Deloitte.

Central European Transfer Pricing Firm of the Year
International Tax Review European Tax Awards 2012

Hungary Tax Firm of the Year
International Tax Review European Tax Awards 2011

Tax News+

10 October 2012

Tax News+

Below you will find the tasks and potential issues arising from key tax law changes of the past month and recent weeks. We would be ready and glad to discuss with you any of your company specific issues.

NAV practices in transfer pricing review

The growing significance of transfer pricing reviews is clearly reflected in the increasing number of reviews and amounts of tax difference found by the tax authority. Considering that the definition of arm's length prices is not an exact science, domestic and international practice plays a more significant role in assessing and managing risks than in other tax matters. This tax alert outlines our latest experience and insights concerning NAV's transfer pricing review practices. In this respect please note that in its article on transfer pricing published in the August 2012 edition of the journal *Adóvilág ("Search for comparable data when using non-designated methods for determining arm's length prices")*, NAV confirms our opinion on review and advance pricing arrangement (APA) procedures.

Annual update

In an increasing number of cases we saw the tax authority expect an annual update of the database search / arm's length range presented in the report for the previous year. Although in our opinion this requirement is not clearly obvious from the 2010 OECD Guidelines and the relevant PM Decree, the tax authority imposed default fines in the first instance procedure on several occasions if the database search/arm's length range documentation was not updated. This approach was also confirmed by the representatives of the tax authority at various discussions. Given the scale of the default fines, it is recommended to consider preparing the generally simple and brief updates.

Arm's length price range

According to NAV's definite and consistent approach, it is the interquartile range[1] that is considered, in general, acceptable to constitute the arm's length range in the case of database search. In cases where the margin achieved by the party through the transaction under review is not within the interquartile range or if it is not the interquartile range that is accepted as the arm's length range, a reasonable explanation is required to avoid transfer pricing adjustment. In particular exceptional cases, the entire range is accepted as the arm's length range. Part of the problem is that NAV's review practice is ambiguous about which section of the range—the spread range (average or median) or some closer extremes of the range—prices should be adjusted to in the case of transfer price adjustment.

Please note here that if the price applied is not within the interquartile range, you will have every reason to expect tax inspection. If NAV accepts only the interquartile range as the arm's length range after the tax review, it has the right to propose an adjustment, which will then be probably closer -- instead of the extreme of the range - to some middle value farther away from the price applied.

Hierarchy of methods

The tax authority's approach, in line with the revised 2010 OECD Guidelines, is, however, clear in the respect that the comparable uncontrolled price method ("CUP method") is prioritized over other designated methods if the conditions of its reliable adoption apply. Therefore, it seems reasonable to make sure that in cases where the report presents the arm's length nature of the price using a method other than the CUP method it is undoubtedly impossible to use the CUP method, which is explained in the documentation adequately.

[1] The middle 50% of research results.

Search for comparable data

Data sources

The tax authority concentrates increasingly on the verifiability of data used for determining the arm's length price and reviewed the research results on several occasions through a cross-check with the AMADEUS database or requested a reproduction of the research in the case of other databases. The need for reproducibility might raise complaints against the on-line versions of various databases whereas, as a further complication, reliable data sources other than the on-line databases are in many cases unavailable and, therefore, their disqualification from the process would practically make it impossible to determine the arm's length range. It is therefore recommended to document the research process with particular care, getting ready for satisfying the verifiability criteria in a potential subsequent tax review. It seems reasonable to ensure that the accurate details of the database used are included in the report and that every important step is recorded at least in the form of a "print layout".

Selection of comparative data

It is an interesting question whether a further certification of data extracted from AMADEUS or other company databases is necessary. Since in our experience none of the databases seems faultless, we believe—as the tax authority's official position also confirms—that a subsequent manual cross-checking of the extracted data (e.g. concerning owners, activities etc.) with other data sources might prove extremely helpful and, therefore, is highly recommended. At the same time, the qualitative examination following the software database search is highly time-consuming and, therefore, and owing to the volume of the transaction, represents an unreasonably disproportionate burden for the taxpayer. As we have seen, it varies from review to review whether the tax inspector accepts the comparative analysis without a subsequent qualitative check although the tax authority's practice seems to imply that a manual qualitative elimination will be necessary in the future. Therefore, we recommend a review of database searches presented in transfer pricing reports with particular emphasis on the required detail and, if necessary, please consider any reasonable adjustments.

International outlook

In a number of its decisions (Denkavit C-170/05, Amurta C-379/05, Aberdeen Property Fininvest Alpha Oy C-303/07 and Santander Asset Management et al C-338/11, C-347/11), the European Court of Justice found that national regulations requiring the deduction of withholding tax on dividend paid to foreign resident parent companies while not requiring the same obligation or requiring it only to a lesser extent from resident parent companies are contrary to EU legislation.

The tax treatment of the case appears established from the ECJ's decisions while many member states adopt measures which are suitable to efficiently restrict the reclaim of potentially unlawfully deducted withholding tax. Austria is one of the few EU member states which—responding to the ECJ's decision—introduced a special „Denkavit" refund procedure which facilitates a relatively brief and simple withholding tax reclaim procedure. Since Hungarian dividend rules were similar to the Austrian regulations, Deloitte, referring to a breach of EU law, has helped a number of companies successfully in the procedure to reclaim Hungarian withholding tax.

