26/2017
29 June 2017

wts klient newsletter

WTS Klient.
The Bridge.

Dear Readers,

Before we celebrate the beginning of summer and the school holidays with pupils and students, we would like to recommend again our four-part video series and the related articles, which you can now comfortably watch and read in your hotel or on the plane. To start achieving your objectives dynamically after the holidays we suggest that you watch our video highlighting the tax implications of accounting in a foreign currency, once having covered the strategic, accounting and legal aspects. In this video we focus on key areas such as corporate tax, value added tax and personal income tax, which are important if we are considering making the transition.

You can reach our video on tax aspects by clicking on the following link: wtsklient.hu/en/2017/06/28/switching-currency-tax/

I trust that besides the video you will find our other newsletter articles interesting as well, the first of which focuses on one of the above-mentioned tax types in more detail: corporate tax.

I wish you a relaxing and informative summer:

Béla Kovács
senior manager

Paying and topping up corporate tax

"With economic growth of 4% and a budget deficit of less than 2%, now is perhaps the time to abolish this economically unjustified system."

Author: **Zoltán Lambert**
zoltan.lambert@wtsklient.hu

July is just around the corner. This is an important date for companies paying corporate tax because it signals the start of corporate tax advance payments for the current year, based on the profits of the previous year. What is the logic behind this system and how was it affected by the cut in the corporate tax rate this year? Besides this, is there really a need to top up corporate tax at the end of the year? These are the questions I will be seeking to answer in this article.

How does corporate tax finance the state budget?

For companies that prepare annual financial statements on the calendar year, the deadline for filing corporate tax returns is 31 May of the year following the reporting year. According to the original intention of the legislators, companies with payable corporate tax in excess of HUF 5 million (approx. EUR 16,000) have to pay the same amount in 12 equal instalments as a tax advance from July of the year after the reporting year to June in the following year (for tax amounts less than HUF 5 million (approx. EUR 16,000) the same applies just in 4 instalments, starting three months later). The logic behind this rule is that a given company should **contribute to financing the state budget** in a given year in Hungary, up to the level of its profit in the previous year, with **regular and balanced tax advances**.

This relatively well-established system was shaken up a little with the introduction of the new, uniform, single-rate corporate tax of 9% in 2017. For companies with a corporate tax base of less than HUF 500 million (approx. EUR 1.6 million) and therefore paying a preferential rate of 10%, this did not bring about any significant change, but for those with tax bases in excess of HUF 500 million (approx. EUR 1.6 million) and paying corporate tax of 19%, the legal amendment signalled a significant reduction. However, paying their previous year's corporate tax amount as a tax advance meant these companies would likely have made considerable overpayments in comparison to their actual liabilities. The amendment to the law contained a relatively complex transitional rule to solve the problem.

Reduction in corporate tax advances too

It is easy to understand that the tax advance payable monthly from July 2017 to June 2018, which had to be recorded in the 2016 corporate tax return, no longer correlated with the previous year's tax but with 9% of the previous year's tax base. This way, companies pay tax advances over 12 months that tally with their tax payment liability assuming their tax base remains unchanged. However, something also had to be done with the surplus tax advances that would have been paid by these companies in the first half of 2017, compared to the amount of actual tax they had to pay in the first six months of 2017, again assuming an unchanged tax base. This resulted in the following **transitional rule** in Hungary:

"For taxpayers applying a 19% rate in 2015, the tax advance for the first half of 2017 is 50% of the amount equal to 9 nineteenths of the tax payable in 2015 plus HUF 20 million (approx. EUR 64,000), as determined by the NAV in a resolution by 15 January 2017."

The "9 nineteenths" rule is just about understandable, but why did this have to be raised by HUF 20 million (approx. EUR 64,000)? Nobody in the profession has yet managed to figure this out. The preferential 10% tax payable on tax bases less than HUF 500 million (approx. EUR 1.6 million) clearly distorted the "9 nineteenths" ratio, but quite why this was rectified by adding HUF 20 million (approx. EUR 64,000) lacks all logical reasoning in my opinion. Given that we are not talking about actual tax payments, and only tax advances, it would perhaps have been simpler if the taxpayers subject to the 19% rate (too) could have halved their tax advance payments for the first half of 2017.

What is the point of topping up corporate tax payments?

Hungarian taxpayers which had net sales revenues in excess of HUF 100 million (approx. EUR 320,000) in the year prior to the reporting year must estimate their entire annual tax liability by the 20th of the last month of the given financial year, and pay the difference between this amount and the tax advances already paid.

How does the system work?

Alongside the tax advance system outlined above, which itself is not overly simple, **it makes no sense to have to estimate corporate tax** by 20 December (or by the 20th of the last month of the financial year if the company follows a different financial year), and pay the difference taking the paid tax advances into account. Those who invented this extra payment liability clearly never worked at any company with responsibilities for calculating annual profits!

