2011 tax law changes enacted

Tax Alert

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Tax advisory

Parliament enacts tax law changes for 2011

The Hungarian Parliament adopted the proposed tax law changes for 2011 on 16 November 2010, with certain modifications.

Changes to the tax rules on companies include a reduction of the corporate income tax rate, abolition of the 30% withholding tax on interest, royalties and service fees paid to nonresidents located in a non-treaty country and the inclusion of a new methodology for transfer pricing purposes. Individual income taxpayers will benefit from the introduction of a flat rate tax regime with respect to both consolidated and separately taxable income, major changes to the family allowance system to reduce the tax burden on families and simplification of tax administration. Changes are made to the VAT law to conform to EU rules. A new National Tax and Customs Office is created by merging various tax agencies.

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 anti-crisis tax, applicable from 2010 to 2013, will apply to legal entities and other organisations, as well as private enterplenuers that carry out retail or telecommunications activities, or that qualify as "energy suppliers". The tax base is the total net revenue in the given fiscal year. For entities carrying out retail activities, the tax rate is 0% if the tax base is HUF 500 million or less; 0.1% on the part of the tax base exceeding HUF 500 million but less than HUF 30 billion; 0.4% on the part of the tax base exceeding HUF 30 billion but less than HUF 100 billion; and 2.5% on the part exceeding HUF 100 billion.

For entities pursuing telecommunications activities, the rate is 0% on the part of the tax base that is HUF 100 million or less; 2.5% on the part exceeding HUF 100 million but less than HUF 500 million; 4.5% on the part exceeding HUF 500 million but less than HUF 5 billion; and 6.5% on the part exceeding HUF 5 billion. The tax rate for energy suppliers is 1.05%. A taxpayer that carries out more than one taxable activity will have to pay the tax only on the activity that results in the highest tax liability. Anti-avoidance rules (aggregate approach) will apply in establishing the special tax liability of group entities.

Corporate income tax

Tax rates

To make Hungarian companies more competitive internationally, effective 1 January 2013, the corporate income tax rate will be reduced to 10%. The general rate is currently 19%, with a favourable 10% rate applying to the part of the tax base up to HUF 500 million.

As from 1 January 2011, the 30% withholding tax levied on interest, royalties and service fees paid to nonresident entities located in non-tax treaty countries will be abolished, as well as the provisions (introduced in 2010) that determine nonresident entities that are subject to corporate income tax.

Interest exemption rule

The corporate income tax exemption for 75% of interest income earned from abroad will be repealed as from 1 January 2011. Such interest may be exempt under the general rules provided an exemption is granted under an applicable tax treaty.

Deductions

A deduction from pretax profits will be available for capital gains on shares reported to the Tax Authority (notified shares), as well as for gains recognised on the retirement of notified shares as in-kind contributions.

A taxpayer may decrease its tax base by 50% of the value of donations, benefits, services and assets transferred free of charge to the Hungarian Relief Fund ("Magyar Kármentő Alap"), provided the taxpayer has obtained the appropriate certificate required by law. This tax base allowance is applicable to donations made in the tax year that commenced in 2010.

Controlled foreign companies

The tax rate criterion based on which companies are deemed to be controlled foreign companies (CFCs), which – according to the favourable domestic tax rate of 10% – discriminates against nonresident companies as compared to resident companies, will be reduced to 10% from the existing two-thirds of the current general tax rate (i.e. 19% x 2/3 =12.67%). As a result, nonresident companies subject to an effective tax rate of 10% or more in their country of residence will no longer qualify as CFCs. This rule applies as from 1 January 2011.

Top-up liability

A taxpayer will be subject to a year-end tax advance supplement liability if its revenue in the year preceding the tax year exceeded HUF 100 million (currently HUF 50 million). This provision will apply to tax advance supplements due after 16 December 2010 (regardless of whether the taxpayer's business year end corresponds with the calendar year).

