Answers

1 Mr Smith

(a) Sale of flat

(1) Mr Smith realised income from the sale of his flat. The income is the difference between the sales price and the acquisition cost of the property plus additional costs. Thus Mr Smith derived a HUF 19·8 million capital gain on the sale of the flat (25 million – 4 million – 1·2 million).

(2) The capital gain can be further decreased if the property is sold in the sixth year following the year of the purchase or later. Since Mr Smith sold the flat in the twelfth year, the capital gain realised on the sale (HUF 19·8 million) can be further reduced by 70%. Thus the taxable gain is HUF 5,940,000 (30% of 19·8 million).

(3) In principle, the tax on the capital gain would be 25%. However, the tax does not have to be paid if the capital gain is invested (in part or in whole) in real estate. Since Mr Smith used the proceeds from the sale of the flat to purchase the house, the tax on the capital gain does not have to be paid. However this is only a deferral and the tax will become payable if the property is sold within five years.

(b) Personal income tax 2007

Consolidated tax base:	Note	HUF
Salary (880,000 × 12)		10,560,000
Lecturing	1	405,000
Bonus		1,100,000
Vouchers	2	60,000
Consolidated tax base:		12,125,000
Tax on the consolidated tax base:		4,059,000
Tax on income which is taxed separately:		
Interest	3	168,000
Income from immovable property (see part (a))		—
Total personal income tax in 2007:		4,227,000

Notes:

(1) Lecturing is an independent service, where – in the absence of deductible expenses – a 10% deemed allowance can be taken into consideration. Thus, Mr Smith's taxable income from independent services is HUF 405,000 (450,000 × 90%).

(2) Vouchers for cold meals are tax free up to HUF 5,000 per month. Therefore, HUF 5,000 a month is taxable income of Mr Smith as part of the consolidated tax base.

(3) Mr Smith earned interest income of HUF 840,000 (15 million × 5·6%) in 2007. Interest income is taxable at 20%.

(c) Solidarity surtax

(1) Private individuals (other than private entrepreneurs) have to pay solidarity surtax on the basis of their consolidated tax base. The tax has to be paid only on that part of the consolidated tax base which exceeds the cap for the social security contributions. The tax rate is 4%.

(2) Mr Smith's consolidated tax base is HUF 12,125,000. Since the cap for the social security contributions is HUF 6,748,850 the solidarity surtax is payable on HUF 5,376,150. Thus, Mr Smith has to pay HUF 215,046 solidarity surtax in 2007.

(d) Company car

(1) If a company car is used for private purposes without the private individual reimbursing the employer for his private use, the company has to pay company car tax. The tax rate depends on the number of years for which the company has been using the car and the purchase price of the car. The tax is payable by the company on a monthly basis.

(2) The car provided to Mr Smith cost HUF 5·2 million and it is less than four years old, thus the company car tax payable by the bank is HUF 42,000 per month.

(3) In addition, the bank has to pay a health care contribution equal to 25% of the company car tax, which is HUF 10,500 per month.

(e) Coffee vending machine

(1) The coffee given to the employees for free is considered to be a fringe benefit. The tax thereon should be paid by the employer, at 54%. The basis of the tax is the market value of the product (or service) given to the individual for free. In our case, the bank should pay 54% on HUF 800,000, which is HUF 432,000.

(2) In addition, 29% social security is payable on the fringe benefit. The basis for the social security liability includes the tax on the fringe benefit. Thus, the bank has to pay the 29% social security on HUF 1,232,000 (800,000 + 432,000) which is HUF 357,280.

2 Jordan Kft

(a) Unused development reserve

(1) The development reserve created in 2003 was still available in 2006 as it is only the third year after the year of its creation. Therefore, in 2006, the company had altogether a HUF 220 million (50 million from 2003 and 170 million from 2005) development reserve of which HUF 100 million was used, so there was HUF 120 million left in 2007.

(2) Since the value of the assembly line was HUF 150 million, the whole amount of the development reserve had to be used. Therefore, Jordan Kft has only HUF 16 million development reserve carried forward from 2007. This reserve has to be used within four tax years, i.e. by 2011.

