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Taxation in Hungary

General

The Hungarian taxation system is harmonized with EU directives and provides a secure legal framework for the conduct of business. Foreign investors are further benefiting from special protections and privileges. The favourable tax laws associated with the cheap factor conditions (labour, energy, land etc.), highly skilled labour force and excellent geographic location make Hungary the preferred location for trading and financial operations in the Central and Eastern European region.

Hungary has entered into tax treaties on the avoidance of double taxation with more than 60 countries. The provisions of these treaties override the provisions of the national laws.

Taxes in Hungary are levied by the Parliament, or other bodies holding the authorization of the Parliament, and are valid with rare exception throughout the country. Uniform rules are applicable in the whole country and determine the subjects of the taxes, the taxable income or other bases for taxes, the collection of the taxes by the tax authority as well as the procedures. Besides the major national taxes, the Local Taxes Act empowers local governments to levy five different local taxes at rates maximized by the Act.



With rare exceptions taxpayers in Hungary pay their due taxes on a self assessment basis, meaning that they file the return and make payments by the due date without receiving any formal notice from the tax authorities. Only a limited amount of information must be submitted, but, the tax authority from time to time carries out audits. In the case of late payments or false data provision, interest and penalties may be levied.

The Hungarian tax system is designed to tax income, sales and other specific transactions, rather than capital. Most often individuals are subjected to pay personal income tax, while businesses, irrespective of their legal form, pay corporate income tax. Domestic sales are typically subjected to a general sales tax (VAT), to which other taxes (e.g. excise) are occasionally added.

The basic methodology of the taxation system is unlikely to be changed even in the longer term. However, modifications may occur from year to year.

As an important feature of the Hungarian tax system, a binding tax ruling may be obtained. Accordingly, the taxpayer may request a preliminary opinion from the Ministry of National Economy of tax payment obligations associated with a future business transaction. The Ministry of National Economy is obliged to issue its opinion with binding validity if the facts are fully disclosed and the

request is countersigned by a lawyer or a tax adviser. This request is subject to a fee amounting to 1% of the value of the business transaction, but minimum HUF 1 million, and maximum HUF 8 million. In case of a contract package, the fee is maximum HUF 10 million. The opinion is binding on the tax office in the course of a future audit if the facts and circumstances of the business transaction have been fully disclosed in the request and the applicable tax law had not changed. The ruling of the Ministry does not have, however, any precedent effect on similar transactions.

Additionally, in a so called APA (Advance Pricing Agreement), a multinational taxpayer and at least one government's administration can agree in advance concerning the appropriate approach to determine the "arm's length" price to be charged in transactions between related entities. Under this regime unilateral, bilateral and multilateral APAs can be reached in internationally accepted procedures. Bilateral and multilateral APAs (i.e., APAs involving the competent authorities of more than one tax administrations affected by the transactions) create an assurance in advance for taxpayers that a consistent approach will be taken by the governments involved in a cross border transaction, thus avoiding the possibility of costly later disputes. Under such rules an APA can be requested for future transactions and can be effective for three to five years.

Corporate tax

The taxable income of Hungarian companies is subject to corporate income tax at a rate of 10% up to HUF 500 million tax base and 19% for the exceeding part. The corporate income tax rate applies to the taxable income of all business forms without distinction.

Dividends and liquidation proceeds received by corporations are exempt from taxes. Moreover, tax regulations make it possible for the capital gain realized on certain investments to be tax exempt. Accordingly, if a taxpayer holds at least 30% of the registered share capital of a domestic legal entity or foreign entity for at least one year and reports such holding to the tax authority within 60 days following the acquisition of the investment, the amount of profit deriving from the sale of "reported shares" will decrease the corporate income tax base of the taxpayer. That is, the capital gain on the sale of such shares is tax exempt. As a downside of the reporting of the holding, any loss to be realized in relation to these investments will not be tax deductible. The reported share rules may also apply to subsequent share acquisitions in the target company.

From 1 January 2012 a similar exemption applies to the gains realized on the sale of "reported intellectual properties". Accordingly, if the taxpayer holds the

intellectual property for at least one year and reports the acquisition of such intellectual property to the tax authority within 60 days following the acquisition, the gain from the sale of such property is exempt from corporate tax. The tax exemption is also available regarding the gain realized on unreported intellectual properties, if, out of the proceeds of the sale of such IP, the taxpayer, within 3 years, purchases a new intellectual property.