Transfer pricing methods

Along with the three traditional transfer pricing methods (comparable uncontrolled price method, resale price method, and cost plus method) the amendment designates two further methods in line with the latest amendments to the OECD Transfer Pricing Guidelines. Accordingly, from 2011, the use of the transactional net margin and profit split methods will generally be available for calculating an arm's length price in related party transactions in addition to the previous traditional methods.

Personal income tax

General

- Unless otherwise noted, the amendments to the personal income tax become effective on 1 January 2011.

- The two-rate (progressive) tax table applied to the comprehensive tax base is abolished. The uniform 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) will be a flat 16%.

- The provisions relating to the 27% tax base addition as part of the consolidated tax base (introduced in 2010) will remain in effect in 2011. However, the rate of the tax base addition will be reduced to 13.5% in 2012 and abolished as from 1 January 2013.

- In addition to the introduction of a flat personal income tax, the concept of non-taxable emoluments is abolished. Certain types of income classified as non-taxable emoluments will be classified as tax-exempt (e.g. pensions and the housing allowance provided by the employer without an obligation of repayment).

- The concept of fair market value will change: the fair market value system used for activities and typical wages, along with the rules on compensation supplements for personal involvement and work, are abolished and the definition of business entertainment and gifts is modified.

- The following rules on separately taxable income are repealed: the imposition of tax on interest, royalties and service fees paid to nonresident individuals in the absence of a tax treaty and the separate taxation rules on the renting out of property.

- Taxes paid abroad will become generally deductible.

Family allowance, tax credit and instructions regarding tax

- Families with one or two children will be entitled to a monthly tax allowance of HUF 62,500 per child. Families with three or more children will be granted a monthly tax allowance of HUF 206,250 per child. The tax allowance would be deductible from the tax base, including the tax base addition. The tax allowance also will apply to individuals eligible for child care benefits under the laws of any EEA member state.

- The tax credit rules are amended by reducing the maximum monthly amount of the tax credit to HUF 12,100. The maximum credit will be available until annual tax base reaches HUF 2,750,000, at which point it will be gradually reduced until it is eliminated at the point where annual income reaches HUF 3,960,000. Thus, individuals with a maximum monthly salary of HUF 180,000 will be entitled to the full tax credit, but the credit will not be available for individuals earning more than HUF 330,000 a month.

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

Non-pecuniary benefits

- The rules applying to benefits in kind are modified significantly, with the range of benefits that may be provided subject to tax payable by the provider being narrowed and the term 'benefit in kind' abolished.

- Under the main rule, benefits in kind will be taxable as part of the consolidated tax base, with the related personal income tax liability being payable by the individual and the contribution and percentage-based health care contribution liability being payable by the individual and/or the provider (employer). Specific rules will govern the potential forms of, and criteria for, benefits that entail a tax liability for the provider.

- Under current law, the payer is subject to a 54% personal income tax and a 27% social security contribution on the value of the benefit increased by the personal income tax (and in some cases, the training contribution), or to a 27% health care contribution on the value of the benefit. As from 2011, the payer will make a 16% personal income tax and a 27% health care contribution where the basis is the value of the benefit multiplied by 1.19 (i.e. the tax rates are 19.04% and 32.13%). Affected benefits include: meals related to business travel, other business entertainment, phone use for personal purposes, and low value gifts (up to 10% of the minimum wage, maximum three times a year), as well as promotional gifts up to 1% of minimum wages.

- Most benefits in kind that are subject to beneficial tax rates under existing rules will qualify as “non-wage benefits” (e.g. holiday vouchers, meals, local travel pass, assumption of school training costs) as from 2011, but the preferential rates will be retained. Such benefits may be provided subject to a 19.04% personal income tax liability payable by the provider (16% on a base that comprises the value of the benefit multiplied by 1.19), without any contribution or percentage-based health care contribution implications.

