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Comprehensive Tax Law Changes

Tax Alert

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The aim of this Newsletter is to inform our clients briefly on the bills put forward by the government on amendments to the accounting and tax laws as well as other related regulations. The proposed legislative changes, which would affect all main tax types and also introduce a new one ("the accident tax"), may be of interest to our clients.

The bill proposed by the Minister for National Economy would amend the tax laws at several points. The bill is on Parliament's agenda for the next few weeks for debate together with several motions for modification. Under the new legislative regulations, the final modifying act must be promulgated on the 30th day preceding the day of entry into force, i.e. by 1 December. Below we focus on key changes relevant for our clients.

Personal income tax

Tax base supplement

Previous plans to reduce the “tax base supplement” to 50% of its present rate would be withdrawn. Instead, from 2012, the tax base supplement would no longer apply to the first HUF 2,424,000 of gross annual wages; the 27% tax base supplement exceeding this amount would apply.

Family tax credit

Families eligible for the child benefit according to the social security legislation (even if unclaimed) also would be eligible for the family tax credit (at its current rate).

Tax withholding

Under a more restricted exception to current rules, companies providing benefits to individuals would not be required to asses and withhold a tax advance from amounts to be paid only if the payment is made to a private entrepreneur or a primary agricultural producer.

Defined benefits

Similar to rules in effect before 1 January 2011, benefits provided by an employer would qualify as “defined benefits” and taxed at the employer if the same benefits are granted to all employees or if based on a policy available to all employees

Business gifts and entertainment costs would be taxable, subject to a few exceptions (e.g. non-governmental organizations).

The rules on benefits provided for promotional and advertising purposes would be modified. Discounts, rebates and the supply of products would be exempt from tax only if the purchase is made in the private individual's own name and only up to the value of the product or service. The excess would be taxed as a “defined benefit.”

That portion of the annual total value of non-wage benefits exceeding HUF 500,000 would qualify as “defined benefits.”

Non-wage benefits

The following changes would be made to the rules governing fringe benefits:

- General meal vouchers would not qualify as a non-wage benefit. Instead, the vouchers would be replaced with catering cards (Széchenyi Recreation Card) as a way of hot meal contribution (up to HUF 150,000 per year). The amount transferred to the SZÉP Card also could be used for accommodation (up to HUF 225,000 per year) and leisure services (up to HUF 75,000 per year).

- Amounts received up to HUF 5,000 per month for “ready to eat meals” would be classified non-wage benefits.

- The provision of Internet access would not be classified as a non-wage benefit.

The rules governing other benefits (e.g. school enrolment support, local travel passes, assumption of school training costs, etc.) would remain unchanged.

Company car tax

The company car tax payment obligations would be amended. As a general rule, the deadline for paying the company car tax would be 20 January of the tax year, with tax rate based on the vehicle’s engine power (kW) and environmental classification, payable by the employer:

Engine power (kW)	Environmental classification		
	Classes 0-4	Classes 6-10	Classes 5, 14 and 15
0-50	HUF 16,500	HUF 8,800	HUF 7,700
51-90	HUF 22,000	HUF 11,000	HUF 8,800
91-120	HUF 33,000	HUF 22,000	HUF 11,000
above 120	HUF 44,000	HUF 33,000	HUF 22,000

Exchange rate calculations

The rules for converting income generated in foreign currency and expenses paid in foreign currency to HUF would be harmonized.

Income from property

- An individual subletting an apartment while renting a second apartment in a different town would be able to deduct the rent paid on the second apartment against income generated from subletting the first apartment.
- In the case of the sale of movable or immovable property as part of a business activity, legal provisions pertaining to independent activity must be applied.
- The tax treatment of income derived from the sale of real property recharacterized from arable land is different from the general rules. The tax rate applicable to income exceeding an arm's length profit is three times higher than the general rate, i.e. 48%.

Social Security

- Changes would be made to expand the range of insured persons (e.g. to include business partnerships).
- The health care and labor market contributions payable by the employee would be increased from 7.5% to 8.5%, and the monthly amount of the health care service contribution would be increased from HUF 5,100 to HUF 5,400.
- The minimum health insurance and labor market contribution would be increased for sole traders and company members (to 1.5 times the minimum wage).
- To broaden the contribution base, the exemption of certain income (severance pay, loyalty bonus, leave pay) from the health care contribution would be abolished.
- In the event of multiple insurance liability, the exemption from the health insurance contribution would be eliminated for insured persons working a minimum of 36 hours per week (2%).