(b) Corporate income tax 2007

Calculation of the corporate income tax base:	Note	HUF
Profit before tax		66,000,000
Decreasing items:		
Dividend received (domestic)	1	–
Dividend received (foreign)	2	(24,000,000)
Royalty	3	(21,000,000)
Depreciation	4/10	(18,234,246)
Development reserve	5	(16,000,000)
Interest	6/10	(12,000,000)
Increasing items:		
Write-down of shares	7	4,000,000
Missing stock	8	3,800,000
Write-down of stock	8	–
Depreciation	9	45,150,684
Tax base:		27,716,438
Tax (at 16%)		4,434,630

Notes:

(1) Since the 2006 dividend was declared prior to the date of preparation of the balance sheet of Jordan Kft, the company would have booked the dividend income in 2006. Therefore, it does not affect the company's 2007 corporate income tax calculations. The interim dividend is not recorded as income until it becomes final, when the annual financial statement is prepared. Therefore, the interim dividend also does not have any effect on the company's tax base. Since the 2007 dividend will only be declared in the middle of May of 2008, it will only be booked as income in 2008. Therefore, it will be taken into consideration in the 2008 corporate income tax calculation.

(2) Foreign dividend income is tax free, therefore, the gross dividend income from Luxembourg should be considered as a tax base decreasing item. €96,000 × 250 = HUF 24 million.

(3) Jordan Kft can take an additional 50% of the royalty income as a tax base decreasing item. 50% × HUF 40 million + 50% × €3,000 × 250 = HUF 21 million. The royalty payments have no effect on the tax base calculation.

(4) The free development reserve is HUF 120 million (220 million – 100 million) (See point a). Due to the fact that the purchase of the assembly line was against the development reserve, HUF 120 million from the purchase price of the asset is considered to be already depreciated from a tax point of view. This means only HUF 30 million tax depreciation remains. Tax depreciation may be claimed as normal on the assembly line until a total of HUF 30 million has been claimed.

Tax depreciation:
150,000,000 × 14·5% × 306/365 = HUF 18,234,246

Since the total amount of the assets acquired in 2006 was set off against the development reserve, the net tax value of these assets is zero.

(5) The development reserve created in 2007 decreases the tax base.

(6) 50% of the difference between the interest received from related parties and the interest paid to a related party may be taken as a tax base decreasing item.

	HUF	
Interest received	25,000,000	
	12,000,000	(€48,000 × 250)
Interest paid	(953,425)	(80 million × 7·5% × 58/365)
	36,046,575	

36,046,575 × 50% = HUF 18,023,287

(7) Generally, the write-down of shares is accepted for tax purposes. However, since Jordan Kft reported the share purchase to the tax authority, the write-down is not tax deductible.

(8) Write-off of loss due to missing stock is not accepted for tax purposes. On the other hand, the write-down of obsolete stock is tax deductible.

(9) Depreciation accounted for in the books on the assembly line:
150,000,000 × 20% × 306/365 = HUF 25,150,684

In the case of all other assets acquired in 2006, the depreciation for accounting purposes is HUF 20 million (100 million × 20%). This amount increases the tax base.

(10) The value of the tax base decreasing items by virtue of royalty income and related party interest income cannot exceed 50% of the company's pre-tax profit. Jordan Kft's pre-tax profit is HUF 66 million, 50% of which is HUF 33 million. The aggregate amount of the two aforementioned tax base decreasing items would be HUF 39,023,287, which exceeds 50% of the pre-tax profit. Thus, the tax base decrease by virtue of the related party interest income is limited to HUF 12 million.

(Alternatively, the decreasing item by virtue of the interest income can be HUF 18,023,287 and the royalty income can be HUF 14,976,713.)

(c) Solidarity surtax 2007

	HUF
Pre-tax profit	66,000,000
Decreasing items:	
Dividend received	(24,000,000)
Increasing items:	None
Solidarity surtax base	42,000,000
Solidarity surtax (at 4%)	1,680,000

(d) Advance payments 2008

Since the company's annual tax liability is less than HUF 5 million, it is liable to make quarterly advance payments from July onwards. The quarterly tax liability is one-fourth of the 2007 tax liability, which is HUF 1,108,657, payable by the 20th of the month following the end of the respective quarter.

