Tax&Legal Highlights

Hungary

The RIC Act is to change again

The spring tax law package was tabled on 2 May 2017, which proposes the amendment of Act CII of 2011 on regulated investment companies ("RIC Act") to facilitate their further extension ("RIC Bill").

This RIC Bill would further amend the RIC Act that entered into force in July 2011 and was amended in summer 2016 to confirm the original legislative intention of stimulating the real estate and capital markets by establishing RICs. The amendments are meant to specify detailed rules and concepts of RICs, prepare for the enforcement of the law and clarify terms and definitions for consolidated financial statements and the adoption of IFRS.

The RIC Bill, among others, includes the following major changes:

- The calculation method of initial capital requirement for RICs is clarified for companies involved in consolidation; the provisions on the HUF 5 billion initial capital shall be clearly considered together with the capital items disclosed in the consolidated financial statements.

- The Bill would modify the concepts regarding mandatory dividend payment: the definition of disposable funds and expected dividend. According to the Bill, disposable funds do not include funds over which the RIC, the regulated investment pre-company and the project company have no right of disposition (e.g. caution money received by the RIC), as these funds are associated with an obligation of repayment. According to the Bill, the RIC, the regulated investment pre-company and the project company would be obliged to pay the expected dividend based on the profit realised during their status under the RIC Act (naturally allowing that dividend may be paid from the profit reserve accumulated in the period before the status under the RIC Act was obtained.)
- Free float restrictions have also changed. Pursuant to current regulations, RICs must have one series of shares representing 25% of the total capital where no shareholder owns more than 5% of the series (free float). According to the RIC Bill, the calculation method of the free float limit should be harmonised with the capital market regulations pertaining to voting rights and the reporting of ownership shares. Accordingly, the 5% small shareholders' limit is defined in proportion to the total nominal value of registered capital. The Bill stipulates new provisions for a case where all the RIC's shares are listed. In this case -- due to operation in a fully regulated market and commitment to transparency -- the free float limit and the 5% voting limit would become unnecessary, and the free float should only be certified when the RIC is registered.
- Provisions pertaining to the diversification of the real estate and asset portfolios as well as the calculation of the debt ratio are clarified. The main rules for reviewing the real estate portfolio of a RIC would be modified: rather than on an individual basis, in case of consolidation the real estate portfolio and the debt ratio would be assessed in a consolidated way for all companies involved. Also, the value of one real estate or other share in the RIC would be maximised 30% of the balance sheet total instead of the previous 20%.
- The RIC Bill would rationalise restrictions on the persons managing the RIC. Accordingly, due to the nature of the real estate sector, no university degree in finance, economy, or law would be required for an executive position, but any university level degree could be acceptable. The RIC Bill further extends executive capabilities by stating that rather than through 90% of the votes, exemption from the conflict of interest rule may be given based on the charter for executives holding offices at credit institutions, investment companies, investment fund managers, appraisers, venture capital fund managers, insurance companies, reinsurance companies and RICs where the RIC that had employed him before in management position holds no shares.
- The RIC Bill lays down several provisions for the adoption of IFRS, with special respect to the valuation methods and the impact of IFRS on the profit reserve. With a view to IFRS financial statements, the relevant tax laws are also specified.
- The restrictions on the share insurance companies and credit institutions may hold will also be specified. Previously it was not clear whether the indirect and direct participations of insurance companies and credit institutions were considered for the 10% ownership limit, but the Bill clarifies that the 10% direct RIC

ownership share is to be considered for the purpose of applying the ownership limit.

If adopted, the RIC Bill would enter into force after the day of promulgation.

The European Court of Justice contested the tax authority's sanctioning policy

In case no. C-564/15 (Farkas), the Court of Justice of the European Union (CJEU) adopted a judgement on 26 April, where the CJEU found the Hungarian tax authority's practice regarding reclassification from ordinary to reverse charge taxation controversial.

As part of an auction organised by the tax authorities, the claimant as a private individual purchased a mobile hangar from a company with an outstanding tax liability. The seller in question issued the invoice, which included the VAT relating to that transaction, and paid that tax to the Hungarian tax authority. The buyer deducted the output VAT recorded in that invoice.

The tax authority conducted a tax audit at the buyer before allocation. During the review the tax authority concluded that the seller charged undue VAT to the customer as the transaction is subject to the reverse charge system. The tax authority consequently found that the customer was liable for the tax difference equal to the VAT mount disclosed on the invoice, and imposed a 50% tax penalty.

