



# Examiner's report

F6 Taxation (HUN)

June 2009

## General Comments

Overall candidates performed well in questions 1 and 2, but the quality of answers 3, 4 and 5 was disappointing. It was especially disappointing that candidates performed poorly in question 3, which was about tax allowance, which is a topic that has always been examined for several years. The quality of answers to corporate income tax and personal income tax related questions was generally better than to value added tax (VAT) related ones.

Candidates generally attempted all five questions, although it seemed that questions 1 and 2 were usually well laid out while questions 4 and 5 seemed to have been left to the end and were not given enough time or consideration.

Those candidates who passed demonstrated a good knowledge of the subject especially in corporate income tax and payroll tax examined in questions 1 and 2 where the majority of marks were earned. Their answers were well laid out – typically with the main calculations, followed by brief workings, including relevant explanations to support the main calculations.

## Specific Comments

### Question One

Question 1 for 25 marks was about personal income tax. Candidates were tested in their knowledge of the tax treatment of basic income of an individual, such as salary and bonus, fringe benefits as well as some more special items of income like foreign source dividend and rental income.

The standard of answer for this question was generally good. Candidates demonstrated clear knowledge of the taxation of various types of income and the factors that determine an individual's tax residency under Hungarian law and the double tax treaty.

In part (b) candidates had to explain the tax treatment of various incomes of the individual from Hungarian and foreign sources. Candidates generally determined the taxation of the salary, bonus, dividend and meal vouchers well. Candidates had to realise that, due to the fact that the real estate is located in Germany, the rent is taxable only in Germany based on the double tax treaty between Germany and Hungary. The most common mistake in this part of the question was that the rent of an apartment by the company for its employee was not considered as income from dependent services, i.e. similar to the individual's employment income.

In the case of private usage of mobile phones most candidates realised that it generated income of the individual on which the employer had to pay personal income tax at 54 percent. Most candidates also knew that the basis of the tax was 20 percent of the cost of the mobile phone; however many of them applied the 20 percent rate on the net cost (without VAT) instead of the gross cost. A large number of candidates were confused about the percentages to be used for the assumed private usage if there is no separation of business and private calls (20%) and the VAT not deductible in this case (30%). Also some candidates did not realise that the basis of the social security contribution was the gross cost increased by the personal income tax payable on the benefit in kind.

Requirement (e) was fairly straightforward with an opportunity for some easy marks, however many candidates did not do this part of the question. This part of the question tested candidates' knowledge about the various deductions from an individual's monthly salary and was generally solved well by those candidates who attempted this part. A common mistake was that the monthly rent paid by the employer for the individual was not treated as part of the individual's monthly income.

**Question Two**

This question was about corporate income tax and was for 30 marks.

In part (a) candidates had to calculate the corporate income tax base, which was generally done well. Candidates generally calculated the tax base adjusting items correctly but in several cases they did not give relevant explanations. For example in the case of dividends most of the candidates stated correctly that dividend received is a tax base reducing item without saying that this only applies if the party paying the dividend is not a controlled foreign corporation (CFC). Another example is the local business tax expense, which is a tax base reducing item only if the company does not have outstanding tax liabilities on the last day of the year and up to the positive pre-tax profit. Also, the 50% related party interest deduction is available up to 50% of the pre-tax profit.

Although calculating the tax base adjustment by virtue of thin capitalisation is a frequent question in this paper, many candidates are still confused about its calculation. Candidates had to realise that when calculating the daily average equity, the valuation reserve should be excluded and the capital increase can be taken into consideration from its effective date (i.e. from the date when it was registered by the Court). The bank loan does not have to be considered as liability for thin capitalisation purposes. Since one of the loans was received during the year, it had to be considered for those days only when it was outstanding.

In the case of the adjustments of thin capitalisation and 50% of the interest paid a number of students stated that only one of the two adjustments is required. This would have been true if the question had included interest paid. This question, however, featured interest received that has nothing to do with thin capitalisation.

A common mistake was that during the calculation of the tax depreciation of the software, candidates had to realise that although the annual depreciation would be THUF 4,500, only THUF 3,000 can be taken into consideration since this was the net tax value of software as per the 2008 opening balance sheet. The available tax loss carry forward was generally treated correctly by candidates. Candidates had to realise that the losses generated in 2002 had already expired in 2007 due to the five years limitation.

In part (b) of the question, candidates generally listed well the requirements for the reduced 10% corporate tax rate and calculated the corporate income tax correctly.

During the calculation of the solidarity tax base, there were only two items that had to be considered: dividend income and debt assumed. Many candidates found none or only one adjusting item.