Due to a specific regime on royalty income, this type of income may be effectively taxed at the rate of 5% / 9.5% instead of 10% / 19%.

Hungary does not levy withholding taxes on payments made to non-resident enterprises; i.e. no Hungarian withholding tax applies to interest, royalty, service fee and dividend (etc.) payments. It must be noted furthermore that the double tax treaty network of Hungary is very favourable in respect of interest and royalty taxation, by many of the treaties completely eliminating source taxation of interest and royalties.

Capital gains realized on the sale of Hungarian property holding companies may be subject to Hungarian withholding tax at a rate of 19%; however, in most of the cases, the applicable double tax treaty excludes the Hungarian taxation of the capital gain.

If the larger of a taxpayer's pre-tax profit or taxable basis does not reach the so called "profit-minimum", then (i) the taxpayer has to make a detailed declaration to the tax authority as to its taxable basis, or (ii) it has to pay its tax based upon the profit-minimum regarded as its taxable basis, instead of calculating the tax in accordance with the general rules. The profit-minimum is 2% of the total revenue adjusted by certain decreasing and increasing items described by the act. Taxpayers may choose between these alternatives on their own decision. However, in the case the taxpayer opts to make the declaration, the burden of proof shifts to the taxpayer in the course of the tax investigation, such that the taxpayer must prove the fulfilment of the transactions challenged by the tax authority and that the costs incurred in the interests of the business activity. If the taxpayer fails to demonstrate that its declaration is true and correct, the tax authority may establish the taxable basis by estimate.

Taxpayers must submit their corporate income tax returns by 31 May of the year following the tax year in question provided that they did not opt for a financial year deviating from the calendar year.

Surtax

A special temporary surtax is levied at varying rates on financial and insurance service providers as well as on

energy, retail, and telecommunication companies until 2012, when this tax will automatically cease to exist. Foreign legal entities may also be subject to the surtax provided that they carry out their business activity in Hungarian through a branch office or a tax permanent establishment.

In case of financial and insurance service providers the determination of the tax base depends on the legal form of the operation. In case of banks the tax base is the asset value shown in the balance sheet of the company; in case of insurance companies the tax base is the adjusted insurance fee revenue; in case of investment companies and companies operating on the capital market, the adjusted net sales revenue; in case of other financial service providers the tax base shall be calculated based upon the interest and commission fee revenue. The applicable tax rates vary in the range of 0.028%-6.5%. Further special surtax rules apply to credit institutions.

In case of entrepreneurs engaged in the retail or telecommunication industry the basis of the surtax is the company's net sales revenue realized on their retail or telecommunication activity. The tax rate varies according to the type of industry and progressively increases depending on the amount of net sales revenue realized in the given year. Related parties shall determine their tax base on a consolidated basis which leads to the application of the higher progressive tax rate due to the higher consolidated tax base. Entrepreneurs operating partly or entirely in the energy industry shall pay tax on their overall net sales revenue at a flat tax rate of 1.05%.

If a company were subject to surtax after its different activities (e.g. it is engaged both in the retail and telecommunication industry) it should not pay surtax after each of its activities; i.e. the surtax should be paid solely after the activity that triggers the highest surtax burden. The surtax is payable annually.

Value-added tax (VAT)

VAT, the most significant indirect tax for the majority of companies, is based upon the framework of the EU directives. The standard VAT rate is 27% for goods and services. Reduced 18% rate applies to certain dairy and baked products, and certain items, such as goods and services related to medical treatment as well as books and newspapers are rated at 5%.

Imports are subject to VAT at the same rate that is applied to similar products of Hungarian origin. The basis of assessment is the sale value of the products and services. In the case of imported products the basis of assessment is the value for customs duty, increased by the amounts of customs duty and customs clearance charges.

The trade to and from EU Member States is considered as intra-community acquisition and supply. The relevant taxation rules are in line with the VAT Directive of the EU.

As a main rule, taxpayers should report VAT quarterly. If the net VAT liability reported for the second year preceding the tax year exceeds HUF 1 million, the taxpayer must file monthly reports. Those taxpayers whose total net VAT liability of the second year preceding the tax year did not exceed HUF 250,000 must report annually. Tax returns must be submitted by the 20th day of the month following the end of the tax period (except for annual reports which must be submitted by 15 February).

