

Doing Business in Hungary



WTS Klient. **The Bridge.**

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Foreword

This booklet has been prepared for the use of clients, partners and staff of WTS Alliance member firms. It is designed to give some general information to those contemplating doing business in Hungary and is not intended to be a comprehensive document. Therefore, you should consult us before taking further action. WTS Klient and WTS Alliance cannot be held liable for any action or business decision taken on the basis of information in this booklet.

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About WTS Alliance

WTS Alliance is one of the leading consultants of multinational corporations based in Germany, and our employees provide the same high quality of service throughout the world. This is how we are able to help our international clients understand the intricacies of special local regulations and identify tailored solutions.

Up-to-date information and general assistance on international matters can be obtained from any of the Hungarian member firm partners and directors listed in this booklet or from the Executive Office in Munich.

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1. Introduction to Hungary

GEOGRAPHY

Hungary is located in the centre of Europe. The country covers 93,030 square kilometres. It shares borders with Austria to the west, Slovenia, Croatia and Serbia to the south, Slovakia to the north, and Ukraine and Romania to the east. The population of Hungary is about 10 million people. The capital, Budapest, with about 2 million inhabitants, is the commercial, industrial and cultural centre of the country. Two large rivers, the Danube and the Tisza, flow from north to south and divide the country roughly into thirds. The climate is temperate but continental, with colder winters and warmer summers than in Western Europe.

LANGUAGE AND CURRENCY

Hungarian is the spoken language of the people. In most Hungarian schools, English and German are taught as foreign languages. People engaged in business normally speak English or German. The unit of currency in Hungary is the Hungarian forint, denoted as Ft, and sometimes as HUF in English.

CONSTITUTION AND LEGAL SYSTEM

The Republic of Hungary is a parliamentary democracy. The laws of the country are based on the constitution. In 2011 the Parliament accepted a new constitution which entered into force from 1 January 2012 and it was modified several times since then up to now. Parliament is the supreme organisation of power in Hungary and is comprised of the people's elected representatives. The president is the head of state. He is elected by parliament for a term of five years. The government is comprised of the prime minister and his ministers. The prime minister is elected by a simple majority of the members of parliament.

The Constitutional Court has the primary obligation to uphold, enforce and interpret the constitution.

It has the power to annul parts of laws passed by parliament if it considers that they violate any rule or principle of the constitution. The supreme judicial authority is the Curia. The Curia, the county courts and the local courts are professional judges who are independent and must not take part in any political activity outside their judicial role.

Hungarian law is based upon the continental civil law system and is therefore codified. The Hungarian Civil Code covers the principal rules of civil relations, including property law and contract law, and is the basis of all civil law. However, there are many statutes and ministerial regulations that explain the specific rules of the Civil Code. With effective from 15 March 2014, new Civil Code will be applicable in Hungary.

Hungarian law declares itself to be subject to the recognised rules of international law, and the legal system undertakes to harmonise itself with the obligations imposed on Hungary by its participation in international treaties.

INTERNATIONAL RELATIONS

In 1982 Hungary joined the IMF. This was the first step towards the economic liberalisation that took place in 1989. Furthermore, Hungary is a signatory to the General Agreement on Tariffs and Trade (GATT), and is a member of the WTO and OECD as well as of the United Nations and NATO.

In 2003 the people of Hungary decided by a large majority to apply for membership of the European Union. From 1 May 2004, Hungary is a full member of the EU.

Hungary's foreign trade is highly oriented towards the EU, taking approximately 80% of all its sales. Hungary is still a favourable target for foreign direct investment.

2. Investing in Hungary

POLITICAL BACKGROUND

Since its first free elections in 1990, Hungary has had a multiparty system. The most recent elections were held in April 2010, after which the FIDESZ-KDNP coalition of democrat parties formed a government (with a two-thirds parliamentary majority). New elections will be held in April 2014.

THE BANKING SYSTEM

The National Bank of Hungary (NBH) is Hungary's central bank. The NBH performs its duties and carries out its obligations independently from the Government or any other institution or body. The major objective of the NBH is to achieve and maintain price stability, and at the same time to support the economic policy of the Government through monetary control. From 1 October 2013, the Supervision Authority of Financial Institutions merged with the NBH.

The following types of bank are distinguished based on their financial activities: commercial bank, specialised credit institution and co-operative credit institution (savings or credit co-operatives). Banks may be established with a minimum of HUF 2 billion in initial capital. In accordance with the EU regulations, new law on Banks and Financial Institutions is in effect from 1 January 2014.

The Organisation for Economic Co-operation and Development (OECD) views Hungary's banking sector as one that is supported by a strong regulatory framework that broadly meets international standards. Nowadays, around 35 banks are operating in the country.

FOREIGN EXCHANGE CONTROLS

The authority for the enforcement of foreign exchange regulations is vested in the Minister for National Economy which exercises the related functions through the central bank. Importers have an automatic right to purchase foreign exchange through the banking system for all bona fide imports. Foreigners may freely repatriate profits and dividends in foreign currency.

Commercial banks may enter into deferred payment arrangements on behalf of their clients, without restriction, for up to one year. These arrangements need to be secured by bank commitments.

In January 1996 parliament passed a foreign exchange bill allowing the free exchange of forint into foreign currencies for any transactions for Hungarians and foreigners alike.

Following the decision of the Hungarian National Bank, the previous intervention band was abolished from 26 February 2008 (currently, as a result of the change, the forint is allowed to float free).

REAL ESTATE

Land in Hungary is subject to a system of registration. Ownership of property, and each transfer of property, must be entered in the Land Register. Acquisition of land by foreign persons is still subject to certain restrictions i.e. they cannot purchase any agricultural land until the end of the moratorium (30 April 2014). From 1 May 2014, citizens of the EU may purchase agricultural land in Hungary only if certain strict conditions are met while in the case of third country persons the moratorium remains effective.

