Development tax incentive - practical issues and recommendations

Tax Alert

The aim of our Newsletter is to draw attention to practical issues that arise in the context of the Hungarian development tax incentive, including circumstances that can affect eligibility for the allowance, frequently overlooked rules and to make recommendations on how to reduce administrative burdens associated with the incentive.

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Tax advisory

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Overview

Hungary offers a development tax allowance for companies investing in new facilities, expanding existing facilities or making a fundamental change in production or services. The incentive comes in the form of an exemption of 80% of the corporate tax payable for 10 years following the year the relevant project is completed. Several requirements must be met to qualify for the allowance, including an investment of at least HUF 3 billion or HUF 1 billion in a priority region, a certain number of employees or specific increases in wage costs, etc.

Economic crisis as *force majeure*?

If a taxpayer benefits from the development tax allowance, but it is subsequently discovered that the taxpayer did not qualify for the incentive, the amount of the benefit obtained generally must be repaid to the Hungarian government. An exception to this rule may apply if there are “unavoidable external reasons” for ineligibility. Circumstances that qualify as “unavoidable external reasons” are somewhat subjective, but arguing about the impact of an economic crisis typically does not fall into this category. However, in response to the protracted economic crisis, the Hungarian government has eased the requirements to qualify for the development tax incentive by allowing a company to take into account the average data for an extended period as the base data to consolidate its business and employee headcount that could be fluctuating as a result of to the economic crisis. However, to benefit from the relaxed conditions, the taxpayer must notify the Hungarian tax authorities of its intent to rely on the average data.

Environmental limit values

Production companies may be unaware that exceeding the environmental emissions stipulated by law can result in the forfeiture of the development tax allowance or an obligation to repay any allowance already received.

SME suppliers

Companies that applied for the development tax incentive before 1 January 2007 for an investment project that had a minimum present value of HUF 3 billion or a minimum present value of HUF 1 billion in under-developed municipalities can opt to comply with legal criteria that applied when the tax incentive claim was registered, rather than the requirements that apply during the years the tax incentive is applied. Therefore, it is possible for companies that applied for the development tax allowance before 1 January 2007 to remain eligible for the allowance to the extent a portion of their liabilities are payable to small- and medium-sized enterprises (SMEs). Companies applying for the development tax allowance after 1 January 2007 cannot opt for compliance with this criterion.

Postponed completion of project

A delay in the completion of an investment project that benefits from the development tax allowance will not necessarily result in the forfeiture of the allowance. With respect to registration of the tax allowance, any delay will not necessarily affect eligibility, but the taxpayer must be aware that the development tax allowance cannot be applied after the 14th tax year from the year the claim is registered.

Tax audits

Companies applying for (or registering) a tax allowance are subject to an ongoing recording obligation relating to eligible costs of the project and the amount of the allowance. The Hungarian tax authority is required to audit such companies at least one time during the years the allowance is applied (at the latest by the end of the third tax year following the year the development tax allowance was first applied). In practice, however, these companies should expect more than one tax audit during this period.

Eligible costs, gross grant equivalent

Difference in eligible costs

Companies that apply for (or register) the development tax allowance and a cash grant in respect of the same project may find that the eligible costs for the two types of benefits could differ because different legal provisions apply. This difference can complicate the calculation of the total available aid amount and, in particular, the amount of the tax allowance.

Supplementing eligible costs

If tangible or intangible assets that are taken into account in the calculation of eligible costs are taken out of use without replacing them during the mandatory operation period, the historical cost of the assets will reduce the eligible costs that are the basis for the development tax allowance. The tax allowance is available only if the taxpayer has the minimum eligible liabilities stipulated by law and the investment project is retained for three or five years after the date it was commissioned in the case of SMEs or large companies, respectively.

Calculation of gross grant equivalent

Companies that apply for (or register) a tax allowance and a cash grant for the same project must calculate the gross grant equivalent for the two types of benefits differently, with the result that the proportion of total eligible expenditure might differ from the initial calculation and therefore could affect the actual amount of the development tax allowance. Complying with this rule can lessen the administrative burden and may mean that the company does not have to repay any allowance that was applied unlawfully.

Calculation of present value

The calculation of the present value of the allowance claimed for the tax year is very important. As this is a recurring obligation, taxpayers should be aware that the reference rate used for discounting changes frequently, sometimes even during the year. An incorrect calculation can result in the company registering a lower tax allowance than is actually available.

Contact

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

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