Proposed 2011 tax laws before Parliament

Tax Alert

This newsletter is designed to inform our clients of a bill presented to Parliament on 15 and 16 October 2010 that would amending the accounting and tax rules and introduce special taxes on specific sectors. The proposed changes affect the main taxes and temporarily impose an additional income tax burden on companies engaged in trade, telecommunications and the supply of energy.

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Proposed 2011 tax laws before Parliament

On 15 and 16 October 2010, the Hungarian government presented to the Parliament bills that would amend the tax and social contribution acts, the accounting act and relevant regulations. Separately, in an effort to balance the budget, the Parliament passed a special temporary tax on the telecommunications, energy and retail sectors (anti-crisis tax) on 18 October 2010.

The proposed changes to the personal income tax include the introduction of a flat rate tax regime with respect to all income (both consolidated and separately taxable), the phasing out of the consolidated tax base supplement, a transformation of the system of family allowances to reduce tax burdens on families and simplification of tax administration. On the corporate side, a general 10% corporate income tax rate would be phased in by 2013 and the 30% withholding tax on interest, royalties and service fees would be abolished. The bill also proposes the creation of a National Tax and Customs Office by merging various tax agencies.

Unless otherwise noted, the proposals would apply as from 1 January 2011.

Personal income tax

General

- The two-rate (progressive) tax table applied to the comprehensive tax base would be abolished and replaced with a uniform 16% personal income tax rate applicable to income in the comprehensive tax base (e.g. employment income) and separately taxable income (e.g. dividends, exchange rate gains, interest income, income from the transfer of property).

- The 27% social security payment added to gross income to form the consolidated tax base (introduced as from 2010) would remain in effect in 2011, but the rate of the tax base addition would be reduced to 13.5% in 2012 and abolished as from 1 January 2013.

- In addition to the introduction of a flat rate personal income tax, the bill would abolish the concept of non-taxable emoluments. Certain types of income that currently are classified as non-taxable emoluments (e.g. pensions, the housing allowance provided by an employer without an obligation of repayment) would be considered tax-exempt income.

- The bill would repeal the system of fair market value for activities and typical wages introduced for 2010, along with the rules on compensation supplements for personal involvement and work (with the effect that these provisions would not apply for 2010 either). The definitions of business entertainment and gifts would be modified.

- The bill would repeal certain rules on separately taxable income, e.g. tax liabilities on interest, royalties and service fees paid to nonresident individuals in the absence of a tax treaty, as well as separate taxation rules on the letting out of property.

- Taxes paid abroad generally would be deductible.

Family allowance and tax credit

- Families with one or two children would be entitled to a tax base decrease of a HUF 62,500 per child monthly and HUF 206,250 for families with three or more children. The tax base to be reduced is always the amount increased with the tax base supplement. The bill would extend applicability of the family allowance to individuals eligible for the child care benefit under the laws of any EEA member state.

- The general employee tax credit rules would be amended by reducing the monthly amount of tax credits to a maximum of HUF 12,100, which would apply to annual income of HUF 2,750,000 and gradually be reduced on annual income of up to HUF 3,960,000. Thus, individuals with a maximum salary of HUF 180,000 per month would be entitled to the full tax credit, but the credit would not be available for individuals earning more than HUF 260,000 per month.

- The reimbursement option associated with amounts paid by an individual to a voluntary mutual fund or pension savings account would be reduced from 30% to 20%.

Benefits in kind

- The bill would significantly modify the rules applying to benefits in kind by restricting the range of benefits that may be provided subject to tax payable by the provider and abolishing the term “benefits in kind.”

- Under the main rule, benefits in kind are taxable as part of the consolidated tax base with the related personal income tax liability payable by the individual and the contribution and percentage-based health care contribution liability payable by the individual and/or the employer. The bill provides for specific regulations applying to the possible forms and criteria of benefits incurring tax liability payable by the employer.

