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Tax News+

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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.

Personal income tax

'Economic employer' under double tax treaties

Article 15 paragraph 2 of the OECD Model Tax Convention on income from employment (dependent personal services) allows remuneration received by residents of one contracting state from dependent personal services provided in another contracting state to be taxable, under certain conditions, in the country of residence (home country) instead of the country where the work is performed (host country).

Previously, the main question asked by the tax authority when determining the tax treatment of income received on short-term assignments was whether the host country entity bears the employment related costs of the business assignee. The tax authority recently published a different interpretation.

The authority notes that the amended Commentary to the OECD Model Tax Convention as announced on 22 July 2010 adopts a new approach for the definition of the 'employer' under Article 15. If the work is performed under employment it might be possible that instead of the company which signed the assignee's employment contract, the company where the assignee performs work would be construed as the employer for economic purposes.

Definition of 'economic employer'

When identifying the host company as economic employer, what needs to be determined primarily is whether the assignee's activity is organically integrated into the activities of the company where the work is performed. This is the so called integration test. The assignee's activity will be seen as one integrated into the organization of the host company if it is the host company which assumes responsibility for or the risks related to the assignee's work performance, i.e. it is the degree and manner of integration of the assignee's activity into the host company's work processes and organization which bears significance here.

If according to the integration test, the formal (legal) employer is not the 'economic employer', further questions must be answered to determine the ‘employer’ for the purposes of Article 15 paragraph 2 of the Commentary. These questions are as follows:

- which company has the right to give instructions to the assignee on the manner of performing the work,
- which company has the right to supervise and is responsible for the place of work,
- whether the assignee's remuneration is charged directly back by the home company to the host company where the work is performed,
- which company provides the assignee with the means and material necessary for performing the work,
- which company has the right to determine the required number and qualification of the assignees performing the work,
- which company has the right to select the employee to be seconded and terminate the contract signed by the selected employee,
- which company has the right to apply employment sanctions against the employee,
- which country determines work and leave schedules.

The above questions must be answered concurrently and are equally relevant without order of priority.

It will be particularly important to identify the economic employer according to the above criteria in the case of short-term secondments, regardless whether a foreign resident company assigns an employee to a Hungarian affiliate or if the employee is seconded by a Hungarian employer to a host company in another contracting state in order to perform work, provided that the country where the work is performed adopts the 'economic employer' approach and the tax treatment is not affected by another circumstance (e.g. duration of stay in the host country exceeds 183 days in any period).

The Commentary includes the interpretation of the Convention as accepted by the contracting states and, therefore, is to be treated as an internationally adopted practice (soft law) regarding its role in the legal system. The new rules were included in the Commentary on 22 July 2010, so in our interpretation taxpayers may apply them in their 2010 and 2011 tax filings.

Accordingly, we propose that in the case of short-term assignments as under Article 15 paragraph (2) of the Convention you should contemplate tax consequences carefully and preferably in advance, or review them in order to reduce any tax risks that may arise from previous and current secondments.

National permanent resident permit for third country nationals (investors)

According to the bill introduced on 27 October 2012 concerning amendments to Act II of 2007 on Admission and Right of Residence of Third-Country Nationals (T/889), third country citizens who satisfy other special conditions may apply for a national permanent resident permit if they or their majority-owned enterprises purchase 'government bonds for third-country national investors' in the value of EUR 250,000 with a definite maturity date of 5 years. (The interest, with the rate determined by ÁKK /Hungarian Public Debt Management Agency/ based on market interest rates, would be paid to individuals.) The amendment is designed to enable the granting of resident status to investors, provided that the applicant satisfies other criteria as well (e.g. no criminal record). According to the draft, legal representatives may act on behalf of individuals in the matter.

The national permanent resident permit would ensure the right of residence and employment for third country citizens but it would in itself not add up to full Hungarian citizenship. Obtaining the national permanent resident permit would be favourable for third country citizens who hold or wish to hold (business) interests (investments) in Hungary which might require frequent travels to and potentially longer periods of staying in Hungary. The national permanent resident permit would greatly simplify holders' administrative obligations related to entering and staying in the country. However, before deciding to apply for it, our clients should make sure whether the permit would change their status or obligations for the purposes of social security and personal income tax.

Changes to Accountancy and Companies Acts

The amendment will help companies combat equity loss

Through the entry into force of the amendment to Act IV of 2006 on Companies (Companies Act) on 16 October, the new provisions will help companies combat equity loss resulting from exchange rate volatility.

A part of companies with EUR loan obligations also suffered equity loss as a result of unfavourable market trends and exchange rate fluctuations. Pursuant to statutory requirements, equity capital must be replenished within a definite period; otherwise companies will face serious sanctions, which might even lead to liquidation. The amendment to the Companies Act has been designed exactly to help companies with equity loss.

Pursuant to the Companies Act, companies lacking a shareholders' equity amount equal to the minimum subscribed capital specified by law for each company form in two consecutive years must raise the necessary funds within 3 months, or, otherwise, decide on transformation to another company form or dissolution without a legal successor. According to the amendment, companies would be allowed to verify, within 3 months of approving the balance sheet, by presenting an interim balance sheet not older than 3 months, that the equity loss has been eliminated, and thus would be exempted from the sanctions.

In addition to general rules on capital consolidation, special rules on capital requirements concerning limited liability companies and stock corporations have also been modified. The law would allow companies to verify the elimination of the equity loss as defined in the law by presenting an interim balance sheet which must be prepared, at the earliest, one month prior to the members' or shareholders' meeting approving the financial statements. Please note that companies must be confident and able to verify that the equity loss can actually be reversed within three months of approving the balance sheet. This requires from companies a greatly reliable and controlled closing and reporting procedure.

A further modification of the Companies Act allows companies, when disclosing equity, to ignore, until 31 May 2014, the amount of consolidated unrealized capital loss recognized in financial statements for business years starting in 2011 and 2012. This extension until 31 May 2014 would actually solve the issue although companies should also contemplate longer-term solutions since operating loss might continue representing a risk due to this problem.

The third change relevant for companies, concerning the Accountancy Act, would allow them, as from 1 January 2013, to carry forward and even make provisions for unrealized capital loss from short-term loans. Since former regulations allowed such carry forwards only with respect to FX loans related to capital expenditure and valuable rights, this change would really make it easier for companies.

Grant programmes

GOP-2.1.3 grant scheme relaunch

On 5 November 2012, the National Development Agency relaunched the most popular EU co-funded GOP-2.1.3 'Complex technology development and job creation' grant scheme aimed at the promotion of large enterprises' capacity expansion projects. Applications are accepted until 31 December 2012.

Amounts of HUF 50-2,000 million are available among others for asset and intangible asset purchases, as well as real property and infrastructural projects.

Since the programme budget is expected to run out still before 31 December 2012, we recommend our clients to finalise potential project plans and start compiling applications as soon as possible.

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