

Tax Law Changes for 2009-2010

Tax Alert



This Newsletter is intended to provide information to our clients on the provisions of the act adopted by the Parliament, and draw attention to the major amendments to the effective legal regulations, since the whole of the Hungarian tax regime will be modified under the act, with the tax package providing for the introduction of a new tax type, the property tax.

Tax Law Changes for 2009-2010



Corporate income tax

Of the tax law changes adopted for 2010, the most remarkable is the temporary increase of the corporate income tax rate to 19%. At the same time, the act on solidarity tax payable by companies has been repealed, except for the provisions on credit institutions' contribution.

Besides the increase of the CIT rate, the legal amendments are aimed at a significant restructuring of the effective corporate income tax system. The modifications belong to the following three large categories:

- New provisions aimed at the prevention of tax evasion in line with the changed personal income tax system include the following:
 - Taxation of undistributed income of controlled foreign companies
 - Introduction of withholding tax on payments to countries without a treaty on the avoidance of double taxation
 - Regulation of the taxable status of a non-resident member of a company that owns real estate
- Crisis management and business incentive measures
- Restriction of modifying items and technical changes

The majority of modifications will take effect as of 1 January 2010, with the provisions aimed at crisis management applicable as early as the tax year 2009.

The key changes relevant to our clients are summarised below:

New provisions aimed at the restriction of tax evasion

New tax base adjustments related to the income of foreign controlled companies

Under the legal amendments the definition of a "controlled foreign company" is to be modified to be stricter than before, but from a certain perspective, the narrowed concept will be less stringent than its former interpretation.

Probably the most remarkable change about the definition is that the rules on controlled foreign companies will only be applicable if there is a Hungarian resident who is an actual shareholder in the foreign entity.

A private individual qualifies as the actual owner if

- he/she holds 25% of the voting rights or has 25% ownership,
- he/she has controlling interest (i.e. is entitled to appoint and recall the majority of the senior executives and members of the supervisory board, or directly or indirectly holds at least 50% of the voting rights under an agreement with other members or shareholders).

This means that the foreign related parties of multinational companies present in Hungary where the ultimate owners are typically non-resident entities will, by

definition, not qualify as controlled foreign companies in the future, irrespective of the geography of their operations and their tax residence.

A foreign entity qualifies as a controlled foreign company if the ratio of its tax paid (or payable) to its tax base is below two thirds of the Hungarian corporate income tax rate (i.e. 12.66% considering the suggested 19% rate), or if the foreign company pays no form of tax equivalent to corporate income tax as a result of having a zero or negative tax base, even though it makes a profit. If both the company's profit and tax base are zero or negative then it is the foreign statutory tax rate that must reach two thirds of the Hungarian corporate income tax rate. Companies in EU or OECD member states, or in countries with a treaty with Hungary on the avoidance of double taxation need not fulfil this criterion, but in this case the act requires real economic presence in these countries as a conjunctive criterion.

Production, processing, agricultural, service, trade and investment activities jointly performed with own assets and human resources by the foreign company and its related parties in the given state qualify as real economic presence if the related income is at least 50% of their total income (to be evidenced by the taxpayer).

Furthermore, under the legal amendments, foreign companies in which a reputable listed entity or one of its related parties has a share will not qualify as controlled foreign companies.

While the currently effective regulations only stipulate a tax liability on income deriving from a controlled foreign company if such income is realised by the taxpayer (receives dividend, etc), the amendment introduces taxes on the undistributed income of the controlled foreign company as well. Consequently, taxpayers having direct share interest in controlled foreign companies must increase their pre-tax profits by the part of after-tax profits (greater than zero) of such companies not distributed as dividends which is proportional to the taxpayer's direct share on the last day of the tax year, provided that the taxpayer owns at least 25% of the votes or shares or has controlling influence, and provided that no private individuals qualifying as resident individuals under the Act on Personal Income Tax possess a direct and/or indirect share in the taxpayer.

However, with a view to the avoidance of double taxation, dividend received from a controlled foreign company will decrease the pre-tax profit up to the previous tax base increase. Similarly, the exchange rate gain realised on the derecognition of the share held in the controlled foreign company will also decrease the pre-tax profit up to the amount of the former tax base increase (due to the undistributed income).

Withholding tax on payments to companies in countries without a double tax treaty

The amendment act would re-introduce withholding tax for foreign entities in some cases. The tax is payable by a foreign person or non-resident person who is paid royalty, interest or service fee by a resident taxpayer other than private individuals, provided that there is no effective treaty on the avoidance of double taxation between the country of the foreign person's residence and Hungary.

The tax base of the foreign entity is the interest, royalty or service fee received. Such interests do not include interests received from the Hungarian State, subsystems of the central budget or the National Bank of Hungary, and default interest. Service fees include fees for management, management consulting, advertising, public opinion polling and business agency activities, as set forth in Regulation (EC) No. 1893/2006.