Corporate income tax

Flat 10% tax rate

Under legislation passed at the end of 2010, the current corporate income tax rate of 19% on taxable income exceeding HUF 500 million (with a 10% rate applying to taxable income below this amount) would have been reduced to a flat rate of 10% regardless of the taxable income base as from 1 January 2013. It is now proposed not to proceed with the 10% flat rate, leaving the current rates/base in effect.

Notified intangible assets

The concept of “notified intangible assets” would be introduced (similar to the concept of notified shares), under which income from the sale or contribution of royalty generating intangibles would be exempt from corporate income tax provided the taxpayer notifies the tax authorities within 60 days following the date the assets are acquired and records the assets on its books for at least one year. (The deadline for the notification of share acquisition would also be extended to 60 days.)

Gains from the sale/contribution of “un-notified” intangible assets could be deducted from the tax base if the taxpayer sets aside an allocated reserve from the profit reserve up to the amount of the gain (similar to a development reserve) and uses that reserve for the purchase of intangible assets in the next three tax years.

Thin capitalization

The thin capitalization rules would be expanded to cover interest incurred on interest-free loans so that a deduction would not be available on the part of the interest-free loan that exceeds the equity of the company multiplied by three, but the new rules would not apply to on-loaned amounts.

Loss carryforwards

Three limits would be imposed on the carryforward of losses:

- The use of losses carried forward would be limited to 50% of the current year’s taxable income, i.e. 50% of taxable income would remain taxable even where losses are utilized. Remaining losses could be carried forward to subsequent years, so they would not go to waste despite of the 50% limitation.

- In case of a legal transformation, the legal successor would be able to utilize losses transferred to it as a result of the transformation only if the direct or indirect majority shareholder (or its related party) remains the direct or indirect majority shareholder(s) of the legal successor. If this requirement was not met, losses could continue to be utilized only where the activities of the legal successor were similar in nature to those of the predecessor and those activities were continued for at least two years after the transformation.

- Loss carryforwards would not be available for offset where a shareholder without having a continuous shareholding in the two preceding tax years acquires direct or indirect majority control, although this limit would not apply to acquisition of control through a legal transformation.

Deductible costs

Entertainment costs and business gifts would again qualify as costs incurred in the course of business operations and, therefore would be deductible expenses. Charitable donations and expenses recognized on transfers without consideration based on a legal regulation [e.g. the obligatory transfer of public utility to the disposal of the municipality] also would qualify as deductible expenses.

Accounting Act

Financial year other than calendar year

All businesses (except financial enterprises, credit institutions and insurance companies) would be allowed to adopt a financial year different from the calendar year (serving also as a tax year) subject to certain criteria (e.g. justification for the use of the different tax year and provided the company already has closed three business years).

Foreign exchange rate

Businesses would be able to choose (for as early as the preparation of the 2011 financial statements) to convert receivables and liabilities denominated in foreign currency into HUF in accordance with the corresponding regulations under the VAT Act provided that application of this rule is set out in the taxpayer's Accounting Policy. The proposed change aims to mitigate the administrative burden derived from applying different exchange rates for tax and accounting purposes.

Accounting for foreign taxes

Similar to the calculation of corporate income taxes, businesses would be able to recognize foreign taxes that correspond to Hungary's corporate income tax (and tax payable on income that would be exempt from Hungary's corporate income tax) against after-tax profits rather than deductible as other expenses.

Filing of financial statements

As from FY2011, the deadline for submitting financial statements (except for consolidated financial statements) would be the last day of the fifth month following the balance sheet date of the fiscal year, thus harmonizing the deadline for submitting the financial statements with the tax return filing date for calendar year companies.

Document retention

As from FY2011, the document retention obligation for financial statements, general ledgers and other analytical records would be reduced from ten to eight years.

Interim dividends

The Companies Act would also be amended to ease the administrative burden of interim dividend payments by allowing companies to rely on data from a financial statement or interim balance sheet prepared on the date of the payment or within six months preceding the payment.