- The previously fully tax-exempt internet usage will be added to the group of non-wage benefits taxable at a preferential to the extent the amount of such usage does not exceed HUF 5,000 and a "Széchenyi Pihenő card" is introduced that may be used to purchase services specified in a government decree up to an annual amount of HUF 300,000.

Tax statement

The “tax statement” is introduced as a new alternate form of tax return for individuals. The option to file the tax statement (in hard copy or electronically) in lieu of a tax return is available to an individual where income earned from a single employer constitutes the individual’s entire tax base, and the payer has duly deducted the taxes in accordance with the effective rules (i.e., the difference between the deducted amount and the

actual tax liability does not exceed HUF 1,000). The taxpayer also would have to meet certain other criteria, e.g. that he/she does not apply itemized cost accounting, that the family allowance is not shared, etc. If the taxpayer opts to submit the tax statement, the employer is required to obtain the appropriate form for the employee.

The tax statement must be filed by 20 May of the year following the tax year. The tax statement includes only personal particulars of the taxpayer, the total taxable income for the tax year, the amount of the personal income tax obligation and advance payments previously deducted.

Transitional measures

Some transitional measures in the Personal Income Tax Act are also modified. For example, the transitional application of tax allowances already abolished (and to be available for the last time in 2015) is restricted and the interest tax exemption for income earned from certain deposit and insurance products (e.g. interest on deposits at financial institutions where the starting day of the interest period was before 1 September 2006 is subject to tax at a 0% rate if certain conditions are met) is abolished.

Social security contributions

General rules

- In line with the amended Personal Income Tax Act, the concept of what income constitutes the contribution base is modified by abolishing the contribution payment rules relating to income from specific activities.

- The cap on the employer's social security contribution that was in the proposed rules has been scrapped; however, the cap on the individual pension contribution payment is retained.

- The definition of employer will change and the social security contribution liabilities on income constituting the contribution base and received from a nonresident entity with respect to an insurance relationship with the employer are abolished.

- The pension contribution rate payable by the insured is increased from 9.5% to 10%.

- During the period from 1 November 2010 to 31 December 2011, private pension fund members also will pay a 10% private pension fund contribution to the state pension fund, with the membership fee being 0% for this period.

- The 14% health care contribution will not be payable on dividend income that was formerly subject to a 10% tax liability (i.e. dividends paid on securities listed on the stock exchange of an EEA member state).

Provisions relating to secondment

- The new rules set out the principles for extending mandatory social security (for employment outside Hungary) in accordance with the rules of EU Regulation No. 883/2004/EC on the Coordination of Social Security Systems.

- Amended rules apply to the contribution payment, reporting and filing obligations related to employees working in Hungary for foreign employers that are not required to register in Hungary under Hungarian law.

- 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 are not entitled to social security insurance if their work period in Hungary does not exceed two years.

- The contribution payment obligation is specified for cases where an individual is seconded to Hungary and, based on an agreement between the employers, wages and related social taxes are paid by the Hungarian company.

Value added tax

Changes to the VAT law generally are designed to incorporate EU law into domestic law. Several amendments target VAT fraud (e.g. harmonization of inspection criteria for tax-exempt imports, extension of reverse-charge taxation to CO^2 quota sales) and a new form of collective taxation ("independent group" taxation) is introduced. Below are some of the more important amendments:

- The changes included in the proposed measures to the rules for determining the “date of performance” for transactions subject to periodic settlement are not included in the final law.

- The place of delivery for cultural, educational, scientific, entertainment, sports and similar services is currently the place where the services are carried out. As from 1 January 2011, the place of delivery will be the place where the customer has its place of business, so that such services provided to a nonresident taxpayer will not be subject to Hungarian VAT under the general rule. This amendment eliminates the competitive disadvantage experienced by Hungary as a result of the high VAT rate applying to the organization of conferences, exhibitions and fairs, and film-making. The place of delivery for services ensuring entry to the above events remains unchanged, i.e. the place of delivery is the venue of the event. Similarly, the event venue is the place of delivery if the customer or participant of the above services is not a taxable person.

