

Fundamentals Level – Skills Module

Taxation (Hungary)

Monday 3 December 2007

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are on pages 2–4.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants



Paper F6 (HUN)

SUPPLEMENTARY INSTRUCTIONS:

- 1 Calculations and workings need only be made to the nearest HUF.
- 2 All apportionments should be made to the nearest month.
- 3 All workings should be shown.

TAX RATES AND ALLOWANCES:

The following tax rates and allowances are to be used in answering the questions

Applicable tax rates for 2007

Corporate tax rate

On the first HUF 5 million of the corporate tax base	10%
On the remaining tax base	16%

Note: the lower band of 10% may only be taken advantage of if the company meets the criteria laid out in the law on corporate tax. If not, the corporate tax rate is 16% on the entire tax base.

Solidarity surtax for companies – 4%

Personal income tax – tax on consolidated tax base

On the first HUF 1,700,000	18%
On the remaining tax base	36%

Solidarity surtax for individuals – payable on the consolidated tax base in excess of the cap for social security contributions. The tax rate is 4%.

Cap for social security contributions – HUF 6,748,850

Personal income tax on dividend

General rate – 25%

On dividends exceeding 30% of the value of the company's equity (excluding the valuation reserve) which is proportionate to the individual's share in the company's share capital – 35%.

Personal income tax on interest – 20%

Personal income tax on capital gains – 25%

Tax on benefits in kind – 54%

The company car tax shall be paid monthly according to the following:

<i>Purchase price of the car (HUF)</i>	<i>In the year of acquisition and in the next one to four years (HUF)</i>	<i>In the fifth and consecutive years following the year of acquisition (HUF)</i>
1– 500,000	6,000	3,000
500,001– 1,000,000	8,000	4,000
1,000,001– 2,000,000	12,000	6,000
2,000,001– 3,000,000	20,000	10,000
3,000,001– 4,000,000	26,000	13,000
4,000,001– 5,000,000	32,000	16,000
5,000,001– 8,000,000	42,000	21,000
8,000,001–10,000,000	60,000	30,000
10,000,001–15,000,000	82,000	41,000
Above 15,000,000	112,000	56,000

Employers may provide food vouchers to each employee with a value of up to HUF 10,000 per month for warm meals and up to HUF 5,000 per month for cold meals, free of benefit in kind tax.

Social security contributions**Employer's contributions**

Pension contributions	21%
Health contributions	8%
Itemised health care contributions per employee per month	HUF 1,950
Health care contribution on company car	25%

Employee's contributions

Pension contributions	8.5%
Health insurance contributions	7%
Contributions to unemployment funds	1.5%

Support and subsidies – development tax relief

The limits applying to subsidies given in the form of tax relief or other subsidies in respect of investments are defined by the following intensity ratios:

1. Regional factors.
 - Budapest: 35%
 - Pest County: 40%
 - Western Transdanubia: 45%
 - Other regions: 50%
2. For companies which qualify as being small and medium sized, 15% is added to the regional factor.
3. The maximum support is then calculated by applying the following to the initial investment:
 - On the first €50 million of the investment: 100% of the intensity ratio.
 - On the portion between €50 and €100 million: 50% of the intensity ratio
 - On the portion over €100 million: 34% of the intensity ratio.

The reference rate to be used in the present value calculations is 8·59%.

Qualifying limits for small and medium sized companies

A company qualifies as small and medium if:

- the company has no state or local government members; and
- total assets are less than €43 million; or
- the number of employees is less than 250; or
- total revenues are less than €50 million

Exchange rates

Euro: €1 = 250 HUF

USD: 1 USD = 200 HUF

ALL FIVE questions are compulsory and MUST be attempted

1 Mr Smith works at a bank. His monthly salary is HUF 880,000. He has a company car, which he can also use for private purposes. He maintains no records of the business use of the car. The car was bought in 2006 for HUF 5.2 million; this is the value at which the car was recorded in the bank's books at the time of the purchase.

The University of Economics invited Mr Smith to teach a semester on banking information systems. He received HUF 450,000 for the semester. He has no expenses which he can deduct from this income.