Value added tax

Tax rate increase

The general VAT rate currently is set to increase to 27% (from 25%) as from 1 January 2012. The bill provides detailed transition rules on the rate increase, such as the specific treatment of contracts for continuous supply and fixed-term contracts, as well as the settings of taxi meters and cash machines. The preferential VAT rates will not change.

Deductible VAT on lease of passenger cars

The prohibitions in the VAT Act on the deductibility of pre-charged VAT on the lease of passenger cars (and other vehicles) would be eliminated. Thus, as from 1 January 2012, VAT charged on the lease/rent of passenger cars would be deductible under the general VAT deduction rules (provided the taxpayer can show that the car is being used for taxable purposes).

Invoice correction

It may decrease the administrative burden of the taxable persons that self-revision obligation would be basically abolished in all cases where the tax base and/or the amount of VAT is reduced after the date of supply.

Moreover, a taxable person would be obliged to issue a VAT invoice even if the transaction falls outside the scope of the VAT Act, if the taxable person has a permanent establishment (PE) in another EU member state other than the country in which the transaction is carried out, but its domestic head office or PE is the one that is most directly involved in the transaction.

Special rules concerning fixed assets

With respect to the subsequent monitoring of the use of tangible assets, the bill clarifies that adjustment must be made uniformly in the last tax assessment period of the calendar year based on the deduction ratio calculated for the given calendar year. Additionally, the rules for calculating pro-rata would partly be modified.

Tax warehousing

In line with an EC regulation, the bill introduces modifications to tax warehousing procedures, according to which the tax liability would be borne by the party dispatching the goods. Moreover, the definition of ‘dispatcher’ would also be changed, i.e. a dispatcher could be the last purchaser of the product, to whom the product was sold by the last certified seller.

Procedural rules

It would also reduce the administrative burdens of the taxpayers that the tax authority would be required to publish on its website whether a taxpayer had opted to charge VAT on the sale of real property rather than applying tax-exemption.

Taxpayers’ VAT and European Sales and Purchases Listing (ESPL) filing obligations would be harmonized by making VAT filing compulsory for taxpayers with an ESPL filing obligation.

Chain transactions

New rules on chain transactions would be introduced, under which only the intermediary company in the supply chain would have the right to rebut the presumption that it was involved in the chain as a purchaser.

Excise tax

The excise tax proposals would facilitate compliance with EC regulations and decrease the administrative burden on businesses, simplify the rules relevant for small breweries and home distilleries. One of the key provisions relevant for our clients provides that the group of reliable licence holders would be extended to include parties holding an AEO (authorised economic operator) certificate, thereby allowing such parties to provide the required excise tax guarantee at 50% of the normal rate.

Registration tax

With a view to a faster and simplified administration the bill would introduce an electronic procedure for registration tax. The bill defines the way of initiating an electronic procedure and cases of exceptions where it is not applicable. By way of simplification, the taxpayer could be represented for issues related to the registration tax by his customs representative.

Public health product tax

The bill expands and clarifies the definition of “pre-packaged products,” and certain other terms such as ‘date of supply’, ‘taurine’ and ‘beer’. In addition, the bill would extend the scope of the tax to include flavored beer and alcoholic beverages.

According to the bill, pre-packaged sugar/sweetened products, soft drinks and snacks/condiments would be subject to the Public Health Product Tax, with the rates increasing to HUF 150/kg, HUF 7/liter and HUF 250/kg, respectively (the tax rate on energy drinks would remain at HUF 250/litre). Flavored beer and alcoholic beverages would become subject to tax at the rate of HUF 20/litre.

Special tax on financial enterprises

As of 1 January 2012, the Solidarity Surtax to Improve the Balance of General Government tax base for “other financial institutions” would be modified so that it would be assessed on the basis of the net amount of the profit from interests, fees and commissions.

The bill also provides that, where a company is terminated by legal succession (merger), the merging company's tax base would constitute the tax base for legal successor’s current year projection base.

Act on Duties

Reduced transfer tax rate and exemption for leasing companies

Extending the limitations applied to the real estate distributors, companies engaged in the business of financial leasing would only be eligible to apply the reduced 2% transfer tax rate on the acquisition of real property if at least 50% of the taxpayer’s net revenue derives from the financial leasing of real estate.