2. Investing in Hungary

VISAS

Unless otherwise provided by law or international conventions, permits may be required for third country nationals in order to enter the Republic of Hungary, and stay in the country.

Types of permits:

- » Visa
- » Residence permit
- » Domicile permit
- » Work permit

The Visa regime is not applicable for European Economic Area (EEA) citizens. However, if the length of stay in Hungary exceeds 90 days, a residence card is required.

In general, third country expatriates who are coming to work in Hungary are required to possess a visa and a work permit. However, Hungary has entered into bilateral agreements that remove visa requirements from individuals from Canada and the United States. Individuals from these countries, who do not want to work in or derive income from Hungary, may enter Hungary without obtaining visas and stay in Hungary without obtaining residence permits (provided that the stay in Hungary does not exceed 90 days within a period of six months).

From 2009, EU/EEA and Swiss citizens can be employed in Hungary without acquiring a work permit. Only a reporting obligation remains effective, based on which the Hungarian employer has to report at the relevant employment office the starting date and the termination date of employment.

TAX INCENTIVES

Development tax allowance

One of the most important tax incentives for companies is the development tax allowance which can be deducted from the amount of corporate income tax (up to the 80 percent of the calculated corporate income tax). This type of allowance can be claimed depending on the amount of the investment, the industry and the region in which the investment is performed. The taxpayer is entitled to the development tax allowance in the following cases:

- » Investments exceeding HUF 3 billion at present value (approx. EUR 10 million);
- » investments in preferred areas exceeding HUF 1 billion at present value (approx. EUR 3.3 million);
- » investments exceeding HUF 100 million at present value (approx. EUR 330,000) regarding food hygiene in food production facility;
- » investments exceeding HUF 100 million at present value (approx. EUR 330,000) regarding environment protection, development of electronic telecommunication network and internet services, research and development and film and video production;
- » investments by SMEs above HUF 500 million at present value (approx. EUR 1.7 million);
- » investments made to create jobs;
- » investments with present value of at least HUF 100 million, if the investment is carried out in a free enterprise zone or performed in energy efficiency sector.

2. Investing in Hungary

Additional conditions, like the determination of an obligatory increase in employee numbers and yearly salary costs from year to year may apply for certain types of tax allowance.

In the case of investments exceeding EUR 100 million at present value the approval of the development tax allowance falls within the competence of the Hungarian Government.

Other tax allowances

The following tax allowances can be deducted up to the 70 percent of the calculated corporate income tax decreased by the development tax allowance.

» Tax allowance on sponsorship of popular team sports

Another type of corporate income tax allowance is a tax allowance for the sponsorship of popular team sports i.e. football, handball, basketball, water polo and ice hockey. The sponsor is entitled to receive a tax allowance, up to the amount specified in the donation certificate issued by the recipient (sport association, foundation) provided that the sponsor has transferred the amount to the recipient's account.

» Tax allowance on sponsorship of film production and performing artists

Similarly to the tax allowance on sponsorship of popular team sports, the sponsor is entitled to receive a tax allowance, up to the amount specified in the donation certificate issued by the recipient provided that the sponsor has paid the amount to the recipient.

The donations are also acknowledged as business-related expenditure for corporate income tax purposes.

From 19 May 2013, the system of auxiliary donations is applicable (in the case of film production and performing artists' sponsorship from 1 January 2014). The sponsor is obliged to pay auxiliary donations amounting to 75% of the value of the particular donation indicated on the donation certificate calculated using a 10/19% tax rate. The amounts of auxiliary donations do not qualify as a recognised cost incurred for the benefit of the business.

The above mentioned tax allowances can be utilised up to the end of the sixth tax year calculated from the tax year when the sponsorship amount was granted.

Accordingly, from 2014, the effective corporate income tax saving available due to these tax benefits is limited.

3. Types of business organisations

GENERAL PROVISION RELEVANT TO ALL BUSINESS ORGANISATIONS

A company which is formed and registered in accordance with Hungarian law has the right to acquire property and conclude contracts, as well as to file lawsuits and have lawsuits filed against it. In addition, it may engage in a wide range of activities. For certain activities, special permission is needed from the relevant authority. Companies with foreign participation may be set up in any form listed in the Companies Act. From 15 March 2014, the detailed rules of companies will be regulated by the new Civil Code instead of the Companies Act.

UNLIMITED PARTNERSHIP (Kkt)

In an unlimited partnership, the liabilities of the members are joint and unlimited, and no minimum initial capital is required. Members do not have to contribute to the activities of the partnership.

LIMITED PARTNERSHIP (Bt)

In a limited partnership, the liability of at least one of the partners is unlimited and, if there is more than one general partner, the general partners are liable jointly and severally. The liability of at least one of the partners is limited to the extent of his or her capital contribution. No minimum initial capital is required.

LIMITED LIABILITY COMPANY (Kft)

A private company limited by equity is founded with a predetermined amount of initial capital provided by its founder(s). The liability of each member in relation to the company extends to the provision of their initial contributions,

beyond which they are not responsible for the company's liabilities. The rights of the members and the share due to them from the assets of the company are represented in the company's equity capital. A limited liability company is managed by one or more managing directors. The minimum capital requirement is HUF 500,000 until 14 March 2014. As of 15 March 2014 the minimum capital will be increased to HUF 3 million. The formation of a limited liability company can be arranged by a simplified procedure which is suitable for most companies; furthermore the costs of the simplified procedure are significantly lower.