Part (c) was generally answered poorly with mostly listing the names of the various transfer pricing methods, without describing the mechanism or details of the methods.

**Question Three**

Question 3 was – as usual – about tax allowances and was for 15 marks.

Many candidates realised correctly what kind of tax relief is required here, which was the tax relief related to interest payable on loans taken to finance asset purchase by small or medium sized companies. Some of them, however, wasted time explaining the differences between the rules in force before and after 2003. This was completely unnecessary as the loan was granted in 2005.

Many candidates demonstrated solid knowledge of this tax relief and how the amount of the tax relief has to be calculated. For this they had to compare 40% of the interest payable on the loan, 70% of the corporate tax decreased by certain other tax allowances and HUF 6 million. The maximum amount of the tax relief is the lowest of the above numbers.

On the other hand, a large proportion of the candidates confused available tax reliefs with each other. Some seemed to state all the rules they knew hoping that they would be awarded with marks for at least some of the good points hit.

In part (c) candidates had to explain the expiry of the tax relief. This was the year when the loan has to be repaid or the year in which the machinery is sold if that is earlier than the loan repayment.

In part (d) candidates had to state the consequences if the company had sold the machinery in 2008. Candidates had to realise that this would mean selling the machinery within three years after putting it into operation. Therefore the company would have had to repay any tax allowances claimed. Many candidates forgot to mention that the repayment is due with late payment interest.

#### **Question Four**

Question 4 was for 15 marks and it was a mix of VAT and corporate tax related questions. In part (a) candidates had to demonstrate their knowledge about what determined the frequency of VAT returns. Many candidates did not realise that in the first year, each company starts with filing quarterly VAT returns and they only need to switch to more frequent filings if the VAT balance of a given quarter exceeds a certain limit. The monthly VAT filing starts from the month following the quarter in which the threshold was reached. Therefore, even though Gamma Kft reached the HUF 1 million limit in January, since the company started filing quarterly VAT returns in 2008, it cannot switch in the middle of a quarter. Monthly VAT filings may only start after a quarter in which – cumulatively from the beginning of the year – the VAT payable balance exceeds HUF 1 million. Therefore Gamma Kft had to switch to filing monthly VAT returns after it had filed the VAT return on the second quarter. The second quarter was the period in which the VAT balance – cumulatively from 1 January 2008 – exceeded HUF 1 million. Once the frequency was determined, candidates generally knew the due dates of the returns.

When stating the frequency of VAT returns to be submitted by any company some candidates annualised the VAT payable/deductible to see if the limits are met or even exceeded. This annualising is not required by the VAT law.

Also in this part candidates had to list at least four items that an invoice should contain, which was managed by almost all of the candidates.

In part (b) candidates first had to calculate the pre-tax profit of the company. Most of the items were identified correctly, but a common mistake was to treat the transfer to development reserve as a cost. However, this transaction does not have any effect to the pre-tax profit of a company; it may only appear as a tax base adjustment – if certain conditions are met. The tax base was generally calculated correctly.

When calculating the top-up payments to be made by 20 December many candidates assumed that the company had made 12 advance payments in the tax year before making the final payment. This is wrong as advances are payable from January to November (11 months) so there can only be 11 advances that had been already paid before the top-up payment is required. Penalty is only due if the company has not paid at least 90% of the annual corporate tax liability by 20 December. The penalty is 20% of the difference between the limit (90%) and the amount actually paid.

#### **Question Five**

Question 5 was about a mix of VAT and payroll tax related issues. The question was generally poorly answered.

In part (a) candidates had to calculate the amount by which the August VAT return had to be revised. Candidates usually determined the effects of the late invoice correctly. Most candidates realised that the VAT on food and drinks is non-deductible. For the calculation of the penalty, candidates had to realise that the penalty is due for the period between the due date of the August VAT return (20 September) and the date of the self-revision (30 September). Therefore the penalty for the self-revision had to be calculated for 10 days using the base rate of the

National Bank of Hungary. Double the base rate would have been due only if the tax authority had revealed the mistake.

A large number of candidates assumed that the rental fee of the hotel conference room is exempt from VAT. This is not the case. Only rental of real estate is exempt as per main rule not rental in general.

When calculating the personal income tax due to the remuneration paid to the trainer in part (b), only a few candidates realised that in case of income from independent services the taxpayer is entitled to a 10% lump sum deduction.

In part (c) many candidates confused the entertainment expenses exceeding 1% of the annual sales revenue (or HUF 25 million) with other benefits in kind to determine how much tax is payable on the cost of food and drinks.