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Tax Alert

Regulated Investment Companies

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Tax advisory

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This edition of our newsletter summarizes the key features of the bill on regulated investment companies (RICs) presented to the Hungarian Parliament on 14 June 2011. If approved, the bill would pave the way for Hungary to become a centre for financial services in the Central and Eastern European region.

RIC - definition and concept

"... The concept of a RIC, a special status company, would be introduced into Hungarian law..."

The bill would introduce the concept of a RIC, a special status company, into Hungarian law. A RIC would be exempt from corporate income tax and the local business tax and would be subject to a lower rate of property acquisitions tax.

To qualify as a RIC, a company would have apply to the National Tax and Customs Office to be registered as such and would have to meet the following requirements:

- Be a publicly listed company limited by shares (with a free float of over 25%) with initial capital of at least HUF 10 billion;
- Limit its business in Hungary to the sale, lease, operation and management of freehold real estate, as well as asset management;
- Have no participations in companies other than Special Purpose Entities (SPEs), other RICs and companies engaged in the business of organizing building construction projects (a share of up to 10% is allowed in the latter two cases); and
- Pay out at least 90% of its profits to its shareholders.

The concept of an SPE is separately defined in the bill as a Hungarian entity that is wholly owned by a RIC and, like a RIC, is involved in the real estate business only (however, an SPE could not hold any participations). An SPE would be required to pay out 100% of its profits to the parent RIC.

According to the bill, property owned by a RIC and its SPE(s) ("real estate portfolio") would be have to be appraised at least quarterly and any differences between the book value and the market value recognized for accounting purposes. Although not specifically stated in the bill, the appraisal would have to be carried out by an independent professional (the explanation to the bill mentions engaging third party appraisers).

The following are some of the more important rules that would apply to the asset and liability portfolio of a RIC and an SPE:

- 70% of the balance sheet total (consolidated, if applicable) of a RIC would have to be invested in a real estate portfolio and the value of any single property would not be able to exceed 20% of the balance sheet total;
- Other assets held by a RIC would only be able to include bank deposits, government securities, stock market shares and the participations mentioned above; and
- A RIC would only be able to have debt of up to 65% of the aggregate value of the property it owned (70% for an SPE).

Tax liability of RICs

The rate of property acquisitions tax payable by a RIC and its SPE(s) would be 25% of the generally applicable rate. This preferential rate also would apply if the acquirer (or, in the case of an SPE, its owner) agreed to comply with the RIC registration rules at the end of the year in which the tax liability arises. However, if the qualification requirement was not met, twice the amount of the "tax benefit" would be charged.

"... the rate of property acquisitions tax payable by a RIC and its SPE would be 25% of the generally applicable rate… however, a RIC would not have any corporate income tax liability…"

A RIC would be subject to corporate income tax, although it would not have any liability provided the company refrained from entering into transactions with related parties not qualifying as RICs or SPEs resulting in transfer pricing adjustments and thereby increasing the pretax profit (in such cases, tax would be payable on the difference).

A RIC that was removed from the registry would become obligated to prepare an interim balance sheet and, based on this balance sheet, the amount of corporate income tax payable for the period in which the company had RIC status would have to be determined in part on the basis of special rules. However, for the remainder of the year, the general corporate income tax rules would apply.

A RIC and its SPE would be exempt from the local business tax.

Other related amendments

According to the bill, attorneys, auditors, legal counsel and public notaries involved in a company's affairs also would be authorized to maintain the company's share register, in addition to those persons currently allowed to do so.

Contact

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