Mr Smith keeps money in his bank on a savings account, which earns gross interest of 5.6%. He held HUF 15 million on this account throughout the year.

Mr Smith moved to a house in the suburbs with his family. He bought the house in February 2007 for HUF 45 million. Part of the money was derived from the sale of a flat where the family had previously lived. He sold the flat in January 2006 for HUF 25 million. The flat had been bought in May 1994 for HUF 4 million and it was renovated in 1998 for HUF 1.2 million.

His boss appreciates the hard work of Mr Smith and he was paid a HUF 1.1 million bonus in 2007.

Each employee of the bank gets a voucher for HUF 10,000 a month for cold meals. The bank operates a coffee vending machine from which the employees can take coffee for free. The coffee costs the bank HUF 800,000 (including VAT) per year.

Additional information relating to this question

Percentages by which the capital gain from the transfer of real property can be decreased:

Year of transfer taking the year of acquisition as the first year	Percentage
in the sixth year	10 per cent
in the seventh year	20 per cent
in the eighth year	30 per cent
in the ninth year	40 per cent
in the tenth year	50 per cent
in the eleventh year	60 per cent
in the twelfth year	70 per cent
in the thirteenth year	80 per cent
in the fourteenth year	90 per cent
in the fifteenth year	100 per cent

Required:

- (a) Calculate the taxable gain arising on the sale of the flat, and state, giving reasons, the tax (if any) that must be paid on it.** (6 marks)
- (b) Calculate the personal income tax Mr Smith will have to pay in 2007.** (8 marks)
- (c) State, giving reasons, whether Mr Smith has to pay solidarity surtax, and if so, calculate how much.** (4 marks)
- (d) Calculate how much tax and health care contribution the bank will have to pay on the company car provided to Mr Smith. (Ignore the employer's contribution to the unemployment fund.)** (3 marks)
- (e) Explain the personal income tax and social security implications of the coffee vending machine.** (4 marks)

(25 marks)

- 2 Jordan Kft is a shoe manufacturing company, which is part of a European group. The company's factory in Hungary manufactures the sport shoes known as AirMax and Jump. Jordan Kft's profit before tax for the year 2007 is HUF 66 million after accounting for the events below.

The company has two subsidiaries; LotiFuti Kft, a Hungarian entity which is wholly owned by Jordan Kft, and Bigfoot Sarl which is a Luxembourg entity. LotiFuti Kft declared a HUF 2.5 million dividend for 2006 at its annual meeting on 10 February 2007. In anticipation of the 2007 year-end dividend, LotiFuti Kft declared a HUF 1.8 million interim dividend on 21 September. The annual meeting of LotiFuti Kft is expected to be held in the middle of May of 2008. BigFoot Sarl paid a dividend of €96,000 during the year 2007. No tax was withheld in Luxembourg. The Luxembourg company is not considered to be a controlled foreign entity in Hungary. The date of preparation of the balance sheet ('merlegkeszıtes idopontja') of Jordan Kft is 31 March.

Jordan Kft also bought 40% of a small local firm in January 2007 and reported the purchase to the tax authority. However, the investment did not turn out to be as profitable as expected and Jordan Kft had to write down the cost of the shares by HUF 4 million.

On the basis of the year-end stock-take, it turned out that 150 pairs of shoes, worth HUF 3.8 million were missing. The company wrote off this loss in its books. Also during the stock-take, the management realised that they still had 400 pairs of last year's model and decided to write these down by HUF 800,000.

The AirMax brand is owned by the Italian group company to which each subsidiary manufacturing this type of shoe has to pay royalties. The 2007 royalties that Jordan Kft had to pay were €60,000. Based on a sub-licence agreement, the company also paid €25,000 to the Italian company for the brand Jump, which it sub-licenses to its subsidiaries. Jordan Kft collected HUF 40 million from LotiFuti Kft and €8,000 from BigFoot Sarl in respect of these sub-licences. Jordan Kft and its subsidiaries qualify as related parties.