- The range of cases in which a subsequent reduction of the tax base does not require a self-revision are broadened to include a transfer of the right of temporary use of valuable rights if the transaction subsequently does not take place. However, the ability to make a tax base reduction without a self-revision in the case of a closed-end lease,

hire-purchase or lease is abolished. In the future, either party's fault or unavoidable external reasons may also be grounds for a subsequent modification of the tax base without self-revision. To mitigate the administrative burden, the VAT base also may be reduced subsequently without self-revision in the case of tax-exempt transactions (e.g. EU VAT tax-exempt or export sales).

- As from 2011 and in line with EU rules, an "independent group" may be established for VAT purposes, which will provide for group tax liability without the members losing their individual tax liability. An independent group will be able to be formed by VAT taxable and nontaxable persons (members of civil associations) and will be able to include nonresidents provided there are at least two members and the parties join together to achieve common goals. A group will be permitted to provide certain VAT-exempt services to its members if the consideration does not exceed the costs incurred by the group. Such groups are often formed in Europe by companies in the financial sector as part of cost-sharing agreements.

  Contrary to what was provided in the proposed measures, the final law allows a combination of the concepts of VAT group taxation and independent group of persons in such a way that the appointed representative of a VAT group subject to group taxation may belong to an independent group of persons, and thus may acquire rights and assume liabilities for all members subject to group taxation. Accordingly, VAT-exempt services provided to members of an independent group may be resold to group members of a VAT group as a service outside the scope of VAT.

- As from 2011, the sale of natural gas through a network located in the EU or any other network connected to such a network will be deemed to be delivered in the country where the customer has its place of business. The same rules will apply to trade in heat and refrigeration. The concept of a tax-exempt energy import will be extended to include the import of gas supplied to a natural gas network or an upstream pipeline network from a gas tanker and the import of heat or refrigeration through the network.

  The transfer of a valuable marketable right for greenhouse gas emissions will be subject to the reverse-charge mechanism.

- Miscellaneous VAT changes:

  - A sale of tangible assets by a VAT taxable person in an insolvency procedure (e.g. under liquidation) is subject to the reverse-charge mechanism without a value limit. For the sale of other assets of the taxpayer, a value limit of HUF 100,000 per purchase at the market price at the time of sale rather than the purchase price applies.

  - A similar change is made to the tax base of gratuitous product transfers, i.e. the VAT base is not the original purchase price of the product but rather the purchase price at the time of the transfer, which is the price associated with the condition of the product at the time of the transfer (for practical purposes, the fair market price).

- Due to the difficulties of introducing the new VAT refund system, taxpayers registered abroad have until 31 March 2011 to submit their 2009 claims for a VAT refund.

Local Business Tax

To reduce administrative burdens, the range of activities qualifying as temporary business activities will be further restricted (e.g. the concepts of retail activities conducted at fairs and market are abolished for these purposes) as from 1 January 2011. A construction business and a company engaged in exploration for or research into natural energy resources will be considered "temporary" if it lasts for 30 to 180 days (the proposed law would have increased the 30 days to 60). Entities whose activities are likely to last more than 180 days will have to register as permanent establishments and comply with their tax liabilities according to the rules governing permanent business activities. If the entity does not register as a permanent establishment, however, its operation exceeds 180 days, the taxpayer may 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, a further method to the provisions concerning the split of the tax base will be added and for this purpose a separate definition on the group of these companies will be provided. As form 1 January 2011, another new concept will be introduced for the definition of the place of business of a company engaged in telecommunication activities.

The previous methods applying to the split of the tax base will also be amended for all kinds of entities in order to guarantee a minimum tax base to the municipality where the entity has its registered office. In case of companies engaged in telecommunication activities, the tax base will have to be divided – unlike the general methods – according to the proportion of the net revenue connected to the clients' municipality as indicated in the invoicing address and total net revenue generated from telecommunications activity.

