

## Deloitte Hungary conducts survey on transfer pricing review practices

### Tax Alert



The Hungarian tax authorities' transfer pricing review practice was the focus of Deloitte Hungary's transfer pricing conference on 11 March 2010. At the conference, we conducted a survey of our clients' experience with transfer pricing reviews. The number of respondents was high (80 percent out of more than 110 representatives from 80 companies) which shows that the topic is of key importance. The findings and most important messages of the survey are found below.

We would like to thank all participants for attending the seminar and contributing to these statistics.

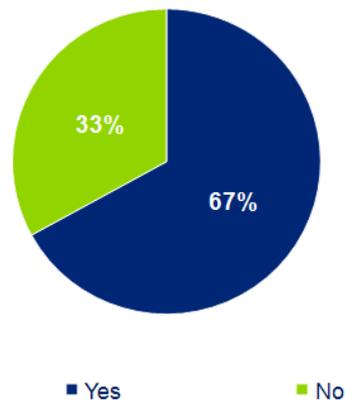
# Survey on transfer pricing review practices



## Transfer pricing reviews and findings

In our clients' experience, the number of cases in which the tax authorities' review was extended to include transfer prices or the inspectors conducted a targeted transfer pricing review has increased. As the graph below demonstrates, almost 70% of our respondents had been subject to transfer pricing reviews, either in the framework of a general tax audit or as a targeted review.

Has there ever been a transfer pricing review at the company?



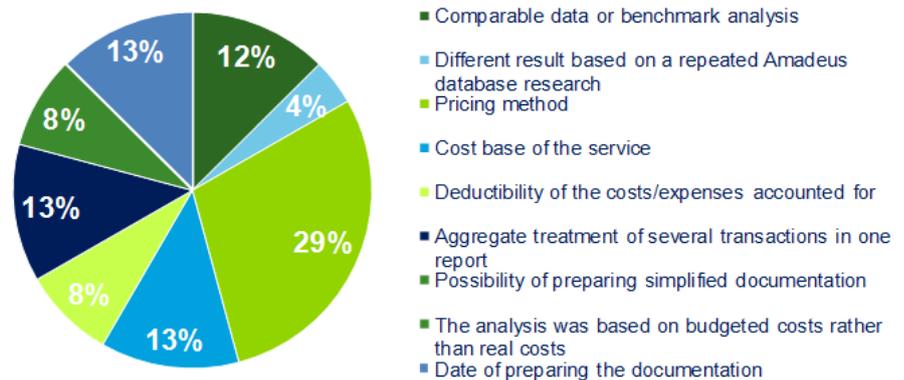
Our respondents confirmed that the tax authorities' transfer pricing expertise has significantly increased recently. The majority of participants agreed that tax inspectors were increasingly well prepared, and in some cases they had even consulted the tax authorities' central transfer pricing group.

While the tax authorities have previously focused almost exclusively on confirming that taxpayers had prepared and in fact maintained transfer pricing documentation, and on the formal elements of transfer pricing reports, the review of the contents of the documentation has also become a focus point recently. Based on the responses to the questionnaire, the percentage of tax audits involving actual review of content (27.27%) is getting close to the percentage of reviews focusing on the existence of the documentation (37.8%) and to reviews focusing merely on form (34.8%).

In those cases when the tax authorities engaged in a review of the content of the documentation, they most frequently contested the transfer pricing method applied by the taxpayers, as shown in the figure below.

In addition, tax inspectors tended to focus on issues regarding comparable data, benchmark analyses, the cost base, the aggregate treatment of transactions, and the documentation's preparation date. According to the answers to our questionnaire, the tax authorities reached a result different from the taxpayer's only in one instance, having performed the taxpayer's AMADEUS database research again.

### In case of the review of content, what did the tax authority focus on/contest?



### Sanctions

According to the representative of the tax authority present at the conference, the tax authorities imposed default penalties totaling a billion forint in 2008 and several hundred million forints in 2009.

According to the responses to the questionnaire, default penalties were imposed primarily because of the lack of documentation by the deadline, formal deficiencies in the documentation, and lack of documentation for individual transactions.

The tax authorities also may impose default penalties if companies fail to report associated parties -- and in our clients' experience, they do indeed exert this authority. The respondents to our questionnaire reported cases in which the tax authorities assessed a penalty based on the number of companies that had not been reported. If a company has a large number of associated parties, the penalty may reach millions; therefore, it is advisable not to forget about this reporting obligation. However, it seems that tax inspectors may refrain from imposing the fine if the associated parties are reported during the time of the review.

In addition to the default penalties, tax base modifications based on transfer pricing rules are also worth mentioning. Under the Hungarian regulations, transfer pricing adjustments must be applied irrespective of all other corporate income tax and solidarity tax base modifying items; thus, there may be cases in which the tax base is increased twice (for example, in cases of free of charge transactions such as assets provided without consideration, services rendered

without consideration, debts assumed by the taxpayer without consideration or other costs not incurred in the interest of the company).

The survey revealed that there had actually been reviews during which the tax inspectors modified the corporate income tax and solidarity tax bases of our clients twice: once under the title of transfer pricing adjustment, and again under a different title.

## APA

Despite the fact that advance pricing arrangements (APAs) made by the tax authority have been available in Hungary since 1 January 2007, the APEH representative at the conference said that the number of APA requests filed was very low. One reason may be that the APA procedure is not known to all taxpayers: 20% of our respondents were not familiar with the APA option, and only 8% were considering filing a request.

As the APEH expert at our seminar explained, the tax authorities' specialized group shows a constructive attitude toward APA requests, and they hope to receive more applications, either for complex cases or very simple transactions. The expert emphasized that APEH would also welcome requests in the latter cases, if a company would like to feel at peace and be sure that the tax authorities would not contest the pricing of a transactions in the course of a potential audit.

In the next issue of our transfer pricing newsletter, we will provide detailed guidance on the Hungarian APA program.

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