The most important costs payable in respect of establishing a Kft in Hungary are as follows:

- » Initial minimum capital of HUF 500,000 / HUF 3 million (from 15 March 2014) (approximately EUR 1,660 / EUR 10,000);
- » stamp duty payable on the request for registration is HUF 100,000 (approx. EUR 330);
- » publication fee in the Company Gazette is HUF 25,000 (approx. EUR 80);
- » from 2012, registration at the Chamber of Commerce and Industry has to be applied for with respect to the place of its registered office within 5 days of the company's registration in the Company Register (HUF 5,000 registration fee, approx. EUR 20);
- » other charges for specimens of signatures, official translations and costs for legalization of signing documents that were signed abroad (these amounts are insignificant).

3. Types of business organisations

COMPANY LIMITED BY SHARES (Zrt, Nyrt)

This type of company is established through the issuing of shares in a predetermined total nominal value. The liability of its members is limited to their contribution to the total nominal value of the shares. The shares of a company limited by shares are securities embodying membership rights. A company limited by shares is managed by the board of directors and must have a supervisory board. Limited companies can be established in Hungary privately (private limited company – Zrt.) – with a minimum capital requirement of HUF 5 million – or open to the public (public limited company – Nyrt.) – for public limited companies, the minimum capital requirement is HUF 20 million. The shares of public limited companies may be traded publicly, in contrast with the private limited company whose shares are not offered to the public.

BRANCH OFFICE

A foreign investor may decide to establish a presence in Hungary as a foreign private entrepreneur, through a commercial agent, as a commercial representative office or a branch of a foreign company.

A branch is an organizational unit of a foreign enterprise having no separate legal identity. The branch is authorized to pursue business activities independently. The foreign company must continuously provide the assets needed for the operation of the branch and settle its debts. The foreign founder and the branch bear joint and several unlimited liability for debts incurred in the course of the activities of the branch. The branch comes into existence and may start its operation when it is registered by the Court of Registration.

A commercial representative office is not allowed to pursue business activities in Hungary independently; its general purpose is to facilitate the local business activity of the foreign company.

SINGLE PERSON COMPANY

A single person company is a new type of corporate taxable entity from 2010 (an organisation with legal personality, established by a natural person and registered in the company register).

4. Accounting and audit

ACCOUNTING PRINCIPLES

Hungarian accounting principles are regulated by the Act on Accounting, which took effect on January 1, 2001. This act is intended to move Hungarian financial reporting practices closer to International Financial Reporting Standards (IFRS) and to EU practices. The Act applies to all entities (with the exception of sole traders, civil law associations, building co-operatives and the Hungarian commercial-representation offices of foreign-registered companies).

AUDITING REQUIREMENTS

According to the Hungarian Accounting Act, audit is not required for enterprises whose annual net turnover does not exceed HUF 300 million as from 2014 and whose annual average number of employees is not more than 50 as an average for the two financial years preceding the current reporting year. For consolidated companies an audit is obligatory regardless of their size. In any other cases in which the auditing of accounts is not compulsory, the enterprise may choose whether to appoint an auditor. Audits must be carried out mainly in accordance with the International Standards on Auditing which are supplemented by a Hungarian National Standard.

REPORTING REQUIREMENTS

The minimum reporting requirements for a business entity depend on the nature of the entity's operations, its size, ownership control and its form, and on whether the company has a controlling interest in other companies. The various forms of statutory reporting are as follows: simplified report, simplified annual report, annual report and consolidated annual report. An annual report consists of a balance sheet, a profit and

loss account, supplementary notes and a business report. In case of a simplified annual report, a business report is not required and the content of supplementary notes is limited also. A simplified annual report is permitted for entities that over the previous two consecutive years have fulfilled at least two of the following criteria: less than HUF 500 million in total assets, up to HUF 1,000 million in turnover and the annual average number of employees is less than 50. Entities not meeting these criteria must prepare a normal annual report. A parent company that has at least one subsidiary must, depending on the size of the group, prepare a consolidated annual report. If the Hungarian parent company has a parent company within the EU, which prepares a consolidated report in which the Hungarian subsidiaries are included, the Hungarian parent company will be exempted from the preparation of a consolidated report. Separate guidelines apply to financial institutions and insurance companies. Companies have to publish their annual statements via online submission up to the end of the fifth month from the end of the tax year at the Court of Registration. These reports become publicly available in hard copies at the Court of Registration upon request (documents are also available online).

From 2010, most companies (except for financial institutions) can opt to keep their books and prepare their financial statements in Euros and from 1 January 2014 in USD, as long as they have recorded their decision in their accounting policy and specified the Euro or USD as the accounting currency in their deed of foundation, prior to the first day of the given business year. The taxpayer is not allowed to return to forint-based book-keeping for five years after switching to Euro-based or USD-based accounting.

5. Social security

HEALTH AND PENSION INSURANCE

Participation in the Hungarian social security system, which consists of health and pension insurance, is mandatory for all Hungarian citizens who work in Hungary and for all foreign nationals who work in Hungary for Hungarian companies. Special rules are applicable for assignments in Hungary from another EU Member State based on EU Directive 883/2004.

An employer is obliged to pay a 27% social contribution tax on the gross salary. Each employee is subject to a 10% pension contribution and 8.5% health care contribution on earnings from his or her principal employment. The upper daily limit for pension contributions paid by the employee is abolished from 1 January 2013 meaning that the 10% pension contribution is payable regardless of the level of income.

PRIVATE PENSION FUNDS

Besides the above-mentioned state social security system, there is also a system of regulations for private pension funds in Hungary. From January 2011 many former members of private pension funds returned to the state pension system. The number of people still being members of a private pension fund is very limited and we expect a continuous drop in the number.

SOCIAL CONTRIBUTION TAX

This type of tax covers employer social security contributions. The rate is 27%.

