Tax&Legal Highlights

Hungary

Facts and Myths of PIT and Social Security

The significance of 183 days in Hungarian work performance and taxation of non-resident individuals

One of the most frequent misconceptions concerning the Hungarian work performance of non-resident individuals is that it is not subject to personal income tax in Hungary if the stay in Hungary of the individual employed by the non-resident company does not exceed 183 days. Since any misinterpretation of the law may impose considerable tax risks, we must ask the question: Is the "183-day" factor the only circumstance to take into account?

First of all, let us see why the "183-day rule" could have taken hold of public opinion

Those who are not familiar with the taxation of work performed in several countries, may pose a number of questions in practice; one of these issues is the concept of tax residence. Tax residence is one of the most important factors that define taxation and, therefore, requires the analysis of a number of circumstances. Tax treaties typically tie the taxation of an individual's income to the country of residence. Establishing residence is a complex process. It is determined for instance by the permanent home (which is not identical to registered address) or the location of the centre of vital interests, which reflects the individual's ties with respect to the countries concerned. Since these questions themselves are interesting we will devote a separate chapter to the question of residence.

The 183-day stay is related to the above in that the Hungarian PIT Act mentions the 183 days in determining the tax residence in two of its provisions. For instance, EU citizens staying in Hungary longer than 183 days in any tax year qualify as Hungarian tax residents under the PIT Act. On the other hand, when other conditions do not apply, tax residence may also be defined by and individual's habitual adobe, which is also determined by the PIT Act using the 183 days of stay in Hungary.

Furthermore, in the case of cross-border work performance, it may be necessary to look at the provisions of the double tax treaties signed by the countries concerned in addition to the PIT Act in order to define the tax obligations arising. Of the provisions of the treaties discussing employment income there is also one section mentioning the 183-day stay for cases where the individual has no tax residence in the state where he/she performs work.

As you can see, the 183-day stay may appear frequently in cases where the issue is the personal income taxation of cross-border work performance. The only questions is whether it is really the 183-day stay that is the decisive factor determining where personal income tax is paid.

To answer this question, we have to look at the provisions of the treaties on the avoidance of double taxation.

Although the relevant provisions of the treaties in place may differ, they basically follow the OECD Model Tax Convention. In addition to establishing that the individual's income may remain taxable in the state of his/her tax residence in the case of a stay in Hungary for not longer than 183 days, the section of the Model Tax Convention which discusses the right to establish tax obligations in connection with employment income sets out further terms, of which the least known, however highly important question is the one of the economic employer.

The question of the economic employer in Hungarian terms means that it must be established whether the Hungarian host company is to be regarded, in economic terms, as the employer of the non-resident individual irrespective of the fact that the legal employer is the non-resident home company. If the answer to this question is 'Yes', the individual's employment income for his/her activity in Hungary will be taxable in Hungary even in the case of a stay not exceeding 183 days given that both of the above conditions must apply at the same time to avoid taxability in Hungary. For further information and help please refer to the relevant Communication of the Hungarian Tax Authority (Oct 31, 2012).

To illustrate the question, let us take a plant operating in Hungary receiving a German citizen production manager who fulfils a similar role at the German affiliate or parent company and, therefore, will perform work divided between the two countries. In this example, the employee's family remains is Germany and he/she will not stay in Hungary longer than 183 days in the calendar and tax year concerned. It is assumed that the employee will remain a tax resident of Germany under both the internal policies and the double tax treaty signed by both countries.

Although the stay not longer than 183 days is an important factor in this case, it does not automatically relieve the employee of the obligation to pay PIT in Hungary. These circumstances require further investigation.

It must be determined in the first place whether the employee's activity is organically integrated into the activities of the Hungarian company where the work is performed (so-called "integration test"). The employee's activity will be seen as one integrated into the organisation of the Hungarian company if it is the company that assumes responsibility for or the risks related to the employee's work performance.

If, using the aforementioned test, it cannot be precluded that the employee is integrated in the Hungarian Company's operations, it is recommended to observe the other circumstances indicated in the Communication of the Hungarian Tax Authority (8-point criteria). The points of the criteria should be observed and weighed collectively; no order of importance may be set up among them.

As the points of the criteria include numerous conditions which, in the case of facilities managers, may typically be satisfied in the case of a host company (e.g. the Hungarian company may be entitled to oversee and is obliged to take responsibility for the place of work or provide the employee with the necessary equipment, etc.), it cannot be precluded that the Hungarian host company may be regarded as the employer of the employee in an economic sense, and so the employment income attributable to work days may become taxable in Hungary.

Therefore, based on the above, we may conclude that the stay in Hungary excluding or not exceeding 183 days is an important but not, or not always sufficient condition for establishing whether a non-resident private individual has to pay personal income tax related to their work in Hungary or not.