However, the tax advances payable from January to June depend on the 2006 corporate income tax liability of the company. Should the 2006 liability have exceeded HUF 5 million, the tax advances would be payable monthly, by the 20th of the respective month. If the 2006 tax liability was less than HUF 5 million, then the tax advances are payable quarterly, by the 20th of the month following the respective quarter.

By the 20th of December, the company should pay at least 90% of the expected annual tax liability, otherwise a penalty of a maximum of 20% can be levied by the tax authority.

(e) Tax base calculation in 2008

(1) The depreciation accounted for in the company's books will increase the tax base whereas the tax depreciation will decrease it.

(2) Tax base increasing item – Accounting depreciation:
150 million × 20% = HUF 30,000,000

(3) Tax base decreasing item – Tax depreciation:
The annual tax depreciation would be 150 million × 14·5% = HUF 21,750,000. However, since the asset was purchased against the development reserve, HUF 120 million is already considered to have been depreciated for tax purposes. Considering also the 2007 tax depreciation, the net value of the asset for tax purposes is HUF 11,765,754 at the beginning of 2008. Therefore, this is the maximum amount that can be taken as a deduction from the tax base.

3 Black Kft

(a) Size of the investment

(1) In order to see the size of the investment for the purposes of the development tax relief, the net present value (NPV) of the expenditures must be taken as at the start date of the investment.

(2) The NPV of Black Kft's investment is HUF 3,583 million, which is calculated as follows using the reference rate of 8·59%:

(in million HUF)	2004	2005	2006	Total
Investment	1,800	1,200	800	3,800
Discount rate (%)	100·00	108·59	117·92	
NPV	1,800	1,105	678	3,583

(3) As only investment in new assets qualifies for tax relief, the assets taken over from the other Hungarian affiliate cannot be taken into consideration.

(4) Since the threshold for the development tax relief is HUF 3 billion and the net present value of Black Kft's investment over the three years is HUF 3,583 million, the size of the investment qualifies for the tax relief.

(b) Number of employees

One of the conditions for qualifying for the tax relief is that the annual average number of employees must exceed, by at least 150, the average number of employees in the year prior to the commencement of the investment. Thus, since Black Kft had 120 employees in 2003 – the year preceding the commencement of the investment – it must employ at least 270 workers in the four tax years following the first tax year in which the tax relief is claimed.

(c) Maximum amount of tax relief

(1) The maximum amount of the tax relief (at net present value) is a certain portion of the investment value calculated using the intensity ratio. This is 40% since the investment is located in Pest County. As the value of the investment is less than €50 million (HUF 12·5 billion), no multiplier has to be used for the intensity ratio (HUF 3,583 million equals €14·33 million). The net present value of the maximum tax relief is therefore HUF 1,433·2 million (3,583 million × 40%).

(2) The tax relief can be claimed in ten tax years following the year when the investment is first put into operation. The starting date of the ten-year period may also be the actual year when the investment is put into operation. Therefore, Black Kft may claim the tax relief in years 2007 to 2016 or in years 2008 to 2017 (provided that there is no change in the tax years as a result of which there is more than one tax year in any calendar year).

(3) Another condition is that the last tax year when the tax relief is claimed can be the fourteenth tax year following the year in which the request for the tax relief was submitted. Since the request for the tax relief was submitted in 2003, the fourteenth tax year is 2017, thus in either case, the company is within the deadline.

(d) Minimum period

Black Kft must use all of the assets which were included in the investment plan for at least five years following the year in which the investment was put into operation. Since the investment was put into operation in 2007, it must use the assets until at least 2012, otherwise it does not meet one of the preconditions for the tax relief which will result in it having to pay back the tax relief claimed in prior years with penalties.

4 Sweet Kft

(a)

	Note	HUF
VAT payable:		
Domestic sales (250 million × 20%)		50,000,000
Sale of car (4·8 million × 16·67%)		800,000
Gift (7,500 × 200 kg × 20%)	1	300,000
VAT deductible:		
Purchase of ingredients (180 million × 20%)		(36,000,000)
Purchase of vans (13·2 million × 16·67%)		(2,200,000)
Purchase of passenger car		—
Sale of car	2	(1,800,000)
Marketing services (2 million × 20%)		(400,000)
VAT balance of April:		10,700,000
Negative VAT balance from March:		(12,900,000)
Total VAT balance of April:		(2,200,000)
From this reclaimable:		(1,750,000)
From this carry-forward:	3	(450,000)

Notes:

(1) A free asset transfer is considered to be a sale which is subject to VAT. The basis of the VAT is the market value of the product.