SOCIAL SECURITY TREATIES

Hungary has concluded several social security treaties to provide relief from double social security payments and to assure a certain level of benefits coverage. Most of these agreements apply for an indefinite period. EU Regulations regarding Social Security are applicable from 1 May 2004 and override Hungarian rules. In addition to the EGT members Hungary have been concluded bilateral social security treaties with the following countries: Montenegro, Bosnia-Herzegovina, Canada, Quebec, Mongolia, Republic of Korea, Australia, India and Japan.

From 1 January 2010, tax liabilities arising from benefits disbursed under the heading of social services, family support or welfare assistance on the basis of foreign laws must be determined in accordance with tax liabilities related to similar benefits under domestic law.

Any citizen of a third country with which Hungary did not conclude a bilateral social security treaty can be assigned contribution-free in Hungary generally for two years calculated from the date of assignment (from 2014, under certain conditions assignments lasting longer may also be treated the same way). Social security payment obligation will not arise before 1 January 2015 even in the case of assignments commenced prior to 1 January 2013 (for treaty countries, generally a longer exemption period applies).

6. Taxation

GENERAL STRUCTURE

The Hungarian parliament adopted a number of wide-ranging tax reforms in its 1987 sessions, which effectively set the seal on a change to a free market economy and the abandonment of central planning in most spheres of economic activity. By now Hungary has a complex system of taxation to accommodate the increasingly sophisticated business environment. Hungary has concluded tax treaties with more than 70 countries¹.

Hungarian taxation operates under a self-assessment system. Taxpayers are required to register, determine their tax obligation, make advance tax payments, file tax returns on their own behalf, make corrections to the tax returns as needed, keep records and supply information as required by the law. Normally, individuals are assessed once a year, but corporations are subject to continuous assessment throughout the year. The authorities randomly examine tax returns to enforce the self-assessment system. The statute of limitations for tax liabilities in Hungary is five years from the end of the calendar year in which returns must be submitted for the relevant period. In 2011, Hungarian Tax Authority and Customs Authority merged under the name of National Tax and Customs Authority (NAV).

CORPORATE INCOME TAX

A company, which is domiciled in Hungary, is obliged to pay corporate income tax on its worldwide income. A non-resident company is taxable on its Hungarian source income, as well as income taxable in Hungary based on double taxation treaties. State companies, companies limited by shares (Zrt, Nyrt), limited liability companies (Kft.), partnerships (Bt and Kkt), branch offices of foreign enterprises and single-person

companies are subject to corporate income tax. In addition, permanent establishments of foreign enterprises and foreign organisations may also, under certain circumstances, be liable to pay corporate income tax in Hungary.

Tax rate

The standard rate of income tax for Hungarian and in limited cases for foreign companies is 19%.

From July 2010 up to a tax base of HUF 500 million (approximately EUR 1,660,000), the corporate income tax rate is reduced to 10% which is applicable without any conditions while 19% is payable on the rest of the tax base.

From 1 July 2007, an "expected" minimum tax is levied on companies, whose corporate income tax base does not reach the "expected" minimum tax base, i.e. 2% of the total revenue (reduced by certain items, e.g. costs of goods sold and value of intermediated services). The "expected" tax base is subject to tax on the general corporate income tax rates. Paying corporate income tax on the "expected" tax base can be avoided by filling out a detailed declaration regarding the income generated and costs recognised during a given business year.

From 2006, former offshore companies are subject to the general corporate income tax rate (10%/19%) as well. The former effective tax rate of 8% for companies engaged in financing activities (instead of the formerly applicable 16% tax rate) is abolished from 1 January 2010. Only companies generating royalties are taxed at 5%/9.5% on this income.

From 2010, if realising capital gains upon sale of their shares in companies holding real estate

¹ Please see Appendix 1 for the list of countries.

6. Taxation

(except for reported shareholding), foreign entities, under some circumstances, may also be subject to Hungarian corporate tax.

CFC rules

From 1 January 2011, a foreign company will be classified as a "controlled foreign corporation" if it has a beneficial owner tax resident in Hungary or generates mainly Hungarian source revenue if the effective ratio of the paid (payable) corporate tax for the given year is less than 10%, or if the foreign company does not pay corporate tax despite making a profit, because its tax base is zero or less. This provision is not applicable if the foreign company's registered headquarters or tax residency is in the EU or an OECD member state, or any other state having concluded a double taxation treaty with Hungary. A foreign company does not qualify as controlled foreign corporation if a person or a related party thereof that has been listed on a recognised stock exchange for at least five years, as of the first day of the year holds at least a 25% share in it on every day of the tax year.

As an important change from 2012, the qualifying conditions have to be proved by the taxpayers themselves. Additionally, if a consideration is paid by a company to a CFC, it qualifies as tax deductible only if the company verifies that the respective costs are linked to the company's business activity also by preparing documentation on the transaction.

Tax administration

Companies are assessed on a calendar-year basis or on a business-year basis. The business year may only differ from the calendar year if the Hungarian company is a fully consolidated

subsidiary or branch of a foreign parent company that uses a business year different from the calendar year.

Taxable income is based on financial statements prepared in accordance with Hungarian accounting standards. Some items are tax deductible, such as dividends received (with the exception of dividends from controlled foreign corporations). The taxable profit is determined by adjusting the profit shown in the annual accounts by items specified in the Act on Corporate Income Tax.

Companies must file their corporate income tax returns and pay any balance of tax due by 31 May of the year following the tax year concerned, or by the 150th day following the end of the business year if different from the calendar year. Based on the actual corporate income tax liability indicated in the tax return, the company calculates its corporate income tax advance payments for the next 12-month period. If the tax liability is more than HUF 5 million, then the advance payments are payable monthly in 12 equal instalments, otherwise the tax advances are payable quarterly.

If previous year's net revenue exceeds HUF 100,000,000 companies must estimate their annual corporate income tax liability and pay the difference in addition to their advance payments by the 20th day of the last month of the current business year (top-up payment liability). If 90% of the actual corporate income tax liability (which is finalised only five months later) exceeds the tax-advance payments in total, a 20% default penalty is levied on the difference.