Building tax

Under the adopted tax law amendments, for the purpose of assessing the tax base of the building tax, the upper limit of the tax rate pertaining to useful floor space will be increased from 900 HUF/m^2 to 1100 HUF/m^2 while pertaining to adjusted market value it will be increased from 3% to 3.6% as from 1 January 2011.

The definition of useful floor space will be further specified.

Special tax on financial institutions

The special tax on financial institutions will remain in effect for 2011 in a manner similar to that in which it was in effect under the rules applying for 2010. The tax should be assessed by 10 March 2011 and paid in four equal installments (together with the submission of corresponding return) by the 10th day of the last month of each quarter (i.e. by 10 March, 10 June, 10 September and 10 December 2011.)

For credit institutions, the special tax rate applicable on a tax base exceeding HUF 50 billion will be increased from 0.5% to 0.53%, and a bracketed tax system will apply to insurance companies (the special tax rates for insurance companies will be 1.5%, 3% and 6.4% on a tax base of HUF 1 billion, HUF 8 billion and above HUF 8 billion, respectively).

To avoid double taxation in the case of credit institutions, the items that decrease the special tax base in case of transactions with domestic credit institutions (e.g. intra-bank loans) also will apply in respect of transactions with institutions that are resident in other EU member states. The reason for this modification is that several EU countries are planning to introduce a similar special tax on credit institutions in 2011.

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

Special tax on credit institutions

The amendments include a special tax for credit institutions: credit institutions that earn sufficient profits will account for this tax on their after-tax profit instead of the special tax of financial institutions payable on the balance sheet total. The amount of the special tax for credit institutions will decrease the amount of special tax payable on the balance sheet total, i.e. the special tax on credit institutions may be deducted from the special tax on financial institutions.

The tax base for the special tax on credit institutions is the company's pretax profit (increased by adding back the special tax determined upon the balance sheet total and recognized as expenses), with the tax rate being 30%. The tax must be declared and paid by the due date for the corporate income tax return. This new tax, however, will not impose an extra burden on the credit institutions concerned since the amount of special tax payable on their profit may not exceed the amount of special tax on financial institutions payable on the balance sheet total. The part of the special tax on financial institutions that is not taken into account in arriving at pre-tax profits due to the deduction referred to above will decrease the corporate income tax base; therefore the special tax burden (irrespective of whether it was accounted for against pre-tax or after-tax profit) may be taken into account as quasi cost for the purpose of assessing the corporate income tax base.

Accounting Act

Several changes are made to the Accounting Act. The most important change requires that companies subject to the act, in their financial statements prepared for the financial year starting in 2011 must carry out a revaluation to HUF value of their FX-denominated assets, receivables, and liabilities and recognise any unrealised exchange rate difference at the balance sheet date regardless of their internal accounting policies. Unlike under the existing rules, this obligation would apply even where the effect of the recognised difference with respect to the value of assets, liabilities and profits would qualify as immaterial under the company's internal accounting policies.

The revised act abolishes the provisions concerning the elimination of the effects of exchange rate fluctuations on capital gains for FX-denominated shares, participations and debentures.

The amendment extends the concept of “irrecoverable receivables” to include warrants for payment processes that ultimately create or increase losses.

Furthermore, a company’s obligation to raise funds for tax liabilities arising directly from a company transformation (i.e. for tax obligations arising from the overvaluation of assets) within tied-up reserves if no funds are otherwise available is repealed.

Companies can opt to apply the amendments when preparing their financial statements already for the financial year starting in 2010.

Miscellaneous

- Amendments to the Act on the Rules of Taxation generally clarify the rules or add interpretative or approximating provisions.
- The period for processing property transfer tax cases is extended from 30 to 60 days.

National Tax and Customs Office

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

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