As the AirMax shoes are very popular, Jordan Kft had to install a new assembly line, at a cost of HUF 150 million. This was put into operation on 1 March 2007. The company had created a development reserve of HUF 50 million in 2003 and HUF 170 million in 2005. It used HUF 100 million of this reserve in 2006 to acquire new machinery. The remaining part of the reserve at 1 January 2007 is to be used towards the cost of the new assembly line. The assets acquired in 2006 and 2007 are all depreciated at the rate of 20% per annum for accounting purposes. These assets all qualify for tax depreciation at the rate of 14.5%. At the end of 2007, the company created another HUF 16 million development reserve.

Jordan Kft has lent money to its subsidiaries. During 2007, it received HUF 25 million interest from LotiFuti Kft and €48,000 interest from BigFoot Sarl. Due to a temporary cash shortage, Jordan Kft had to borrow a short-term loan from its parent company to purchase the assembly line. It took a HUF 80 million loan on 1 March at 7.5% (which was considered to be the market rate at that time) and paid it back in full on 28 April.

Jordan Kft had no thin capitalisation issues in the year 2007 since its debt was less than three times its equity.

Jordan Kft is not eligible for the 10% corporate income tax rate.

Required:

- (a) **State how much unused development reserve Jordan Kft will have at 1 January 2008 and the last year in which the company will be able to use it.** (3 marks)
- (b) **Calculate the 2007 corporate income tax liability of Jordan Kft. Support your computation with relevant explanations.** (18 marks)
- (c) **Calculate the 2007 solidarity surtax liability of Jordan Kft.** (3 marks)
- (d) **Explain the rules by which Jordan Kft will have to make corporate income tax advance payments for the year 2008.** (4 marks)
- (e) **Explain how the depreciation of the assembly line will affect Jordan Kft's tax base in 2008, assuming that it will be used throughout the whole year.** (2 marks)

(30 marks)

- 3 Black Kft, a printing company, made a HUF 3·8 billion investment over three years, mainly to increase its capacity. The company employed 120 workers in 2003. As a result of the investment this number increased to 180 by 2006. The investment plan was as follows:

	2004	2005	2006
Investment (in million HUF)	1,800	1,200	800
Average number of employees	130	130	180

The investment was put into operation in 2007 in Pest county.

In addition to the above, Black Kft took over the assets, including the printing machines, of another Hungarian affiliate of the same group, which, due to reorganisation, has changed its business from one of manufacturing to one of distribution. The assets taken over by Black Kft in 2006 were worth HUF 900 million.

Black Kft does not qualify as a small or medium sized enterprise. The request for the tax relief was submitted in 2003.

Required:

- (a) Explain whether Black Kft is entitled to claim development tax relief based on the size of its investment. Support your explanation with relevant calculations. (4 marks)
- (b) State, giving reasons, the minimum number of workers Black Kft must employ if it is to qualify for the tax relief. You should assume that the company will not meet the requirement concerning the increase in annual wage costs. (2 marks)
- (c) Assuming that Black Kft does qualify for the tax relief, calculate the maximum amount of tax relief (at net present value) that it may claim and state the last year in which it may be claimed. (7 marks)
- (d) State, giving reasons, the minimum period for which the investment assets acquired must be used in order for the tax relief to be claimed, and the consequences of not satisfying this condition. (2 marks)

(15 marks)

- 4 Sweet Kft's main product is chocolate chip cookies, which it sells all over the world through its Hungarian distributors. In April 2007, its sales (net of value added tax (VAT)) amounted to HUF 250 million. The cocoa, sugar, nuts and other ingredients cost HUF 180 million (net of VAT) in that month. The ingredients used for the cookies are solely purchased from Hungarian vendors.