6. Taxation

Tax losses

Tax losses may be carried forward for an unlimited period of time to relieve the company's profits provided that losses are established in accordance with the good faith business principle. However, when offsetting the current tax year's positive taxable income by losses brought forward, the earliest losses must be used first (according to the FIFO principle). Moreover, according to a modification to the Act on Corporate Income Tax effective from 2012, tax-payers are able to use the accrued losses of previous years up to 50% of the tax base excluding losses used. This provision affects the schedule of the utilisation of accrued losses brought forward from earlier tax years.

From 2013, legal successors are entitled to use loss carry forwards, if in the two fiscal years following the reorganisation, sales revenue is generated from at least one activity carried out by the legal predecessor. In the event of a spin-off, this obligation also applies to the taxpayer from which the spin-off took place. This condition no longer has to be met if the taxpayer is terminated without legal succession within two fiscal years following the reorganisation, or if the activity of the legal predecessor was only related to asset management.

From 1 January 2014, in the case of company mergers, the legal successor can utilize the legal predecessor's corporate tax losses generated in the year of the merger at first in the year when the transformation took place.

Similar restrictions apply regarding the utilization of tax losses in the case of changes in the ownership of companies. The rules have been eased going forward since the two-year condi-

tion does not have to be met if the acquired company is terminated without legal succession within two fiscal years following the acquisition.

Thin capitalisation rule

The thin capitalisation rule is even more stringent than the limitations contained in the OECD model. If a Hungarian company or branch takes out a loan that exceeds its equity by a factor of more than three during any given business year, the interest charged on the excess is non tax-deductible. A further limitation is that these provisions are applicable for all loans (except for those from financial institutions), including non-public bonds and certain notes. The provisions are also extended to interest paid by companies in a cash pool structure.

From 1 January 2012, pursuant to the modification of thin capitalisation regulations, in the course of applying the rules on transfer pricing the liabilities that are to be taken into account when identifying thin capitalisation include not only liabilities pursuant to which the taxpayer must pay interest to the charge of its profit, but also interest-free liabilities, if the taxable entity reduces its tax base with the amount of arm's length interest in accordance with the transfer pricing rules ("deemed interest adjustment"). When calculating thin capitalisation, the daily average volume of liabilities is reduced by the total daily average volume of financial receivables reported among invested financial assets, receivables or securities.

As from 1 January 2013, when assessing thin capitalisation, commercial liabilities and receivables should not be taken into account for the purposes of the calculation.

6. Taxation

Transfer pricing rules

Transfer pricing documentation has to be prepared for contracts between related parties to support the market price. From 2010, transfer pricing documentation rules cover transactions between a foreign company and its Hungarian branch as well as transactions between taxpayers and their foreign branches. Transfer pricing rules also refer to company foundation by way of contribution in kind if the founder becomes a person having majority interest upon establishing the company. Transfer pricing documentation can also be prepared in English, German or French.

From 1 January 2011, the Transactional Net Margin method and the Transactional Profit Split Method can be used to determine the arm's length price for transfer pricing documentation purposes in accordance with OECD Transfer Pricing Guidelines.

In some cases, there is no need to prepare transfer pricing documentation at all from 2012 while certain transactions qualifying as low value intercompany services can be documented by way of a simplified documentation.

As from 21 July 2013, no transfer pricing documentation has to be prepared for related party transactions with a net transactional value up to HUF 50 million (without VAT) in the corresponding tax year. This rule can be applied for the transfer pricing documentation liability concerning tax year 2012 for taxpayers having a tax year different from calendar year.

Most important corporate tax base-decreasing items

Companies are able to establish a tax-deductible reserve of up to 50% of their pre-tax profit, up to a maximum of HUF 500 million. This develop-

ment reserve must then be used for investment in tangible assets. Assets acquired using this reserve do not then qualify for tax depreciation up to the value of the reserve used, so this is, in effect, a form of accelerated depreciation. The reserve established must be applied within four years while the tax amount falling on the unused reserve amount has to be repaid with default interest.

Pre-tax profit may be decreased by direct costs of research and development incurred during the tax year performed in relation to the taxpayer's business activity (from 2012, R&D costs are re-defined in the law). Companies may choose to decrease their pre-tax profit by depreciating the capitalised value of research and development. However, this rule applies neither to research and development costs financed by subsidies, nor to research and development services received. Under this provision, the accounting profit may be decreased by twice the amount of the research and development cost or the depreciation related to its capitalised value. As of 2014, taxpayers may lower their corporate tax base with the direct costs of research and development activity carried out by a related party, if the related party has not used such relief so far. This requires that the activity be related to the income-generating activity of the taxpayer and its related company, and that the taxpayer has its related company's statement on the amount of direct costs of research and development performed as part of its own activity.

In case of donation contracts with public-benefit organizations for supporting their activities performed in the interest of the public the pre-tax profit may be decreased by 20% in the case of public-benefit organizations while pre-tax profit may be decreased by 50% if it is provided to the

6. Taxation

Hungarian Salvage Fund or the National Cultural Fund. An additional tax benefit of 20% is available in the case of long-term donation contracts. These tax base deductions are available up to the pre-tax profit.

From 1 January 2012, the concept of “reported intangible asset” has been introduced in corporate taxation. Reported intangible assets are intangible assets that entitle their holder to receive royalties and are reported by the taxpayer to the Hungarian tax authority within 60 days following their acquisition. Provided the taxpayer has kept the intangible asset in the books continuously for at least 1 year before the sale or in-kind contribution of the reported intangible asset, a tax payment obligation will not incur in relation to the profit accounted for on the basis of the sale or in-kind contribution of the respective intangible asset. As of 1 January 2013, the concept of intangible assets is extended to cover also self-manufactured intangibles.