(2) Input VAT on the purchase of passenger cars is non-deductible. However, if a car is sold within 60 months after its purchase, then part of the input VAT that was non-deductible at the time of the original purchase becomes deductible. The deductible portion is calculated by multiplying the input VAT with a ratio, which is the number of months remaining from the 60 month-period divided by 60.

Since the car was originally purchased in April 2005, 24 months have elapsed from the 60 months. Thus the ratio is (60 – 24)/60.

The input VAT is HUF 3 million (15 million × $^{25}/_{125}$) which was originally non-deductible in April 2005. The deductible part of this input VAT is HUF 1,800,000 [3 million × (60 – 24)/60].

(3) Sweet Kft has not paid all its suppliers. VAT included in such suppliers' invoices cannot be reclaimed. Thus, the negative VAT balance of HUF 2,200,000 must be decreased by HUF 450,000 (2·7 million × 16·67%) which is the VAT content of the unpaid invoices.

Thus the VAT reclaimable is HUF 1,750,000 and the remaining HUF 450,000 must be carried forward to May.

(b) Possible reasons why Sweet Kft had to carry forward the HUF 12·9 million deductible VAT from March include:

(1) This amount corresponds to the VAT content of suppliers' invoices which have not been settled in previous periods.

(2) The threshold of HUF 4 million in sales revenues has not been reached.

5 Mr Painzesh

(a) Taxation of dividend income

(1) Dividend income from Hungarian shares is taxable according to progressive rates, at 25% and 35%. In the case of the dividend income from Money Kft, first the value of the equity (excluding the valuation reserve) of Money Kft which is proportionate to Mr Jones' share in the company's share capital has to be calculated. Dividend income up to 30% of this value is taxable at 25%.

(2) The company's equity excluding the valuation reserve:
35 million – 4 million = HUF 31 million

(3) Mr Jones' interest in the company is 45% (9 million/20 million).

(4) Mr Jones' share in the company's equity:
31 million x 45% = HUF 13,950,000

(5) 30% of this amount is taxable at 25%:
13,950,000 × 30% = HUF 4,185,000
4,185,000 × 25% = HUF 1,046,250

Dividend in excess of the above amount is taxable at 35%
15 million – 4,185,000 = HUF 10,815,000
10,815,000 × 35% = HUF 3,785,250

(6) Income which qualifies as dividend income according to the law of the foreign country, is taxable at 25%. According to the treaty between Hungary and Luxembourg, dividends paid to a person who does not hold directly at least 25% of the capital of the company is subject to 15% withholding tax in Luxembourg. The tax withheld in Luxembourg can be credited against the Hungarian tax payable, thus only the difference has to be paid in Hungary.

Tax withheld in Luxembourg according to the treaty:
3 million × 15% = HUF 450,000

Tax payable in Hungary according to domestic law:
3 million × 25% = HUF 750,000

Tax actually payable in Hungary after crediting the Luxembourg withholding tax:
750,000 – 450,000 = HUF 300,000

(b) Guernsey is included in the list of low-tax countries, a document issued by the Ministry of Finance. Thus, any dividend income, which is paid by a Guernsey company is taxed as other income (as opposed to being taxed as dividend income). Other income (‚Egyéb jövedelem') is taxable at the general progressive rates. Consequently, the dividend income from the Guernsey company would have to be added to Mr Painzesh's other income (income from dependent services, income from independent services, other income) and taxed at the progressive rates of 18% and 36%, plus the 4% solidarity surtax if the individual reaches the threshold.

(c) Capital gain

(1) Personal income tax has to be paid on the capital gains realised by an individual. The capital gain is the difference between the revenue received from the sale of the shares and their acquisition cost. Costs ancillary to the sale, e.g. broker's fees, also reduce the capital gain. Capital gains are taxed at 25%.