According to the Austrian regulation, the refund of unlawfully deducted withholding tax is subject to certain conditions and is to be requested within 5 years from the year of deduction. It means that requests for a refund of withholding tax deducted unlawfully in 2007 should be filed with the Austrian tax authority until 31 December 2012 at the latest.

Accordingly, if your company or any of your affiliated companies received dividend in or after 2007 with the respective withholding tax deducted in Austria, it is advisable to make sure whether the conditions of tax refund actually apply.

We are ready to help our clients assess the justification of the reclaim, file the request and assist them throughout the procedure.

The provisions of the Corporate Income Tax Act effective until 2009 allowed loss carry-forward only upon the tax authority's approval provided that certain conditions applied. Studying the tax related judgments and practice of the European Court of Justice, experts concluded that the former regulations might raise issues concerning their

harmony with EU legislation. If it is established definitely that the above regulations are contrary to EU law, it might become possible to subsequently carry forward previous years' losses. We suggest that those of our clients whose applications for the carry-forward of considerable losses were previously rejected by the tax authority should consider the above opportunity.

Grant programmes, R&D tax incentives

New government decree on individual government grant decisions

Government Decree no. 270/2012. (IX. 25.), which revived the system through which the government can award project grants on an individual basis, entered into force on 26 September 2012. The new government decree codifies the practice that has been applied for grant negotiations between the government and investors over the past few years and included some new provisions. The main parameters of grant programmes, however, remain unchanged: non-refundable grants are available without territorial restrictions, deadlines or a maximum cap for projects planned in Hungary with eligible cost levels equal to at least EUR 10 million which involve the expansion of capacities, the establishment or extension of regional service centres, or assets purchases for R&D purposes, as well as the creation of new workplaces.

GOP-2.1.3 grant programme relaunch

According to the communication released by the National Development Agency on 26 September 2012, it is possible that the most popular EU co-funded GOP-2.1.3 grant programme entitled Promotion of complex technology development and employment aimed at the promotion of large enterprises' capacity expansion and job creation projects might be relaunched this year. The exact details of the programme are still unknown but it is known about the previous scheme that amounts of HUF 100-1,000 million were available among others for the wage costs of new hires, for assets and intangible assets purchases, as well as real property and infrastructural projects.

New regulation for the R&D qualification procedure

At the end of September, the Hungarian Intellectual Property Office (Office) published its detailed Guidelines, which present, through various examples, the criteria the Office applies when deciding whether a particular project qualifies as research and development activity. In addition to a resolution on the R&D nature of the project, applicants may also request the Office to determine (i) the proportion of basic research, applied research and experimental development within particular R&D projects (relevant for grant applications where the various R&D categories enjoy different aid intensity [100%, 50%, 25%]), (ii) the applicability of R&D carried out as part of a company's operations (‘own R&D’), as well as (iii) the amount of eligible project costs. Office qualification may be requested for joint R&D projects, as well. Applicants shall pay a public service fee upon the submission of requests, which may not be modified subsequently (except for the subsequent supply of missing information). Requests must be filed by applicants actually involved in the project.

Replacing the Frascati Manual, the detailed Guidelines will guarantee that R&D tax incentives will be granted to genuine R&D projects and that, in the case of well-grounded requests with details comparable to what is required for an R&D application, the desired 30-60 days' deadline will prove an acceptable compromise in return for enhanced legal certainty. A suitable and functional qualification system could in the long term enable an increasing proportion of the GDP to be spent on R&D.

Contacts

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

Dr. Attila Kövesdy

Partner in Charge
Deloitte Co. Ltd.
Tel: +36-1-428-6728
E-mail: akovesdy@deloitteCE.com

László Szakál

Partner
Deloitte Co. Ltd.
Tel: +36-1-428-6853
E-mail: lszakal@deloitteCE.com

István Veszprémi

Partner
Deloitte Co. Ltd.
Tel: +36-1-428-6907
E-mail: iveszpremi@deloitteCE.com

Péter Gémesi

Director
Deloitte Co. Ltd.
Transfer pricing
Tel: +36-1-428-6722
E-mail: pgemesi@deloitteCE.com

Dr. Eszter Gyuricsku

Director
Deloitte Co. Ltd.
Global employer services
Tel: +36-1-428-6756
Email: egyuricsku@deloitteCE.com

Tamás Knébel

Director
Deloitte Co. Ltd.
Indirect tax
Tel: +36-1-428-6460
E-mail :tknebel@deloitteCE.com

Dr. Gábor Kóka

Director
Deloitte Co.Ltd.
International tax
Tel: + 36-1-428-6972
E-mail: gkoka@deloitteCE.com

Babett Korponai

Senior manager
Deloitte Co. Ltd.
Mergers and acquisitions
Tel: +36-1-428-6766
E-mail: bkorponai@deloitteCE.com

Dr. Csaba Márkus

Director
Deloitte Co. Ltd.
R&D and government incentives
Tel: +36-1-428-6793
E-mail: csmarkus@deloitteCE.com

Zsolt Sándor

Director
Deloitte CRS Ltd.
Business Process Outsourcing
Tel: +36-1-428-6800
E-mail: zsandor@deloitteCE.com

Dr. István Falcsik

Attorney-at-Law
Senior manager
Szarvas, Falcsik and Partners Law Firm
Tel: +36-1-428-6696
E-mail: ifalcsik@deloitteCE.com

Dr. Júlia Szarvas

Attorney-at-Law
Senior manager
Szarvas, Falcsik and Partners Law Frim
Tel: +36-1-428-6465
E-mail: jszarvas@deloitteCE.com