

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.

New rules of local business tax to be applied also to advance payments – Interpretation difficulties

As we previously informed our Clients, the rules on local business tax have significantly changed this year. While in 2012 all net sales revenue decreasing items were fully deductible regardless of the volume of the net sales revenue of the tax year, as of 2013 the deduction of the costs of goods sold (COGS) and the costs of the mediated services at companies with a net sales revenue exceeding HUF 500 million is limited. For the part of the net sales revenue exceeding HUF 500 million, the deduction of these items is limited with degression determined for each level based on a certain proportion of the sales revenue (between 70 per cent and 85 per cent). This limitation is not applicable to the costs of goods sold and to the costs of intermediated services that are accounted for in relation to export sales.

In the case of companies qualifying as related parties – provided that certain conditions are met – the tax base should be determined first on group level and the total amount of tax base decreasing costs related to the cost of the sold goods and the mediated services should be calculated also on the group level using the above method. The tax base of each group entity from the aggregated group-level tax base shall be in proportion to the net sales revenue of each group company to the total net sales revenue of the group.

The application of the new rules gives rise to many questions that have not been settled on the level of national legislation. Even though the costs of sold goods and the costs of mediated services that relate to the export are exempt from the "degression rules", the question still remains whether, in the degression system for the purposes of qualifying the other (not export-related) net sales revenue

items, the export-related items could be completely disregarded or they push the revenue into higher progression levels. Many questions have been raised with regard to the interpretation and application of the new rules of determining the tax base on the level of the company groups not only in the case of daily operations but when, for example, a change occurs in the organizational structure (for instance, if a company becomes related party or if a member firm is liquidated during the calendar year).

Should any difficulty arise at Your Company in relation to the complexity of the new rules or during the interpretation thereof, our experts are at the disposal of Your Company with pleasure. Although, the deadline of top-ups and tax returns for 2013 may be afar, it is advised to prepare for the application of the new rules in due time as the amount of future advance payments shall already be determined in accordance with the new rules in tax returns related to 2012.

Transfer pricing

We would like to draw the attention of our Clients that as continuance to the experienced increase in the tax authority's audit activity in the previous years, *Guidance no. 4001/2013 of the National Tax and Customs Administration (NAV) on the implementation of the audit tasks in 2013* establishes that it is still considered among the most essential audit targets and is explicitly labeled as a specific factor for selecting taxpayers for comprehensive tax audit if loss is accounted for at a company continuously throughout its daily operations for a long period of time. The guidance further refines the criteria for the above principle as the case when a member firm of a company group is constantly making losses may be considered to be in conflict with the economic rationale. Therefore, special attention will be paid to such companies in the future. Additionally, taxpayers

may be selected for tax audits with a higher probability if the profit of financial transactions of a company that has at least one affiliated party is disproportionate to its operating profit or to its sales revenue.

In the course of tax audits in relation to corporate income tax and dividend tax, the applied pricing method between related parties constitutes to be a significant tax risk; especially if as a result of the transactions one of the member firms incurs loss continuously. According to the reasoning of the tax authority, taxpayers often try to establish the conditions of tax avoidance in many cases by engaging in artificial transactions with exceptionally high and economically unjustified interest rates or with disproportionately high rate penalties with the aim of shifting tax liability to companies without enough assets to fulfill tax payment obligations.

For affective action against the aforementioned behavior of taxpayers, it was established as a requirement for the tax authority that if possible every Hungarian resident subsidiary of the group should be subject to audit applying general criteria.

In such pace of audit activity and with taking into account the deadline of the tax returns and the preparation of the transfer pricing documentations, the proper pricing and the supporting documentation could be high priority.

Practice in the EU customs law

We would like to draw our Clients' attention to the fact that the European Court of Justice (ECJ) has recently interpreted the provisions of the Community's Customs Code on the applied import duty exemptions during the import of means of transportation in the case represented by the attorney of the correspondent law firm of Deloitte Hungary, *Szarvas, Falcsik and Partners Law Firm*.

According to the fact pattern, a passenger car from a third country has been imported under temporary customs procedures and was imported duty exempt. The vehicle was used by a person in Hungary for private purposes who – according to the viewpoint of the customs authority – has not been in employment relation of any form with the owner of the car. Therefore, the customs authority claimed that the complete exemption from the import duties could not be applied and it obliged the user of the vehicle to pay public duties.

In the emerged legal dispute, the Court of Székesfehérvár referred the case to the ECJ that had to decide whether in the present case the employment contract is a requirement for the exemption from customs or it is sufficient if the owner of the vehicle authorizes the user in any other way to use the car for private purposes.

In its decision, the ECJ concluded that in accordance with the custom regulations of the European Union, in the case of the import of means of transportation to be used for private purposes by a person resident in the territory of the Community, the complete exemption from the customs can only be granted if an employment contract between the above private person and the owner of the vehicle who is resident outside of the territory of the Community is concluded in relation to the private use of the vehicle.

In the light of the judgment if your Company is concerned with passenger car import similarly to the above, it seems to be necessary to review the employment contract of the user and the reason for the usage of the vehicle from a duty exemption point of view.

New decisions of the Curia regarding the right to deduct VAT

The Curia (successor of the Supreme Court) requested in many cases the preliminary ruling of the European Court of Justice (ECJ) in order to clarify the circumstances of the VAT deductibility to be verified, especially those of the taxable person deducting the VAT (Gábor Tóth C-324/11; Mahagében Kft. and Péter Dávid C-80/11 and C-142/11). In the above cases, the ECJ stated that the right to deduct the VAT may be refused only on the condition that it is established by the tax authority, on the basis of objective evidence, that the addressee of the invoice knew or should have known that the transaction relied on as a basis for the right to deduct was connected with a fraud committed by the issuer or another operator supplying inputs in the chain of supply.

The Curia has recently disclosed its decision in the case of Gábor Tóth (Kfv. I.35.611/2012/4) based on the guidance of the ECJ. According to the judgment, the tax authority set up a system of conditions unduly strict when denying the right of the taxpayer to deduct the VAT, by referring to such reasons that were outside of the circle of interests

of the taxpayer and it is unclear whether the taxpayer could have been required to verify them. As per the Curia *the fact, that the taxable person exercising the right to deduct did not verify whether the employees working at the field of work were in legal relationship with the issuer of the invoice, cannot be considered as objective evidence of knowing or obligation of knowing the intention to circumvent the system of value added tax.* Thus, the Curia repealed the decision of the County Court that has left in effect the resolution of the tax authority and obligated the tax authority to conduct a new procedure.

In another decision (Kfv. V.35.128/2012/15.) with respect to a similar case, the Curia highlights, that it is not contrary to the Community law if the tax authority requires every actor of the economy *to take every step which could reasonably be required of them to ascertain that the transactions taxpayers are executing do not result in tax evasion.* The

range of the steps reasonably required of taxpayers is basically determined by the circumstances of the case. Nevertheless, the Curia considered is as such a circumstance if the taxpayer concluded its transactions (contracts) with a person not entitled to represent the issuer of the invoice. Based on the decision of the Curia, such circumstances can justify the denial of the right of the taxpayer to deduct the VAT.

With respect to certain cases, the decisions of the Curia can project those circumstances that can reasonably be verified by the receiver of the invoice and that cannot confirm the denial of the right to deduct on their own. According to the above, it is suggested to review the current and finished cases related to the denial of the right to deduct, as well as to consider the possibilities to appeal.

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