(2) Gain realised on the sale of the shares in Money Kft:

	HUF
Income from the sale	25,000,000
Acquisition cost	(9,000,000)
Capital gain	16,000,000

Capital gain tax   16,000,000 × 25% = HUF 4,000,000

(3) Gain realised on the sale of the Luxembourg shares:

	HUF	
Income from the sale	10,000,000	
Acquisition cost	(7,000,000)	
Broker's fee	(150,000)	(1·5% of 10 million)
Capital gain	2,850,000	

Capital gains tax   2,850,000 × 25% = HUF 712,500

(d) Dividend withholding tax for foreign non-individuals was abolished from 1 January 2006. Since that date, dividend income of foreign non-individuals is not taxable in Hungary based on domestic law regardless of when the dividend was declared or from which year's earnings it is paid. Thus, Money Kft will not have to withhold tax.

			Marks
1	(a)	**Sale of flat**	
		Income from the sale of the flat	2
		Additional decrease	2
		Allowance for reinvestment	2
			6
	(b)	**Personal income tax**	
		Salary	0·5
		Lecturing	2
		Bonus	0·5
		Vouchers	1
		Consolidated tax base	0·5
		Tax on the consolidated tax base	1
		Income taxed separately	
		– interest	1·5
		– income from immovable property	0·5
		Total personal income tax	0·5
			8
	(c)	**Solidarity surtax**	
		Is liable to pay	1
		Consolidated tax base	1
		Cap	1
		Tax	1
			4
	(d)	**Company car**	
		Company car tax	1·5
		Health care contribution	1·5
			3
	(e)	**Coffee vending machine**	
		Fringe benefit	1
		54% personal income tax	1
		Social security	2
			4
			25

			Marks
2	**(a)**	**Unused development reserve**	
		– Balance at 1 January 2007 fully utilised	1·5
		– 2007 carried forward	0·5
		– four years/2011	1
			3
	(b)	**Corporate income tax base**	
		Decreasing items:	
		Dividend received	
		– Domestic	1·5
		– Foreign	1
		Royalty	1·5
		Depreciation (decreasing item)	2·5
		Development reserve	1
		Interest	
		– interest margin	2
		– 50% rule	1
		– limitation	1
		Increasing items:	
		Write-down of shares	1·5
		Missing stock	1
		Write-down of stock	1
		Depreciation (increasing item)	2
		Tax base	0·5
		Tax liability	0·5
			18
	(c)	**Solidarity surtax**	
		Pre-tax profit	0·5
		Dividend received	1
		Increasing item – none	0·5
		Solidarity surtax base	0·5
		Solidarity surtax	0·5
			3
	(d)	**Advance payments 2008**	
		– quarterly advances from July	1·5
		– monthly/quarterly advances, January to June	1·5
		– top-up obligation	1
			4
	(e)	**Tax base calculation in 2008**	
		Accounting depreciation	0·5
		Tax depreciation	1·5
			2
			30

			Marks
3	(a)	**Size of the investment**	
		NPV calculation	2·5
		Exclusion of assets taken over	1
		Qualifies for the tax relief	0·5
			4
	(b)	**Number of employees**	2
	(c)	**Tax relief claimable**	
		Maximum amount	2·5
		Ten-year periods	2·5
		Fourteenth year	2
			7
	(d)	**Minimum period**	
		Five years	1
		Repayment with penalties	1
			2
			15
4	(a)	**VAT payable**	
		Domestic sales	1
		Sale of car	1
		Gift	2
		VAT deductible	
		Ingredients	1
		Vans	1
		Passenger car	1
		Sale of car	2
		Marketing services	1
		VAT balance of April	0·5
		Carry forward from March	0·5
		Total balance	
		– reclaimable (balance)	0·5
		– carry forward	1·5
			13
	(b)	Reasons	2
			15

			Marks
5	(a)	**Mr Jones' share in the equity**	
		– equity	1
		– share in the company's equity	1
		Taxation of dividend	
		– at 25%	1
		– at 35%	1
		Foreign dividend income	
		– tax withheld in Luxembourg	1
		– tax payable in Hungary	1
		– tax credit	1
			7
	(b)	**Taxation as other income**	**2**
	(c)	**Capital gain**	
		– domestic	2
		– Luxembourg	2
			4
	(d)	**Withholding tax on dividend**	**2**
			15