrectly treat the two registered intangible assets (asset A and asset B) in the question. This relates to the problem mentioned in part (b) too. Asset B has been held for less than one year so the gain of disposing of it was not a tax base reducing item.

Other tax base adjusting items were mostly correctly identified and applied in the calculation. I would highlight though the importance of time-apportioning of depreciation of tangible non-current assets both for accounting and tax purposes. There is still a proportion of candidates that ignore the dates of acquisition and disposal of such assets.

#### **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 long-term deposits is taxed in terms of deposits of different time horizons (tartós befektetésből származó jövedelem). Performance of candidates for this

requirement was satisfactory, and quite a few achieved maximum marks by stating the correct percentage of tax payable for deposits with different time horizons.

Part (a) (ii) for six marks involved a comprehensive calculation of the personal income tax liability of a private individual. Although the overall performance of candidates was reasonable, there were some common mistakes. Common mistakes made by candidates in part (a) (ii) were:

- not reducing the rental income (independent income) by the lump sum deduction of 10%;
- applying the wrong rate to a long-term deposit (a three-year deposit is taxed at 10% and not 15% as many assumed);
- the treatment of foreign dividend received from a country with which there is no double tax treaty. Although the question was quite clear about the net amount of dividend and the tax paid abroad (from which the gross dividend could be determined), many candidates assumed that the money received was a gross amount. Candidates should read the question carefully and take into consideration all information provided to them.

Part (b) for five marks required a calculation of the personal income tax and health care contribution payable on the income from the interest rate discount, and candidates had to state who is responsible for declaring and paying the taxes.

Most candidates correctly stated the rules on how to determine the income from interest rate discount (the difference between the actual interest paid and the deemed interest being the prime rate + 5%), but unfortunately many did not gain all the marks because they could not determine the tax base (income from interest rate discount  $\times$  1.18). Also a few candidates calculated the health care contribution as being 14% of the tax base, however the correct rate is 27%.