- If the value of benefits provided to an employee cannot be determined, the employer is required to pay tax on the benefits (currently a 54% personal income tax and a 27% social security contribution on the value of the benefits, increased by the personal income tax (and in some cases the training contribution) or a 27% health care contribution on the value of the benefit). Under the bill, the employer would pay a 16% personal income tax and a 27% health care contribution where the basis of the benefit is its value multiplied by 1.19 (i.e. the tax rates are 19.04% and 32.13%). Affected benefits would include: business entertainment provided by an entity not subject to the Corporate Income Tax Act, benefits provided at various events (if they do not qualify as business entertainment), group insurance premiums and phone use for personal purposes.

- Most benefits in kind that currently are subject to favourable tax rates (e.g. holiday vouchers, meals, local travel passes) would qualify as non-wage benefits, with the preferential rates retained. According to the bill, such benefits could be provided subject to a 19.04% personal income tax liability payable by the provider (a 16% personal income tax on a base that comprises the value of the benefit multiplied by 1.19), without any contribution or percentage-based health care contribution implications.

- Tax-exempt internet use would be added to the group of non-wage benefits taxable at a preferential rate up to HUF 5,000, and a recreation card would be introduced to purchase services specified in a government decree up to HUF 300,000 annually.

Tax statement

The bill would introduce a new tax filing option in addition to the employer's tax assessment, self-assessment and filing with the assistance of the tax authorities: the concept of a "tax statement." If an individual earns income that is part of the comprehensive tax base from a single employer, and the payer has deducted tax in accordance with the effective regulations (i.e. the difference between the deducted amount and the actual tax liability does not exceed HUF 1000), the individual could opt to file a paper-based or an electronic tax statement. The bill also provides additional criteria (e.g. the individual does not apply itemised cost accounting, the family allowance is not to be shared, etc.) and situations where a tax statement could be submitted.

Transitional measures

The bill would modify certain transitional measures stipulated in the Personal Income Tax Act. For example, the bill would restrict the transitional application of tax allowances that have been abolished and would abolish the interest tax exemption on income earned from certain deposit and insurance products.

Social security contributions

General

- In line with the amended Personal Income Tax Act, the definition of income constituting the contribution base would be changed, and the contribution payment rules applying to specific activity-related income would be abolished.

- The bill would introduce a ceiling for social security contributions payable by the employer that would be promulgated in the Act on the State Budget of the Republic of Hungary. The cap on individual pension contribution payments would be retained.

- The definition of employer would change, but the contribution liabilities on income constituting the contribution base and received from a nonresident entity with respect to an insurance relationship with the employer would be abolished.

- In the period between 1 November 2010 and 31 December 2011, private pension fund members would pay a 9.5% private pension fund contribution to the state pension fund with the membership fee being 0% for this period.

Secondment

- The bill sets out the principles for extending mandatory social security (for employment outside Hungary) in accordance with the rules of Regulation No. 883/2004/EC of the European Parliament and of the Council on the Coordination of Social Security Systems.

- The bill contains procedural rules relating to the contribution payment, reporting and filing obligations of employees working in Hungary for foreign employers that are not required to register in Hungary.

- Under the proposed amendment of the Social Security Contribution Act, citizens of third countries who are employed in Hungary by a foreign employer on a secondment, assignment or workforce hiring and who qualify as foreign individuals would not be subject to social charges if work in Hungary does not exceed two years.

- The bill would clarify the contribution payment obligation for cases where the employee is seconded to Hungary based on an agreement between the employers and where the salary and related social taxes are paid by the employer using the employee.

Corporate income tax

Rates

As from 1 January 2013, the bill would generally reduce the corporate income tax rate to 10% from the currently applicable 19% and the favourable 10% rate applicable up to the tax base not exceeding HUF 500 million.

The bill would abolish the concept of nonresident entities subject to corporate income tax (introduced in 2010) and the 30% withholding tax on interest, royalties and service fees paid to such nonresident entities.

Controlled foreign companies

The tax rate criterion for controlled foreign companies (CFCs), which has become unfavourable to nonresident companies compared to resident companies, would be reduced to 10% from two-thirds of the current general tax rate (12.67%). As a result, nonresident companies subject to a 10% effective tax rate would no longer qualify as CFCs.