From 1 January 2012 a contingent tax exemption is also granted with respect to profit realised from the sale or from the cancellation from the books as a contribution-in-kind of (non-reported) intangible assets that entitle its holder to receive royalties. The condition of tax exemption is that the taxpayer must release the allocated amount during the three tax years following the tax year concerned for the purpose of acquiring additional intangible assets that entitle its holder to receive royalties. If the conditions are violated, the unpaid tax must be paid together with late payment interest.

Deduction from the corporate income tax base of the amount of local business tax accounted for as an expense is not possible.

Free benefits provided to foreign persons and persons with foreign tax residence based on the place of business management (grant, benefits or assets provided, or liabilities assumed, without a repayment obligation, or services provided free of charge in the given tax year) may no longer be reflected in the company's tax base as expenses incurred in the interests of the enterprise (even if the beneficiary is party to a double-taxation treaty with Hungary). To prove that such a benefit provided to a domestic company qualifies as justified expense, the recipient party has to provide a declaration with specific information about its profit.

Reported shareholding

Capital gains/FX gains realized as a result of certain investments are exempt from corporate income tax. From 1 January 2014, if the taxpayer holds at least 10% (earlier 30%) of the shares of a domestic or foreign company continuously for at least one year, and the acquisition of shares was reported to the tax authority (from 2014 within 75 days) following the acquisition, with certain adjustments to be made from 2013 the corporate income tax base can be reduced by the capital gain/FX gain deriving from the sale or in-kind contribution of the registered stockholding in the year of disposal/contribution of the shares. However, the corporate income tax base has to be adjusted by any realized / unrealized losses on such a reported shareholding.

WITHHOLDING TAX

The 30% withholding tax payable by foreign entities and foreign private individuals with respect to any interest, royalties and certain service fees payments is abolished with effect from 1 January 2011.

6. Taxation

No tax should be withheld from dividends paid to foreign organisations.

VALUE ADDED TAX (ÁFA)

Value added tax is the general sales tax in Hungary (known as ÁFA), and is based upon the framework of European Union directives. A completely new VAT law is in effect in Hungary from 2008. VAT must be charged by all individuals as well as legal entities or foreign enterprises that supply goods or services on a regular basis within the territory of Hungary. From 1 January 2012, the standard rate of VAT is 27% and the preferential rate is 5%. Furthermore, besides the currently effective preferential VAT rate of 5% applicable for certain products (medicines, books etc.), there is another preferential VAT rate (18%), which applies to dairy products, bakery products and for certain heating services.

The tax base is the net sales price. Imports (from third countries) are also subject to VAT at a taxable base calculated as the sum of the customs value, customs duties and other charges.

Transactions such as financial services, insurance, transfer of shares and provision of loans are exempt from VAT. In general, with certain exceptions, the sale and lease of properties is also exempt from VAT provided that the taxpayer did not opt for treating such transactions as taxable. As an exception, the sale of properties qualifying as "new" in accordance with the Hungarian VAT law and construction lands are subject to VAT.

The procedures for filing VAT returns depend on the amount of income constituting the base for the VAT calculation. As a general rule, VAT-registered taxpayers are required to file a VAT return quarterly, but those VAT-registered taxpayers

(excluding taxpayers possessing an EU VAT number) with an annual tax balance less than THUF 250 have to file their tax returns annually. If the net cumulated VAT liability calculated from the beginning of the corresponding tax year exceeds HUF 1 million, the taxpayer is obliged to file tax returns on monthly basis (switch to monthly filing).

Intra-community summary reports have to be submitted electronically. As a general rule, summary reports (for both products/services and sales/acquisitions) have to be submitted to the Hungarian tax authority on a monthly basis by taxpayers obliged to make monthly VAT returns, and on a quarterly basis in the case of taxpayers obliged to make quarterly tax returns. Irrespective of the applicable frequency of filing tax returns, any given taxpayer has to switch from quarterly summary statements to monthly statements provided that the total value of product sales for the given quarter, calculated without VAT, exceeds EUR 50,000 (the applicable HUF amount should be calculated by using FX rate 252.19 HUF/EUR).

In line with the new provisions of the EU VAT Directive, from 1 January 2013, taxpayers complying with the terms and conditions set forth in the law and reporting this to the tax authority beforehand can opt for a cash accounting procedure regarding the settlement of value added tax. This system can be opted for by the end of the calendar year in question. A further criterion to opt for the cash accounting procedure is that the net sales during the current and the previous calendar year cannot exceed HUF 125 million.

From 1 January 2013, taxpayers have to submit a summary report for domestic product supplies (purchase of goods) and service supplies (use of services) where the amount of value added tax

6. Taxation

charged is at least HUF 2 million. The determination of the HUF 2 million threshold and the reporting obligation is technically different at the vendor/service provider and the buyer/ service user.

Based on Council Directive 2013/43/EU, the period to apply reverse charge taxation on certain agricultural products is extended from 30 June 2014 to 31 December 2018.

PERSONAL INCOME TAX

Personal income tax is an obligation imposed on all private persons in relation to income derived from sources within Hungary as well as to any foreign-source income of private persons resident in Hungary. From 1 January 2013, a flat 16% personal income tax rate is levied on incomes that are subject to tax as part of the consolidated tax base (e.g. employment income) as well as for incomes taxed separately (e.g. interest, dividend income). In 2011, a significant family tax benefit system was introduced to personal income taxation. In the case of one or two dependants the deductible amount from the tax base is HUF 62,500 per eligible dependant per month. In the case of at least three dependants HUF 206,250 is deductible from the personal income tax base per eligible dependant per month. Certain additional documents are needed to benefit from this deduction. From 1 January 2014, private persons who are unable to fully utilise the family tax allowance during a certain calendar year due to lack of sufficient tax base, entitled to validate the remaining amount of the tax allowance in the form of relief from individual health insurance and pension contributions payable.