By way of legal remedies the parties interpreted the legal ground for tax shortage differently. The Hungarian court requested the CJEU's position whether in the case the tax deduction right of the customer may be restricted and whether the tax difference and the tax penalty are proportionate to the improper tax treatment of the transaction.

Irrespective of the Hungarian court's inquiry, in its judgement the CJEU laid down as a fundamental principle that under the VAT Directive member states may only apply reverse taxation in compulsory sale procedures for immovable property sale transactions (without a special permit). Accordingly, the provisions of the Hungarian VAT Act that apply reverse taxation to both movable and immovable property supply go against the EU law.

With respect to the assessment of the tax authority, the CJEU concluded that the parties did not meet the criteria of reverse taxation in terms of content and form in the transaction; therefore the customer was not entitled to deduct the input VAT, but is entitled to reclaim the tax paid to the seller in a civil procedure. According to the CJEU, this settlement of improperly paid VAT is in harmony with EU law. However, if VAT may not be reclaimed from the seller due to insolvency, the customer is entitled to turn directly to the tax authority for reclaim.

Regarding the tax penalty, the CJEU found that it was not in proportion with the weight and nature of the breach as it was merely of an administrative nature without the Hungarian central budget losing any tax income, and there were no signs implying tax fraud either.

The questions that may arise in the wake of the judgement:

- can we expect any change in the tax authority's practice, and what kind of change, in cases where the tax treatment of the transaction is reclassified as reverse charge?
- can taxpayers penalised under similar conditions seek legal remedy retrospectively in the light of this judgement?
- is it necessary to consider in compulsory sale procedures whether the asset sold is movable or immovable, with special respect to the new rules effective from 2017 pertaining to services directly linked to immovable property, which introduce new elements and issues in the evaluation of the property?

Spring tax package

We would like to take this opportunity to inform you that on 2 May 2017 the spring tax package (the 'Bill') was brought before Parliament. The Bill contains modifications affecting the remainder of 2017 in addition to 2018. The vote for the acceptance of the Bill will take place between 13 and 16 June 2017.

Personal income tax and contributions

Income from real estate rental

One of the most important changes concerning individuals is that the 14 per cent health tax liability on income (exceeding HUF 1 million per year) deriving from real estate rental would be abolished as of 2018.

Housing subsidy to promote mobility

Several favourable amendments would be made to the provisions introduced in 2017 on housing subsidy to promote mobility, including:

- the amount of the subsidy would increase significantly as of 2018,
- the tax exemption would also be available to individuals with employment contracts concluded for a definite period.

Accounting Act

Accounting of modified tax authority audit findings

The Bill sets forth that as of 1 January 2018 if findings of a tax authority audit, which had previously been treated as material errors and, as a result, had to be presented in a separate column in the income statement and the balance sheet relating to the previous years, were subsequently modified by an authority or court through a final resolution before the balance sheet preparation date, then the modification must be recorded in the current year.

Release of deferred income from development grants

According to the Bill, as of 1 January 2018 the deferred income recognised in connection with development grants would have to be released when the repayable amount of the grant is recognised as an expenditure, rather than on the date on which the grant is repaid.

Valuation of assets acquired through derivative contracts

The Bill provides that as of 1 January 2018 assets (both financial and non-financial) acquired as part of derivatives with physical delivery would have to be revaluated at fair market value as of the date of acquisition regardless of prior classification even if the company did not apply the fair value assessment in its accounting policy. Such assets must continue to be revaluated against other income and expenses from financial transactions.

The Bill provides the option for the application of the above proposed changes in the rules also to the financial year started in 2017.

IFRS rules

The Bill refines certain details of the tax rules applicable to taxpayers operating under IFRS rules. Information about the modifications to the IFRS related rules will be provided in a subsequent newsletter.

Corporate income tax

Participation exemption

The 10% threshold for capital gains participation exemption would be abolished thus substantially extending the scope and applicability of Hungary's holding regime.

Controlled foreign company

The Bill would include clarifications related to the new CFC rules (that were introduced early 2017).

In particular the conditions related to shareholders of the CFC are considered to be fulfilled, if such shares are held for the majority of the taxpayer's tax year. When calculating a controlled foreign company's profit to be added to the tax base, the amount of profit to be taken into account must be proportional to the ownership share in the controlled foreign company or proportional to the percentage of the after-tax profit to which the taxpayer is entitled. The new rule may be applied by taxpayers at their own discretion for the year 2017.