Hungarian investments of third country investors will require ministerial approval in strategic sectors from next year

At its session on 2 October 2018, the Hungarian Parliament adopted Act LVII of 2018 on the Supervision of Third Country Investments Threatening Hungarian Security Interests, which, as of 1 January 2019, may require investors with a registered seat outside EU/EEA member states or Switzerland to obtain ministerial approval for investing in sectors that are supervised by the state for strategic-security reasons as specified in the law. In addition to the public utility sector (electricity, gas, and water management), the new law will affect the financial services, electronic communications and military engineering industries.

Act LVII of 2018 on the Supervision of Third Country Investments Threatening Hungarian Security Interests was promulgated on 11 October 2018. According to the new regulation, natural persons and legal entities qualifying as "third country investors" will have to obtain, in a newly developed administrative procedure, ministerial approval for investing in sectors concerned (where investment includes acquisition of shareholding, acquiring or operating assets, and taking up activity).

Third country investor under the definition of the law shall mean a citizen of a state outside the European Union, the European Economic Area and the Swiss Confederation, or any legal entity or other organisation registered under the laws of such states. EU/EEA or Switzerland based legal entities in which such third country investors have a majority control as defined in the Civil Code also qualify as third country investors.

The law applies to services belonging under the scope of the Electricity, Gas Supply, Water Management and Electronic Communications Laws, financial services and the operation of payment systems as defined in the law on Credit Institutions and Financial Enterprises, the development and operation of state and local governmental information systems, as well as certain military engineering activities. The above list, however, only gives an outline of the activities concerned by the new procedure. The Government will set forth the detailed, more specific list of all the activities concerned in a separate implementation decree.

"In the public utility sector, the new procedure will probably only apply to legal entities owning or operating, and activities related to, essential system elements and similar equipment, so the new regulation will likely not concern small power plant developments that are so popular nowadays, neither related transactions, nor the electricity and gas trade activity. A more exact definition, however, will be available only later, when the contents of the implementation decree are known" — Dr. Balázs Várszeghi, Partner Associate – Energy Law, Deloitte Legal

The reporting obligation applies to third country investors acquiring, directly or indirectly, over 25% of the shares of (over 10% in the case of publicly traded companies) or majority control under the Civil Code in a Hungarian based company operating in any of the sectors concerned, or if although the acquisition remains below 25%, the total of shares owned jointly by third country investors would exceed 25%. The reporting obligation also applies if a third country investor founds a branch establishment in Hungary for the performance of an activity concerned, or if a Hungarian based company majority owned by a third country investor wishes to start any of the activities concerned. Obtaining the right of using or operating infrastructure, facilities and equipment indispensable for pursuing the activities defined in the law and to be further specified by the Government is also subject to ministerial approval and is effective only once the minister has acknowledged the report.

In the report, the third country investor must present a record of its business operation and enclose all the documents that verify the ownership structure of the third country investor and its legal entity shareholders, as well as the ultimate beneficial owners. Based on the report, the minister establishes whether the acquisition of the shareholding or the right to operate threatens Hungary's security interests. The minister shall, within 60 (in particularly justified cases within 120) days at the latest from receipt of the report, endorse the acquisition of property or the right to operate by confirming it, or prohibit such act if it is concluded that Hungary's security interests would be threatened as a result of the transaction. It presents a significant restriction that if the third country investor wishes to acquire property indirectly through a legal entity registered in Hungary or an EU/EEA member state, the minister may only prohibit the proposed transaction if the legal entity wishing to obtain direct control and registered in Hungary or an EU/EEA member state does not pursue actual business activities in the state of registration. The acting minister's prohibition may be contested in an administrative lawsuit.

If the acquisition of shares or the pursuing of activity in the sectors defined in the law is subject to an authority license, such license may be granted only once the ministerial approval has been obtained.

In the case of transactions approved earlier, the third country investor is required to supply data to the minister on changes subject to the reporting obligation (e.g. changes to the ultimate beneficial owner).

In the absence of a confirmed ministerial approval of the report it is forbidden to enter the transaction in the share or shareholders' register and the third country investor may not claim its rights (e.g. will not be entitled to dividend) from the company concerned. The unenforceability of the contract aimed at the acquisition of the right to operate shall be established by court based on the minister's petition.

Failure to conduct the procedure found in a subsequent review will be sanctioned with a fine up to HUF 10 million, and if the minister's decisions would have been a prohibition if the procedure had been conducted, the third country investor will be required to sell the Hungarian shareholding concerned. The state has a right of first refusal during the sale.

The law will enter into force on 1 January 2019 and its provisions will apply to contracts consummated, branch establishments founded and activities taken up following that date.

"The adoption of the law is currently surrounded by considerable uncertainty. The complete list of activities concerned is yet unavailable, as are the rules of the minister's review from a "security" perspective. It is also unclear whether it is required to file a report in the case of transactions signed before but closed after the law enters into force. If such obligation applies, the parties concerned must be reminded thereof. For the security of pending or proposed transactions and in order to raise investors' awareness, the Government Decree regulating the implementation of the law in detail should be in place as soon as possible" — Dr. Balázs Várszeghi, Partner Associate – Energy Law, Deloitte Legal

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