Similarly to the above, the exemption from transfer tax for vehicle and trailer purchases also would be allowed only if at least 50% of the purchaser’s net revenue derives from the sale or financial lease of vehicles and trailers.

Passenger car transfer tax

The transfer tax on vehicles would no longer be assessed on the basis of the cubic capacity of the power engine, but on the engine’s power output and the car's age according to a bracketed system (with a tax rate between HUF 300 and HUF 1200 per kilowatt).

Local taxes

Communal tax

The bill would allow municipal governments to introduce new communal taxes in addition to the local taxes set out in the Act on Local Taxes. Communal taxes could not, however, be levied on taxable property that is already subject to any public dues (e.g. income, revenue). The amount of communal tax payable in the tax year could be deducted from the local business tax payable in the tax year.

The bill would cap the communal tax at the amount of the taxpayer's local business tax liability and would only allow a maximum of 20% increase in the communal tax liability from one year to the other.

Maximum building and land tax

Rather than capping the building and land tax rate as is currently done, the bill would cap the amount of tax payable at 3% of the market value (as defined in the Act on Duties) of the taxable property. (Currently the tax base is the adjusted market value as defined by the Act on Duties.) The bill also would modify the definition of land to make the tax imposable on land outside a residential area and land covered by a structure (not a building). In the future only 50% of the value of land subject to a construction prohibition would be exempt from the tax.

Exemption of a foreign PE from local business tax

The bill clarifies the determination of the tax base that is exempt from local business tax with regard to activities carried out through a foreign PE. Similar to domestic PEs, the portion of the tax base attributed to the foreign PE should be determined according to any of the tax base allocation methods designated in the schedule to the act (i.e. the tax base should be allocated based on the asset value and/or personal type costs of the PE).

Accident tax

The bill would introduce an ‘accident tax’ payable on compulsory third-party motor vehicle liability insurance. The liable party for the accident tax would be the insured person liable to the insurance fee, with the tax collected by the insurance company providing the liability insurance service. The tax would be 30% of the annual compulsory insurance fee (including the non-coverage charge). The insurance company would collect the tax together with the insurance premium due; however, the insurance company would be obliged to pay the tax even if it failed to collect the tax from the customer.

Amendments related to research and development

Proposals concerning the tax treatment of research and development (R&D) costs may be relevant to the taxpayer’s innovation contribution and its corporate income tax calculations.

Innovation contribution

In what is likely the most important R&D related change under the bill, companies would not be able to deduct the R&D costs from the innovation contribution as from 2012. The bill also clarifies that consolidated data must be considered in defining the category of micro- and small-sized enterprises that are not subject to the innovation contribution.

Consolidated definitions

Different R&D definitions in various acts would be consolidated in a single piece of legislation (Act CXXXIV of 2004 on Research and Development and Technological Innovation). Simultaneous to consolidating the definitions, some modifications to their scope would be made. For example, the creation of non-marketable prototypes could qualify as R&D (more precisely, as experimental development), while regular, periodical or ordinary changes to a product would no longer belong to the R&D category.

R&D activities performed by the company as part of its operations

The bill defines the concept of ‘R&D carried out as part of a company's operations' that may be deducted from the corporate income tax base. Accordingly, R&D activity performed with the company's own tools and employees for its own profit at its own risk would qualify as R&D performed as part of the company's operation if the results are used by the taxpayer; also qualifying would be R&D activity performed with the taxpayer's own tools and employees upon the assignment of another taxpayer. Furthermore, ‘own R&D’ includes joint R&D activities performed based on an R&D agreement.

Frascati Manual

References to the Frascati Manual (an internationally recognized R&D resource) would be abolished, making its recommendations pertaining to R&D inapplicable. Only the newly defined rules could be used for identifying R&D activities.

Costs

The provision whereby 10% of the R&D wage costs and software developer wage cost may be taken into account as a tax allowance for corporate income tax purposes would be abolished. With respect to the year 2011, this benefit may last be applied for the 2014 CIT assessment.

Direct R&D costs would not be eligible costs under Schedule 3 to the Corporate Income Tax Act if the taxpayer fails to actually use that in relation to its income generating business activity.

Qualification procedure for R&D activities

With little detail, the bill proposes having institutions conduct qualification procedures for R&D activities. In turn, such institutions would also be implicated in administrative reviews, such as during tax audits or for binding ruling request involving R&D qualification. In the latter case, for example, a copy of the preliminary certificate issued by the institution would have to be included with the binding ruling request.