Rental flats built for employees

The amount recorded as the historical cost of rental flats built for employees, or as an increase in such historical cost, may be deducted from the pre-tax profit in the tax year of the completion of the renovation / construction project. The Bill also lists the requirements for claiming the tax base allowance.

Construction of electric vehicle charging stations

When constructing charging stations for electric vehicles, the historical cost of the charging stations would be deductible from the corporate income tax base. The maximum amount of allowance that may be claimed is set forth in the Bill. The allowance can be claimed in the tax year in which construction is completed and is available for construction projects launched after 30 June 2017.

Tax credit for growth

If a taxpayer defers its tax liability, then it must pay interest at a rate equal to the prime rate of the Hungarian National Bank. The interest payment obligation applies to declarations made after 1 January 2017.

Local taxes

In line with the Bill, during the company registration/change registration procedure, data pertaining to the company that are sent by the court of registry to the state tax authority would be forwarded to the municipality of the company's registered office. Thus the company's reporting obligation in respect of the forwarded data toward the municipality would be fulfilled.

As of 1 January 2018, outdoor advertising signs would also be subject to building tax. Similarly to wind farms, solar farms would also qualify as permanent establishments for local business tax purposes.

As of 1 January 2018, IAS 18 Revenue and IAS 11 Construction Contracts would be replaced by IFRS 15 Revenue from Contracts with Customers, and IFRS 9 Financial Instruments would also become effective. For this reason, the rules related to the determination of sales revenue for taxpayers preparing IFRS financial statements must be aligned to these standards.

Duties

Under the currently effective regulations, twice the amount of the duty allowance available in the case of financial leases is payable if the financial lease contract is not effectuated within the prescribed timeframe. Based on the Bill, if the acquirer has passed away or the entity has been dissolved without succession duty penalty would not be applicable.

Based on the Bill, the category of duty-exempt acquisitions where the acquirer is not required to report the acquisition of property would be expanded to include preferential transformation and acquisition through a preferential exchange of shares, as well as the duty-exempt transformation of law firms.

In addition to the above, the Bill also clarifies the definition of a business organisation, making it clear that foreign persons also qualify as business organisations for the purposes of the Act on Duties. The Bill provides further amendments regarding the rules on the duty liabilities and exemptions of individuals in connection with the exchange of apartments.

Value added tax

According to the Bill, the VAT rate applicable to both edible fish and internet services would be reduced to 5%. The modified tax rates would be applicable as of 1 January 2018.

Furthermore, the Bill would amend the definition of internet access services. Network services would not qualify as internet access services, which means that the preferential VAT rate would not be applicable to such services.

According to the Bill, the provision that would reduce the minimum threshold for the submission of domestic sales and purchase lists to HUF 100 thousand would not enter into force on 1 July 2017. The introduction of the real time data provision regarding invoices issued by an invoicing software would also be delayed. A test period is required before the system goes live. Therefore, reporting would be on a voluntary basis for a transitional period of one year.

Special taxes concerning the financial sector

The Bill provides that the entities subject to the bank tax would be able to deduct the amount of support provided for preferential purposes (up to 50% of the special tax of financial institutions) from the amount of special tax payable.

The Bill lists the conditions for claiming such allowance, as well as the purposes which may qualify as preferential (e.g. supporting amateur sports organisations and work with youth teams). It is important to note that the provisions on claiming the allowance with respect to the special tax for financial institutions may be applied by the taxpayer in connection with the 2017 tax year at the taxpayer's discretion.

In addition to the above, credit institutions, which are members of voluntary institutional protection fund or a mandatory institutional protection organisation, as defined by the Act on Credit Institutions and Financial Enterprises, may reduce their special tax by the amount paid to such voluntary institutional protection funds or mandatory institutional protection organisations during the tax year, provided that certain criteria are fulfilled.

The scope of exemption from the financial transaction duty would be amended. The payment transactions on a client account or, in connection with investment services, on any other account would not give rise to any financial transaction duty liability if the payment service provider and the party providing investment services were members of the same mandatory institutional protection organisation.

Excise tax

According to the Bill, the scope of financial security would be expanded, as a result of which a certificate of coverage would also be acceptable as a form of security in the future.

For the purpose of ensuring harmonization with the relevant EU Directive, the Bill would clarify the scope of controlled energy products. Furthermore, the Bill stipulates that a tax liability arises even if other controlled mineral oils and monitored products are imported for own use.

Customs regulations

The amendment to the provisions of the Customs Act would clarify the definition of customs deficiency and would stipulate that the form for customs representation could be filed by electronic means only. In addition, the Bill provides that the customs authority may hand over risk information to entities possessing an AEO certificate which are subject to customs simplifications, provided that the handover of such information does not infringe upon the provisions on confidential customs information.