From 2013 there are limitations on family allowances claimed by non-resident foreign individuals to protect the taxable base. On one hand, the allowance may only be claimed if the same or a

similar allowance is not available in the other country for the same period, while on the other hand, at least 75% of the private individual's total income must be taxable in Hungary to qualify for this allowance.

For further information on the applicable treaty withholding tax rates on dividends, interest and royalties regarding personal income tax, please see Appendix 1.

LOCAL BUSINESS TAX

A company may be subject to local business tax within the territory of a given municipality if it has its registered seat or a permanent establishment there. The maximum rate of the local business tax is 2% of the tax base (i.e. net revenue based on Accounting law – cost of materials – purchase price of goods sold – intermediated services – direct costs of research and development).

When assessing the taxable base for local business tax, the cost of goods sold and the value of intermediated services are deductible from the tax base only to a limited extent in certain cases from 1 January 2013. Detailed rules are laid down in the law to regulate the deductible ratio. The entire amount is deductible up to a net sales revenue figure of HUF 500 million (full deduction is not possible in respect of the tax base exceeding HUF 500 million).

PROPERTY TRANSFER TAX

From 2010, the general rate of transfer duty payable on property transfers is 4%. If the market price of the property (before allowing for any encumbrances) exceeds HUF 1 billion, the rate of duty will be 2% on the portion in excess of this, although the total amount of transfer duty

6. Taxation

payable per property cannot exceed HUF 200 million. In the case of companies engaged in the sale of properties in a business manner, the rate of duty is 2% provided that the company complies with the related statutory regulations.

The acquisition of a participation (shares, equity interest, co-operative share, investment share) in a company holding properties in Hungary may be subject to transfer tax (and a reporting obligation). Companies with domestic real estate representing a value of at least 75% of the asset value in its balance sheet are considered as companies holding real estate. Acquisition of such participations as well as properties between related parties is free from transfer tax/stamp duty. In the case of transfer of properties, the related party recipient's main business activity should be transfer or lease of properties to qualify for exemption from transfer tax.

There is duty exemption for acquisitions of movable assets not subject to duty on onerous property transfer by economic entities within uncompensated transfers of assets or free transfers of receivables between economic entities if certain conditions are met. The conditions for this are that the property acquirer (based on his declaration) must be seated or have residency based on the place of business in a state in which the corporate tax to tax base ratio reaches 10% (or the lowest tax rate is at least 10%, for zero or negative earnings and tax base), or income from the sale of business interests or capital contributions is subject to tax similar to corporate tax of at least 10%.

OTHER TAXES AND CHARGES

The special tax obligation on store-based retail, telecommunication and energy sector is abolished from 1 January 2013.

Special tax on financial organizations

Financial organizations have to pay a special tax based on modified net sales revenue deriving from the annual report. In the case of credit institutions the rate of tax up to a tax base of HUF 50 billion is 0.15% and on the part in excess of HUF 50 billion it is 0.53% while the tax rate differs for other types of financial organizations. The tax base is the modified amount of total assets of 2009.

In addition to the above, in 2014 the financial organisations are obliged to pay a one-off 19% tax which is payable on the amount of general risk provision reclassified as a profit reserve on 31 December 2013. This amount must be declared and paid as a corporate tax liability by 10 March 2014.

Financial transaction tax

From 1 January 2013, a financial transaction tax is levied on financial transactions like money exchange activities, money transfer, paying off loans and cash withdrawal. The general tax rate payable by financial institutions is 0.3% but it is capped at HUF 6,000 while in the case of cash withdrawal the tax rate is 0.6% without any upper limit.

Telecommunication tax

From 1 July 2012, a new tax is levied on the telecommunication sector while the former special tax obligation is abolished from 1 January 2013. This tax should be paid on telecommunication services e.g. phone calls, SMS messages. From 1 August 2013, the tax rate is HUF 2 per minute and per SMS capped at HUF 700 per month in case of individuals while HUF 3 per minute and per SMS capped at HUF 5,000 per month for companies.

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Tax on public utilities

From 1 January 2013, a new tax is levied on the owner of the public utility line as per the ownership status on the first day of the calendar year (if the owner is the Hungarian state or local government, the taxpayer is the operator of the public utility pipeline). The taxable base is the length of the public utility line in metres. The tax amounts to HUF 125 for each metre. Taxpayers with telecommunication lines can apply for some allowance (on a declining scale) for a section less than 500,000 metres (taxpayers with telecommunication lines in excess of 500,000 metres must pay the entire sum of the tax).

Tax on energy service providers

The tax is levied on the companies operating in the energy sector (energy service providers). The tax base is the profit before taxation modified by special increasing and decreasing items. The tax rate is 31% of the positive tax base (plus the tax is not deductible for corporate income tax purposes). From 1 January 2014, the companies are obliged to pay tax advance monthly if the tax base of the previous year exceeded HUF 5 million and quarterly below HUF 5 million.

Insurance tax

From 1 January 2013, new tax is payable by the insurance companies on specified insurance services i.e. vehicle insurance as well as property and accident insurance (life insurance is not subject to this tax). The tax base is the insurance fee. The general tax rate varies between 10 and 15% depending on the type of insurance.

Accident tax

From 2012 the operators of vehicles have to pay an accident tax. The tax base is the annual premium of mandatory third party risk vehicle insurance, and the rate of the tax is 30%. Insurance companies are obliged to collect the tax.