Eleven days prior to the reporting date, and often 2 or 3 months before the balance sheet preparation date, not even companies with the most sophisticated IT systems know their profit for the reporting year. The pre-tax profit and thus the corporate tax base are heavily influenced by year-end accruals, turnover-related bonuses and group accounting. There are also many items that can increase or decrease a company's corporate tax base, and it is not easy taking these into account months before the financial statements are prepared either.

continued on page 3

wts

"The transition must always be decided in advance, so you have to calculate with an exchange rate that is still unknown when the decision is made."

dr. Tamás Felsmann, WTS Klient Hungary tax law specialist

Source: inforadio.hu

Turn on your radio!

Dr. Tamás Felsmann, tax law specialist at WTS Klient Hungary, discusses the legal requirements of changing to accounting in a foreign currency on InfoRadio on 29 June. "It is possible to amend forint-based contracts already in force, but you need to assess the flexibility of your business partners in this context, and potential modifications should be negotiated with them", he suggests.

[Listen to the conversation at this link!]

Please note that the conversation is available only in Hungarian.

If the tax advances paid during the year and the top-up payment at the end of the year are collectively less than 90% of the actual corporate tax payment liability, which is assessed only 5 months later, then a **default penalty becomes payable** amounting to 20% of the difference. And all because, several months before preparing its annual financial statements, the company did not know precisely how external factors would impact on its profit. What is more, the tax authority is unrelenting in its levying of default penalties. If the top-up payment is transferred one day late because the authorised signatory was perhaps not in Hungary the day before, the penalty is imposed in full amount and without exception.

I have my suspicions that this system serves only one purpose: in order to avoid the significant default penalty, companies pay tax advances and make their top-up payments at amounts which exceed their actual corporate tax payable, thereby **financing the state budget interest-free for 5 months from the end of the year**. With economic growth of 4% and a budget deficit of less than 2%, now is perhaps the time to abolish this economically unjustified system.

Reporting according to cash-flow approach and profit/loss approach

Main reasons for differences between profit/loss and changes in liquid assets:

- purchase of tangible assets
- accounting of depreciation
- sale of tangible assets
- increase of capital
- decrease of capital
- borrowing
- loan repayment
- changes in other balance sheet rows

Author: **Andrea Potássy**
andrea.potassy@wtsklient.hu

The profit/loss of companies for a given year is shown in the **income statement**, which forms part of simplified or annual financial statements prepared during the annual closing. According to the Accounting Act, the results of business activities can be established with either the **total-cost or the cost-of-sales method**. In the case of companies preparing financial statements, a **cash-flow statement** is a mandatory part of the supplementary notes, presenting the changes in liquid assets. For statements that form part of the financial statements, the structure and minimum required breakdown of both the income statement and the cash-flow statement including the profit/loss under the cash-flow approach are defined in advance.

Interim reports can also be prepared with a cash-flow approach

Most companies prepare interim reports with a form and structure showing the company's typical income and expenses appropriately. An **interim report** may be prepared on a profit/loss or a cash-flow basis, depending on what types of decisions need to be supported. The basis for interim and annual reporting is always the data recorded during bookkeeping. When keeping **double-entry books**, true, continuous and transparent records are kept of the company's assets and liabilities as well as the changes therein, in a closed system.

By contrast, when keeping **single-entry books**, the company only keeps records of the liquid assets it owns along with their liabilities, so the recognised profit/loss and the change in liquid assets are largely the same. Use of the latter is significantly limited, so for the vast majority of companies there is a difference between the profit/loss recognised based on double-entry books and the cash-flow-based result (i.e. the change in liquid assets).

How can amounts recognised under the cash-flow approach and the profit/loss approach be reconciled?

The profit/loss approach and the cash-flow approach can be connected via an "**indirect cash-flow statement**". When preparing the indirect cash-flow statement, starting with the company's profit/loss we eliminate the items that do not involve any cash movements, and take into account the impacts of changes in the individual balance sheet positions. For example, if a company's receivables have risen, we have to decrease the accounted profit by the amount of the increase. The growth shows that our receivables have risen, so recognising growth in profit is not justified based on the cash-flow approach. We can say the same about a company's liabilities, just in reverse: in this case, we probably accounted higher costs due to the increase, but these costs have not yet been financially settled, so we increase our profit/loss to establish the actual change in liquid assets.

One further reason for the differences between profit/loss recorded on an accounting basis and the changes in liquid assets **can be an increase of capital, a decrease of capital, a borrowing or a repayment, etc**. We have to treat the effect of tangible asset movements on profit/loss and liquid assets appropriately.

If a company's profit/loss recognised according to the rules of double-entry bookkeeping and the changes to liquid assets show a significant difference, reviewing the reason for the difference is justified. If this analysis is also important for the owners of the company, they may prescribe the preparation of regular interim reports, which include cash-flow-based calculations of profit/loss.

Services of the WTS Klient Hungary:

- Tax consulting
- Financial advisory
- Legal consulting
- Accounting
- Payroll

Should you have any questions regarding the above or any other professional issues, please do not hesitate to get in touch with your WTS advisor or use any of the contact details below.

WTS Klient Hungary
1143 Budapest • Stefánia út 101-103. • Hungary
Telephone: +36 1 887 3700 • Fax: +36 1 887 3799
info@wtsklient.hu • www.wtsklient.hu