In-kind contribution of notified shares

A deduction from pretax profits would be available not only for capital gains derived from the alienation of notified shares, but also for gains recognised on the retirement of notified shares as in-kind contributions.

Transfer pricing methods

Along with the three transfer pricing methods, the traditional (comparable uncontrolled price method, resale price method and cost plus method), the bill would designate two further methods in line with the latest amendments to the OECD Guidelines. Accordingly, the transactional net margin and the profit split methods also would be generally applicable in related party transactions.

Value added tax

The proposed change to the VAT rules primarily aim to approximate Hungarian law with EU law. Provisions would be introduced to reduce VAT fraud (e.g. harmonisation of inspection criteria for tax-exempt imports, extending the reverse charge mechanism to CO2 quota sales) and a new form of collective taxation ("independent group") would be introduced.

Periodic settlement

Periodically settled transactions would no longer include those where the parties agree on payment by instalments, while transactions based on annuity payment (structured or equal payments made regularly, e.g. every month or every week) are specifically mentioned.

Invoicing and accounting systems would need to be adapted to address the following modifications:

- The date of delivery would be the last day of the period, while tax liability would arise at the due date of payment;

- The tax liability would arise on the 30th day following the last day of the settlement/annuity period if payment deadline is later.

As a result of these changes, systems would need to be able to handle up to four different dates: date of delivery, invoice date, payment date and date of tax liability.

The 30-day rule would not apply to services received from abroad, taxable according to the customer's place of business where the place of delivery is according to the general rule and the VAT amount payable is to be assessed on the last day of the settlement/annuity period.

This change would eliminate any difference caused where an EU-resident provider and the domestic customer of the service subject to periodic settlement listed the service fee in the European Sales Listings for different periods. This would need to be disclosed in the tax return and the European Sales Listing based on the last day of the period.

However, domestic tax liabilities also would need to be disclosed in the tax return as VAT payable based on the payment deadline but not later than the 30th day following the last day of the period and as deductible by the customer regardless of the fact that the delivery date on the invoice is the last day of the period.

According to transitional provisions, the new rules would first apply in cases where the settlement/annuity period starts in 2011.

Cultural, educational, scientific, entertainment, sports and similar services

According to the bill, the place of delivery for cultural, educational, scientific, entertainment, sports and similar services would be the customer's place of business, which means that if the service is provided to a nonresident taxpayer, it would not be subject to Hungarian VAT under the general rule. This amendment would eliminate Hungary's competitive disadvantage because of the high VAT rate applying to conference organisation, exhibitions and fairs, and film-making. The place of delivery would not change for services ensuring entry to the above events, i.e. the place of delivery would continue to be the venue of the event. Similarly, the event venue would remain the place of delivery if the customer or participant of the above services is not a taxable person.

Subsequent reduction of tax base

The range of cases where a subsequent reduction of the tax base does not require a self-revision of the original VAT return would be extended to a transfer of the right of temporary use of valuable rights if a transaction subsequently fails to take place. In addition to the ability to make a tax base reduction without a self-revision in the case of a closed-end lease, hire-purchase or lease as a result of recession, in the future, the fault of either party or unavoidable external reasons could constitute grounds for a subsequent modification of the tax base without a self-revision. The above option only would be available in the designated cases.

To lessen administrative burdens, the VAT base also could be reduced subsequently without self-revision in the case of tax-exempt transactions (e.g. EU VAT-exempt or export sales).

Independent group of persons

The bill provides for the establishment of an “independent group,” Which would provide for collective taxability without the members losing their individual taxability. An independent group would be able to be formed by VAT taxable and nontaxable persons and could include nonresident members. A member of an independent group would be permitted to provide certain VAT-exempt services to the members of the group if the consideration for the services did not exceed the amount of costs incurred by the group. In European practice, such groups are often formed in the financial sector as part of cost sharing agreements.

Independent groups (which may be civil associations founded under the Civil Code and holding a tax authority permit, or any other taxpayer) may be formed if the members join together to achieve common goals and the group has at least two members. In addition to taxable persons, other non-taxable persons (e.g. members of civil associations) or a shareholder of the group may be members.