Tax administration

New measures to tackle the underground economy

The bill proposes two measures to combat the underground economy: a tax registration procedure and intensified reviews by the tax authorities.

The new tax registration procedure is designed to ensure that persons with accumulated tax arrears, those that have committed serious offenses or became inaccessible to the tax authorities would be unable to establish or operate a new taxable entity for a specified period of time. This – despite the denomination of "registration procedure" – reflects the opposite, i.e. that the tax authorities would be able to deny requests for a tax ID number for such persons wishing to establish a new company or to become officers or representatives in a company.

Further, the information required to be registered with the tax authorities also would be extended.

Intensified reviews by the tax authorities would be conducted to closely monitor taxpayers during their first period of operation if a risk analysis justifies the review. Accordingly, the tax authorities also will be empowered to impose more stringent tax liabilities or withdraw the taxpayer's tax ID number if specific circumstances prevail.

Termination of affiliated companies

The bill would require affiliated parties to report the termination of an affiliated relationship to the tax authority, i.e. when the conditions of the affiliation are no longer met – the previously affiliated companies' participation in one another drops under 50%.

Extraordinary filing of tax return on termination

For legal entities not subject to a company registration obligation that are terminated without a voluntary dissolution, the extraordinary filing obligation would have to be fulfilled simultaneous to the decision to terminate without legal succession. The change will enable the tax authority to effect any necessary refunds or conduct tax audits before the company is dissolved.

Tax audit

The tax audit rules would be significantly restructured and changed. For example, in case of the obligation of repeating the audit, a deadline would apply to carry out the audit. Any obstruction of the audit by the taxpayer or other delays attributable to the taxpayer would be taken into account in determining the deadline. Where a legal remedy has been requested on behalf of the Hungarian tax authority, and the foreign tax authority fails to respond within one year following the request, the audit may be concluded in the absence of the foreign tax authority's response.

To avoid obstruction by a taxpayer, preliminary notification of a tax audit would be abolished and the audit procedure would commence with the presentation of the engagement letter. Also, the practice of test purchases without revelation – in case when the tax instructor does not reveal his identity before the tax payer – would be introduced.

However, taxpayers would not be required to provide technical translations into Hungarian of source documents, contracts and other documents available in English, German or French.

In the course of pre-refund reviews, uncontested amounts could be refunded, while the review is continued for contested amounts, in which case, no default interest would be payable.

Finally, for contractual relationships, the authenticity of business events would be subject to targeted review.

Binding ruling requests

An expedited binding ruling would be available (for a higher fee); that ruling would have to be issued within 30 days of the application (although that deadline could be extended by 30 days).

A special binding ruling would be available for large taxpayers (i.e. those employing more than 200 person or having a balance sheet total exceeding HUF 1 billion) for corporate income tax and transfer tax purposes that would not be affected by proposed tax law changes. This ruling would be binding for three years irrespective of future tax law changes.

Regulatory action

As a significant change affecting the legal remedy system (i. e. the procedure of appeals), requests for a supervisory procedure could only be submitted to the minister in charge of taxation and supervising the Hungarian tax authority if countersigned by an attorney, tax advisor, tax consultant or certified tax consultant

Penalties

The tax penalty would be increased to 200% of the tax shortage if related to concealed income or the falsification or destruction of invoices, books or records. More stringent sanctioning would entail eliminating the 'preferential' penalty rates for qualified taxpayers.

The bill also provides specific sanctioning rules if an employer (payer) fails to fulfil his obligation to determine the amounts of payable tax and contribution, to deduct and file the determined tax, or the noncompliant performance thereof. Additionally, employers will exclusively bear the responsibility of a tax shortage and legal implications of a contribution difference.

Failure to deposit with the Court of Registry the statutory financial statements would result in a doubling of the default penalty under the bill.

Transfer pricing penalties for failure to comply with Hungary's documentation requirements would be increased. The default penalty for repeated breaches could reach HUF 4 million per failure, and, for repeated breaches related to the same documentation, the penalty could reach up to eight times the default penalty first imposed.

The importance of retaining documents would be further emphasized with the introduction of a new category of penalties of up to HUF 1 million.

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please contact one of our tax experts below:

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