Recent news relevant to branches

Tax Alert

With respect to the approaching deadline for filing the corporate income tax returns, this issue of our Newsletter focuses on the corporate income tax rules relevant for branches, as well as law changes effective as from 2010.

31 March 2010
Branches

Tax issues relating to Hungarian branches of non-resident companies

Characteristics of branches

As an organisational unit of a nonresident company, a branch office has no legal personality, but is vested with financial autonomy and must be registered in the Hungarian company register as an independent company form. Although considered an institution with a special legal status, in many respects a branch is similar to a Hungarian company.

A branch of a foreign company is subject to the same rules that apply to a domestic company (e.g. if an activity requires a permit, the branch must obtain a permit). A branch is subject to Hungarian corporate income tax and is obliged to perform double-entry bookkeeping and prepare annual financial statements under the Accounting Act. In practice, while a branch will often keep its books under the system of the head office (perhaps in accordance with the accounting regulations of the country where the head office is located), at year-end, the pretax profits and the tax base must be determined based on Hungarian statutory accounting, and the annual financial statements must be deposited and published in accordance with the general rule.

A Hungarian branch whose head office is located in an EU member state or in a country where the relevant laws are harmonized with EU regulations is exempt from the depositing and publishing requirements. Such branches are only required to publish and deposit the financial statements drawn up by the head office in accordance with the regulations of the country where the registered office is located. However, the branch must fulfill this obligation in Hungarian.

A branch must have sufficient resources to be able to perform its tasks, and the head office is obligated to provide all assets and funds needed for the branch's operations.

Special rules for corporate income tax treatment of branches

The tax base of a branch (similar to a domestic company) is the pretax profits disclosed in the income statement prepared in accordance with Hungarian accounting rules. This amount must be adjusted by items increasing or decreasing the pretax profits as per the Corporate Income Tax Act. Such modifying items include depreciation, impairment on receivables and the write-back of such impairment. For example, for purposes of calculating depreciation, the rates and rules prescribed in the schedules to the Corporate Income Tax Act must be observed. Branches are also entitled to carry over any negative tax base (deferred losses).

The foreign company and its domestic branch, as well as the domestic branches of the same foreign company qualify as associated parties for the purpose of settlements between each other; also all the associated parties of the head office are associated party to the domestic branch, too. Consequently, if the above parties apply a price different from the arm's length price in their controlled transactions, their tax bases must be adjusted by the difference. These transactions are also subject to a transfer pricing documentation obligation. It is a new development that as from 1 January 2010, the above provisions are not only applicable to a foreign company and its domestic branch but also to a Hungarian company and a foreign branch.

Consequently, transfer pricing documentation must be prepared for all controlled transactions of the branch office, and if the prices applied are not of arm's length rate, the tax base must be modified accordingly.

Various issues can arise in transactions between a branch and its head office. For example, branches tend to use the assets of its head office, and branch employees often are also employed by the head office, with the associated costs allocated to the branch by the head office. Transactions must be assessed and qualified for tax purposes based on legal title in each transaction between the branch and its head office.

Finally, according to a new rule that applies as from 1 January 2010, interest, royalties and service fees paid to residents in countries with which Hungary has not concluded a tax treaty are subject to a 30% withholding tax. This withholding tax also applies to such payments made by a branch.

Based on the above, it is clear that branch offices need to focus on corporate income tax and accounting issues to ensure that all uncertainties are identified and issues addressed.

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Should you have any questions, please contact one of our professionals. We would be pleased to assist you in dealing with tax issues relevant for branches and/or in the preparation of the corporate income tax return and transfer pricing documentation.

Contact

If you have any questions or comments concerning the above, please contact one of our tax experts below:

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