An independent group could provide services directly related to the joined aim of the group to a member (if the relevant member is not a taxable person or, if taxable, does not act in that capacity when ordering the service) exempt from VAT provided the group only requires a reimbursement of costs and the amount does not exceed the contribution provided by the members. The same rule would apply if the group provides services to a taxable member that used the services for a tax-exempt provision of services or supply of goods and would not be entitled to full tax deduction due to the exemption.

It should be noted that the VAT group and the independent group regime could not be applied simultaneously because a member of a VAT group could not be a member of an independent group of persons.

Special rules for energy industry

Changes to the sale of natural gas as from 2011 would provide that a gas supply through a gas network located in the EU or any other network connected to such network would qualify as delivered in the country where the customer has its place of business. The same rules would apply to heat and cooling supplies.

The concept of a tax-exempt energy import would be extended to include gas imports supplied to a natural gas network or to an upstream pipeline network from a gas tanker and the import of heat or cooling energy through the network.

The transfer of a negotiable valuable right for greenhouse gas emissions would be subject to the reverse charge mechanism.

Other modifications

The bill clarifies that the sale of tangible assets by a taxable person under an insolvency procedure (e.g. liquidation) would be subject to the reverse charge without a value limit. For the sale of the taxpayer's other assets, a value limit of HUF 100,000 per purchase in the market at the time of the sale, rather than the purchase price, would have to be taken into account.

Used batteries are subject to reverse charge procedure.

The bill stipulates that the VAT base on a transfer of products free of charge would not be the original purchase price of the product but the purchase price at the time of the transfer, which could be the purchase price associated with the product's condition at the time of the transfer (practically the fair market price).

Due to the difficulties of introducing the new refund system, taxpayers registered abroad - in accordance with the European legislation - may exceptionally submit their claims for refund from 2009 by 31 March 2011.

Local business tax

Primarily to mitigate administrative burdens, the range of activities currently qualifying as temporary business activities would be restricted (e.g. the concepts of retail trade activity at fairs and markets would be abolished). For companies in the construction industry or those engaged in the exploration or research of natural energy resources, the bill would set the first date of registration for pursuing a temporary business activity the 60th day instead of the currently effective 30th day. An entity whose operation is likely to last more than 180 days would have an option to register as a permanent establishment (PE) and meet its tax obligations according to the rules applying to permanent business activities. An entity deciding not to register as a PE but whose operations last for more than 180 days would be allowed to deduct the amount paid as local business tax on the temporary activity from the tax payable subsequently on the permanent business activity.

For companies in the construction industry, the bill would add a further method to the provisions concerning the split of the tax base and for this purpose would provide a separate definition on the group of these companies. The bill would also amend previous methods applying to the split of the tax base for all kinds of entities in order to guarantee a minimum tax base to the municipality where the entity has its registered office.

Special tax on financial institutions

The bill would introduce the rules of special tax on financial institutions for 2011. Financial institutions would be required to assess the special tax payment liability for 2011, similarly to the rules for 2010, based on financial statements for the 2009 business year. The tax would be assessed and the tax return should be filed by 10 March 2011, while the tax liability should be paid in four equal amounts by the 10th of the last month of each quarter (i.e. 10 March, 10 June, 10 September and 10 December 2011.)

The bill includes supplementary provisions on the tax liability of financial institutions established without a legal predecessor, using a business year different from the calendar year or that were being liquidated in 2010.

Sector-related special tax

In order to improve the balance of the budget, the Government will introduce a special tax for certain sectors of the industry ("anti-crisis tax"). The act on the "anti-crisis" tax was passed on 18 October 2010.

Subject to this special tax are legal entities, other organisations, as well as sole proprietors which pursue store retail or telecommunications activities, or which are energy suppliers under the Act on the "Robin Hood tax". Tax base is the total net revenue recognised for the tax subject in the fiscal year concerned.

For entities carrying out store retail activities, the tax rate is 0% if the tax base is lower than HUF 500 million; 0.1% on the part of the tax base exceeding HUF 500 million; 0.4% on the part of the tax base over HUF 30 billion and 2.5% on the part over HUF 100 billion.