Excise tax

Excise taxes levied on certain goods such as hydrocarbon oil, alcoholic drinks and tobacco at rates between 28.4% and 52% or in fixed amounts. This single phase tax is levied on the manufacturer, importer or wholesaler; however, no tax is imposed on export sales.

Local Business Tax

All local governments are entitled to levy certain types of local taxes up to the ceiling set forth in the relevant regulations. Out of the local taxes the local business tax means significantly the biggest tax burden to the enterprises.

The basis of the local business tax is the net turnover of the enterprise decreased by certain eligible expenses (e.g. material costs). The tax rate is determined by the local government, which rate cannot, however, exceed 2%. Budapest, and most of the cities determined the local business tax in 2012 to be the maximum 2%, however, some municipalities do not apply any local business tax.

Local business tax is payable in two instalments, until the 15th day of March and September, respectively.

No local business tax is payable on interest (except for certain financial institutions and insurance companies) and royalty income.

Transfer tax

The transfer of Hungarian real estate or shares in companies holding Hungarian real estate is subject to transfer tax payable by the purchaser at a rate of 4% of the value of the property up to HUF 1 billion and 2% on the part of the value exceeding HUF 1 billion with a total tax liability capped at HUF 200 million per property.

The purchaser is obliged to pay transfer tax on the acquisition of a real estate holding company provided that

the registered main business activity of the purchased company is the development of or the trading in real estates, and the purchaser acquires, together with its related parties, more than 75% interest in the real estate holding company.

Intra-group transfer of real estate or a real estate holding company is not subject to transfer tax.

Employment Taxes

Individuals deriving employment income from Hungarian sources as well as Hungarian tax resident individuals having an employment income are subject to personal income tax on such income. The tax basis of the personal income tax on employment income is, up to HUF 2,424,000, and the gross income increased with 27% (so called "super-grossing") for the excess amount.

The personal income tax rate is a flat 16%. Due to the rules of "super-grossing", the effective personal income tax rate ranges between 16% and 20.32%. According to the proposed tax law from 2013 the super-grossing will be abolished, reducing the effective tax rate to 16%.

Certain forms of tax credits and tax allowances are available to decrease the personal income tax burden (e.g. family tax allowance, etc.).

With certain exemptions fringe benefits granted to employees are generally taxable as ordinary employment income.

Employers have a duty to deduct a personal income tax advance from the salaries paid to employees and to pay such deducted tax advances to the tax authority by the 12th day of the following month. In addition to personal income tax, salaries paid to employees are subject to various contributions and taxes. The most burdensome is considered to be the social security contribution and the social security tax.

Social security contribution is paid by the employee at a rate of 18.5% (including 10% pension contribution which is capped at an annual amount of HUF 7,942,200). Social security tax is paid by the employer at the rate of 27%.

These liabilities are deducted and paid to the tax office in a way identical to the payment of personal income taxes.

Accounting requirements

The Hungarian accounting rules are in line with the EU standards and International Accounting Standards. Double-entry bookkeeping is required for limited liability companies and for companies limited by shares. Depending on the balance sheet total, the yearly turnover of the company and the number of employees, the financial statements must be audited by independent auditors. Companies considered to be parent companies are also required to prepare and submit consolidated reports.

Investment Incentives

The Hungarian incentive system is fully compatible with the EU regulations. Direct and fiscal incentives may be claimed under the current regime. The sum of the investment incentives granted cannot exceed the aid intensity for the specified industry and the targeted region for the production site in Hungary. Aid intensity limits range from 10% (Budapest) to 50% (Eastern Hungary). The development tax allowance may be claimed after (i) investment projects over HUF 3 billion in any area of Hungary, (ii) investment projects over HUF 1 billion in certain depressed areas, (iii) investment projects of SMEs over HUF 500 million (iv) investment projects over HUF 100 million relating to certain activities, and (v) investment projects creating new jobs. If the combined present value of the investment value exceeds the HUF equivalent of EUR 100,000,000, the tax allowance is available pursuant to a decision of the government upon the request of the investor.

Due to the EU accession the former tax incentive regime had to be modified in order to be in line with the *acquis communautaire*. However, to ensure that Hungary remains one of the most competitive business locations for investments, various incentives may be obtained from the central and local governments in the framework of pre-approved aid and incentive programs. In addition, the central government provides individual aid and incentive programs for large scale investments.