Regulated real estate investment companies

The main goal of the amendment to the Act on Regulated Real Estate Investment Companies is to facilitate the establishment and widespread operation of such entities, which could contribute to the expansion of the real estate market and, due to their presence on the stock exchange, the capital markets.

The Bill includes various amendments to the detailed rules related to the Hungarian REIT regime which is expected to become a well applicable option for publicly traded Hungarian property investments.

International cooperation on taxes and other public dues

The Act on the International Cooperation on Taxes and Other Public Dues has been amended. Multinational groups would be required to prepare country-by-country reports if the group's consolidated revenue exceeds EUR 750 million.

As a general rule, the country-by-country report must be prepared by the ultimate parent company of the multinational group and must be filed with the tax authority of the state of which it is a tax resident.

It is important to note that, if certain criteria are fulfilled, the reporting obligation may be passed on to the Hungarian tax resident member of the group. In addition to the reporting obligation, group members which are Hungarian tax residents must report to the Hungarian Tax and Customs Administration (the 'HTCA'), using a special form, if they are subject to the reporting obligation. If they are not subject to this obligation, then they must specify the group member required to provide information. The above notification obligations must be filed before the last day of the reporting financial year.

Failure to comply with the reporting and/or notification obligation or incorrect reporting or notification may result in a severe default penalty of up to HUF 20 million.

Amendments relating to the rules of taxation

The pre-requisite for an allowance is the lack of a net tax debt

As of 1 January 2018, taxpayer requests for a favourable divergence from the general rules in connection with the payment of tax liabilities (not including payment facilitation and tax reductions), may only be approved if the taxpayer does not have a net tax debt on the date the request is filed.

Reporting of foreign bank accounts

Companies must report all foreign bank accounts existing on 1 January 2018 (the name of the foreign financial institution managing the account and the date of opening and closing the account) in writing to the HTCA prior to 31 January 2018. This must be done by means of a special form. Failure to comply with this reporting obligation or late, incorrect, false or incomplete reporting carries a default penalty of up to HUF 600 thousand.

Reporting of office service providers

Entrepreneurs registered for the purpose of obtaining a tax number prior to 1 January 2017, as well as taxpayers required to register with the company registry, must report the details of their provider of corporate headquarters services to the HTCA prior to 29 September 2017 if they engage a provider of corporate headquarters services and their provider has not changed since 31 December 2016.

Email communication for foreign taxpayers

If a taxpayer who does not have a business registration, domicile or residence in Hungary is otherwise not required to communicate by electronic means, then it may opt for communication by electronic mail at his own discretion. In order to do so, the taxpayer must submit his electronic mail address to the HTCA along with a special declaration.

Introduction of tax deposits

As of 1 January 2018, the HTCA would require taxpayers to make a tax deposit after their tax number is issued if either the person authorised to represent the taxpayer or its member or shareholder possessing more than 50 per cent of the votes or qualified majority control is a former senior officer, member or shareholder of another taxpayer which was terminated without succession during the five years preceding the date of filing of the request for the issue of a tax number and had a net tax debt exceeding HUF 1 million (HUF 2 million in the case of the taxpayers with the highest tax performance), provided that the legal relationship existed on the 360th day preceding the date of liquidation or forced deregistration procedure or any other day thereafter.

Furthermore, the Bill also requires making a tax deposit for persons who join a functioning company and fulfil the above criteria.

The amount of the tax deposit is equal to the tax debt recorded by the HTCA and reduced by any overpayments. If there are several grounds for simultaneously requiring a tax deposit, then the amount of the tax deposit would be the value of the largest tax debt. A tax deposit can be made by transferring one lump sum payment to the HTCA's separate deposit account or by submitting a guarantee certificate issued to the HTCA as the beneficiary, which is valid for 12 months from the date of issue.

The HTCA may, without issuing a request to the taxpayer to pay his tax debt, pass a resolution on using the tax deposit in full or in part. Otherwise, the deposit is retained for 12 months after receipt, and the deposit or its remaining amount is returned to the taxpayer within 30 days after this period has passed.

The obligation to make a tax deposit also applies in cases where, after the final resolution on the deposit is issued, the reason for requiring a tax deposit no longer applies due to a change in the senior officer, member or shareholder. However, the person from whom the tax deposit is required may file a request for exemption. Additionally, the taxpayer has a right to appeal against the resolution requiring a tax deposit and the resolution on the use of such deposit.

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