For entities pursuing telecommunications activities, the rate is 0% on the part of the tax base below HUF 100 million, 2.5% on the part exceeding HUF 100 million but below HUF 500 million; 4.5% on the part over HUF 500 million but below HUF 5 billion, and 6.5% on the part exceeding HUF 5 billion.

The tax rate for energy suppliers is 1.05%.

If the tax subject carries out both store retail and energy supplier activity, or both telecommunications and energy supplier activity the tax is payable on only one of the activities, the one which results in a higher tax payment liability. Please note that in order to prevent tax avoidance the net revenues derived by related entities from store retail and from telecommunications activities will be taken into account in aggregate when establishing the special tax payment liability.

Payment liability under the act will arise already in 2010 and it will lose effect in 2013. Tax base for 2010 is the net revenue earned by the taxpayer through the above-mentioned activities during 2010. Taxpayers are required to assess, return, and pay tax advance for the 2010 fiscal year calculating with the expected net revenue figure until 20 December 2010.

Energy tax

Pursuant to the amendment o Act LXXXVIII of 2003 on the Taxation of Energy Products, it is not necessary to obtain an invoice or a customs authority resolution on the levy of the tax for the purpose of enforcing the right for reclaim (right of deduction) in the case of self-assessment.

„Robin Hood tax"

The bill kept in force the provisions of Act LXVII of 2008 on Enhancing the Competitiveness of District Heating, i.e. the special income tax for energy suppliers would remain in effect following 1 January 2011.

Accounting Act

Perhaps the most important amendment to the Accounting Act would require that companies subject to the Act should, in their financial statements prepared for the financial year starting in 2011, carry out a revaluation to the HUF value of their foreign exchange (FX)-denominated assets, receivables and liabilities and recognise any unrealised exchange rate differences at the balance sheet date irrespective of their internal accounting policies. Contrary to current rules, this obligation would apply even where the effect of the recognised difference on assets, liabilities and profits would qualify as immaterial under the company's internal accounting policies.

For FX-denominated shares, participations and debentures, the bill would repeal the provisions relating to the elimination of the effects of exchange rate fluctuations on capital gains. (Current rules require that upon the retirement of securities the part of the exchange rate difference attributable to FX rate fluctuations must be disclosed as a separate item.)

The bill extends the definition of irrecoverable receivables to include warrant for payment processes which incur or increase losses eventually.

A company's obligation to raise funds for tax liabilities arising directly from company transformation (i.e. for tax obligations arising from the overvaluation of assets) within tied-up reserves if no funds are otherwise available would be repealed.

Companies would be able to opt to apply the amendments when preparing their financial statements for the financial year starting in 2010.

National Tax and Customs Office

The bill would merge the Tax and Financial Control Administration and the Customs and Excise Office into a newly established agency, the National Tax and Customs Office. The tax department of this combined office would be the tax authority and the customs department would function as the customs authority. As an added role, the new agency would have the power to investigate cases.

Taxation rules

The bill includes several amendments to the Act on the Rules of Taxation, although in most cases the proposed changes merely clarify existing rules or add interpretative or approximating provisions.

Tax statement

The bill introduces the “tax statement” as a new form of tax return for individuals and, in this context, amends related procedural rules of the Act on the Rules of Taxation.

Accordingly, if an employer does not undertake to assess an employee's tax liability, it would be required to make the individual aware of the option to file either the tax statement or the simplified tax return. If the individual opts to file the tax statement, the employer would have to provide the appropriate form to the employee.

The tax statement (in paper form or electronically) would need to be filed by 20 May of the year following the tax year. The tax statement would include only personal information, the total of all taxable income for the tax year, the amount of the personal income tax obligation and advances deducted previously.

If an individual files more than one statement or other return, only the first statement or return would be regarded as the individual's tax return.

Self-revision

The bill clarifies that a self-revision of a tax return would qualify as a self-correction only if it is submitted (posted) to the tax authorities before a tax inspection commences, i.e. on the day preceding the day the notice of the inspection is received or the engagement letter is handed over. This measure aims to limit abuse of the self-revision rules.

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