Vehicle registration charge

Following accession to the EU, a charge has to be paid by the owner of a car or a motorcycle at the time of its initial registration. The registration charge has to be paid on the basis of the performance of the engine (expressed in kW) registered in the official registry instead of each commenced cm³ of cylinder capacity, and should be differentiated on the basis of the vehicle's age in order to ensure that the stamp duty payable on the acquisition of vehicles is more in line with the value of the vehicle

Tax on company cars

Companies must pay tax on cars owned or leased by them regardless of the fact that the company cars concerned are used for private purposes or not. Until the end of 2011 the tax amount on company cars was payable on a quarterly basis depending on the cylinder capacity of the particular car (HUF 7,000/15,000). However, under the new legislation effective from 2012, the monthly company car tax is payable as one of the 12 tax amounts determined by matching the environmental impact of the cars based on the vehicle's environmental protection class with one of four engine performance (kW) categories in accordance with the following table :

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Engine performance (kW)	Vehicle's environmental protection class		
	0-4	6-10	5; 14-15
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

Innovation contribution

Companies that do not qualify as SMEs (small and medium sized enterprises) have to pay an innovation contribution. However, from 1 January 2012 the determination as to whether a company qualifies as an SME or not is based on consolidated data. As a result of this amendment, the scope of entities obliged to pay the contribution widened. The payment liability is 0.3% on the local business tax base (net revenue based on Accounting law – royalty income – cost of materials – purchase price of goods sold – intermediated services – direct costs of research and development). From 2012, a tax advance top-up payment liability exists for this type of tax, i.e. companies have to estimate their annual innovation contribution liability and pay the difference in addition to their advance payments by the 20th day of the last month of their current business year.

Environmental protection contribution

An environmental protection contribution is payable on products that may damage or pollute the environment (e.g. petroleum products, batteries, tyres, electronic appliances and equipments as well as packaging material) calculated mainly based on their net weight. Such payment is due upon production, importation, intra-Community acquisition and subsequent domestic sale or own use of goods if certain conditions are met.

Public health product tax

A public health product tax was introduced as at 1 September 2011 to decrease the consumption of unhealthy food. The tax base is the quantity of the taxable component (litre, kgs) of products. The tax rate is different depending on the component of the taxable products.

Pollution charge

This type of tax must be paid by consumers who emit certain materials into the air, water or soil. The base of the tax depends on the type and amount of material that is emitted. Taxpayers are obliged to file quarterly returns.

WTS in Hungary

The Klient Group was established in 1998. We are a reliable partner for our clients with many years of experience gathered on the Hungarian market and have become the Hungarian consultants for many national and international corporations. We provide accurate and professional consulting services in Hungarian, German and English. Our expertise is not only limited to Hungarian regulations. With the help of the international network of the WTS Alliance we are able to offer cross-border and global cooperation services.

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Appendix

Appendix 1.1

TREATY WITHHOLDING TAX RATES

	Dividens %	Interest %	Royalties %
Albania	5/10	0	5
Armenia	5/10	5/10	5
Australia	15	10	10
Austria	10	0	0
Azerbaijan	8	8	8
Belgium	10	15	0
Belarus	5/15	5	5
Bosnia and Herzegovina	10	0	10
Brazil	15	10/15	15/25
Bulgaria	10	10	10
Canada	5/10/15	10	10
China	10	10	10
Croatia	5/10	0	0
Cyprus	5/15	10	0
Cosovo*	0/5	0	0
Czech Republic	5/15	0	10
Denmark	0/0/15	0	0
Egypt	15/20	15	15
Estonia	5/15	10	5/10
Finland	5/15	0	5
France	5/15	0	0
Georgia	0/5	0	0
Germany	5/15	0	0
Greece	10/45	10	10
Hong Kong	5/10	5	5
Iceland	5/10	0	10
India	10	10	10
Indonesia	15	15	15
Ireland	5/15	0	0
Israel	5/15	0	0
Italy	10	0	0
Japan	10	10	10
Kazakhstan	5/15	10	10
Kuwait	0	0	10
Latvia	5/10	10	5/10
Lithuania	5/15	10	5/10
Luxembourg	5/15	0	0
Macedonia	5/15	0	0
Malaysia	10	15	15
Malta	5/15	10	10
Mexico	5/15	10	10
Moldova	5/15	10	0

Appendix

Appendix 1.2

TREATY WITHHOLDING TAX RATES

	Dividens %	Interest %	Royalties %
Mongolia	5/15	10	5
Morocco	12	10	10
Netherlands	5/15	0	0
Norway	10	0	0
Pakistan	15/20	15	15
Philippines	15/20	15	15
Poland	10	10	10
Portugal	10/15	10	10
Romania	5/15	15	10
Russian Federation	10	0	0
San Marino	0/5/15	0	0
Serbia & Montenegro (+)	5/15	10	10
Singapore	5/10	5	5
Slovak Republic	5/15	0	10
Slovenia	5/15	5	5
South Africa	5/15	0	0
South Korea	5/10	0	0
Spain	5/15	0	0
Sweden	5/15	0	0
Switzerland (-)	15	0	0
Taipei	10	10	10
Thailand	15/20	10/25	15
Tunisia	10/12	12	12
Turkey	10/15	10	10
Ukraine	5/15	10	5
United Arab Emirates (*)	0	0	0
United Kingdom	10/15	0	0
United States (-)	5/15	15	0
Uruguay	15	15	10/15
Uzbekistan	10	10	10
Vietnam	10	10	10
Quatar	0/5	0	5
Nontreaty countries	0	0/30	0/30

Explanation:

If there are two different rates, then the lower rate has to be applied if the receiving party owns directly at least 25% of the payer (according to the OECD model). For special cases please check the detailed double tax treaty.

(+) Although different countries, the same Treaty applies until separate ones are concluded.

(*) The treaties are not in effect yet.

(-) The new treaties are not in effect yet, but the old treaties can be applied.

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