Other events in April 2007 were as follows:

1. Sweet Kft usually pays its vendors on time. However, in April, due to an administrative problem, it omitted to pay two of its largest suppliers and HUF 2.7 million of supplier invoices were outstanding until the end of May.
2. Sweet Kft purchased two small vans for a total of HUF 13.2 million (including VAT). It also bought a passenger car to be used by the company's chief financial officer for HUF 21 million, to replace his old car which was sold in the month. The company had purchased the old car for HUF 15 million (including VAT) in April 2005. The car was sold for HUF 4.8 million (including VAT).
3. In order to increase its sales in Italy, the company launched a campaign which was organised by a Hungarian marketing firm. The Hungarian firm invoiced HUF 2 million (net of VAT) to Sweet Kft.
4. During Easter, the company gave 200 kilograms of chocolate to children in a supermarket for free. The production cost of this chocolate was HUF 1.2 million. The company generally sells this chocolate to third party distributors for HUF 7,500 (net of VAT) per kilogram.

Sweet Kft carried forward HUF 12.9 million of deductible VAT from March.

The company files its VAT returns on a monthly basis. The general VAT rate in 2005 was 25%.

Required:

(a) Calculate Sweet Kft's value added tax (VAT) liability/refund for the month of April 2007. (13 marks)

(b) Name two possible reasons why Sweet Kft had to carry forward the HUF 12.9 million deductible VAT from March. (2 marks)

(15 marks)

- 5 Mr Painzesh established his company, Money Kft, in Hungary in 1999, with a share capital of HUF 9 million. He originally held 9,000 shares in Money Kft of HUF 1,000 par value each. In 2004, a German investor stepped in, raising the company's share capital by HUF 11 million. The company's equity is now HUF 35 million, including the profit reserve and a HUF 4 million valuation reserve.

In 2001, Mr Painzesh purchased shares in a Luxembourg company for HUF 7 million. He now owns 10% of this Luxembourg company. The company's equity is the Euro equivalent of HUF 110 million.

Mr Painzesh expects to receive a HUF 15 million dividend from Money Kft and a HUF 3 million dividend from the Luxembourg company in 2007. Personal income tax in Luxembourg is withheld according to the Hungary–Luxembourg double tax treaty.

Currently, Mr Painzesh could sell the Hungarian shares for HUF 25 million and the foreign (Luxembourg) shares for HUF 10 million. If he were to sell the foreign shares he would have to pay commission of 1·5% of the sales price to his agent.

Money Kft is not listed on a stock exchange.

Additional information relating to this question

1. Hungary–Luxembourg double tax treaty

Article 10

Dividends

- (1) Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
- (2) However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends the tax so charged shall not exceed:
 - (a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends,
 - (b) 15 per cent of the gross amount of the dividends in all other cases.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

- (3) The term 'dividends' as used in this Article means income from shares, 'jouissance' shares or 'jouissance' rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws the State of which the company making the distribution is a resident.
- (4) The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.
- (5) Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

2. List of low-tax countries for personal income tax purposes

Andorra	Gibraltar	Niue
Anguilla	Grenada	West-Samoa
Antigua and Barbuda	Dutch Antilles	Panama
Arubas	Hong Kong	Solomon Islands
The Bahamas	Cayman Islands	San Marino
Bahrain	Liberia	St Kitts and Nevis
Barbados	Liechtenstein	St Lucia
Belize	Marshall Islands	St Vincent and Grenadines
Bermuda	Maldiv Islands	Seychelles
Cook Islands	Isle of Man	Tonga
Costa Rica	Mauritius	Turks and Caicos
Channel Islands (Guernsey, Jersey)	Montserrat	Vanuatu
United Arab Emirates	Monaco	Virgin Islands (British)
Dominican Republic	Nauru	Virgin Islands (US)

Required:

- (a) Calculate the amount of Hungarian personal income tax (PIT) Mr Painzesh will have to pay on the dividend income received in 2007. (7 marks)
- (b) State, giving reasons, whether the taxation of the dividend income would be different if the foreign company was based in Guernsey. (2 marks)
- (c) Explain the personal income tax consequences in Hungary if Mr Painzesh were to sell all of his shares in 2007. Support your explanation with calculations of any tax payable. (4 marks)
- (d) Money Kft declared a dividend of HUF 10 million in 2005 (from its 2004 earnings) which has not yet been paid to the German investor. State, giving reasons, whether Money Kft would have to withhold tax if it were to pay this dividend in 2007 and, if so, how much tax it would have to withhold. (2 marks)

(15 marks)

End of Question Paper