The withholding tax rate payable on the income of the foreign entity will be 30%, to be deducted and paid by the payer.

Taxation of members of companies that own real estate

The legal amendment introduces the concept of a company that owns real estate referring to taxpayers and related parties owning real estate in Hungary where the value of Hungarian real estate exceeds 75% of the aggregate market value of assets shown in the financial statements, and a member (shareholder) is a foreign resident in a country with which Hungary has not concluded a treaty on the avoidance of double taxation, or the effective treaty allows the taxation of the exchange rate gain in Hungary. Consequently, if - with the related party data also taken into account - the company group qualifies as an entity that owns real estate, then each member of the group qualifies as such independently.

According to the legal amendments, the tax is payable by non-resident persons who gain income from the alienation or divestment of a share in a company that owns real estate ("member of a company that owns real estate"). Tax liability is incurred as of the day of alienating the share or the decrease of registered capital by means of divestment.

The amendment provides specific rules for the assessment of the tax base in case of members of companies that own real estate, under which the tax base is the positive amount of the consideration at the time of alienation or decrease of the company's registered capital, less the purchase price of the share and justified expenses associated with the acquisition or holding of the share, while the tax rate is the general rate stipulated by law.

The legal amendment also provides for the exchange rates to be applied for converting the foreign currency amounts into HUF for the assessment of the tax base, and also defines alienation (sale, contribution in kind, and transfer without consideration) and stipulates what to be regarded as consideration (consideration set forth in a contract, arm's length price in case of related parties).

Pursuant to the relevant amendments to the Act on the Rules of Taxation, the taxpayer shall annually declare within 90 days following the due date of filing the annual corporate income tax return that the company qualifies as a "company that owns real estate" as per the Act on Corporate Income Tax and Dividend Tax or that such status is cancelled and shall also make a declaration on the alienation of the shares by foreign members of the company, the date of such alienation and the residence of the given member.

The foreign member (shareholder) is not liable to declare and pay a tax advance, but the tax shall be declared and paid by 20 November of the year following the tax year.

Extension of the transfer pricing regulations

The legal amendment extends transfer pricing regulations to foundation through contribution in kind, and also to transactions between a foreign entity and his domestic sites or the taxpayer and his foreign sites.

Crisis management and economic incentives

Impairment-related adjustments

A crisis management solution is reflected in the amendment according to which 20% of expired receivables - but no more than the amount of impairment recorded - will be deducted from the tax base, thanks to the new definition of uncollectible receivables. This rule means that 100% of the amount of tax paid upon incurring a receivable can be reclaimed within 5 years and the rule may already be applied for the tax year 2009. Furthermore, financial institutions will be exempted by the legal amendment from the obligation to increase the tax base due to impairment (from 2009 onwards).

As a transitional rule, the amendment allows financial institutions to reduce their tax bases by the amount of impairment increasing the tax base recorded before 31 December 2008, in five equal instalments, one each year.

Thin capitalisation

As a newly introduced rule regarding thin capitalisation, financial institutions will not be required to consider debts related to financial service activities as liabilities. This rule may be applied as early as the tax year 2009.

Development reserve

The period available for the tax-exempt release of development reserves made prior to 31 December 2008 will be prolonged by two years, meaning that such reserves could be released within 6 years.

Development tax allowance

Pursuant to the amendment, small and medium-sized enterprises would be entitled to a development tax allowance if they carry out a construction project with a present value of at least HUF 500 million in any region. A prerequisite is that companies must increase headcount by 20 or staff costs by 50 times the annual minimum wage for small enterprises and increase headcount by 20 or staff costs by 50 times the annual minimum wage for medium enterprises.

Deferral of losses

The legal amendment extends the scope of the rules pertaining to the deferral of losses to credit institutions and financial institutions who will be able to use this option for the first time in 2009.

Restriction of modifying items and technical changes

The legal amendment introduces new provisions for the majority of the tax base modifying items and completely eliminates several of them, mostly for simplification purposes. Other amendments contain clarifications and technical changes.

Adjustment items that typically constitute deviations from the accounting regulations will continue to exist. As such, for instance, dividend received will still reduce the tax base and unrealised exchange rate differences, the impairment of receivables, provisions and revision and self-revision items arising in relation to insignificant errors will remain adjustment items.

All tax base benefits will be abolished, with the exception of benefits related to construction projects, employment, royalties, research and development and reported shares.

The items abolished are as follows:

- tax base decrease based on the income from transactions made on a regulated market,
- tax base decrease based on the proceeds received in compensation for the transfer of any emission allowance unit,
- benefits applicable to small and medium-sized enterprises which are based on a patent, consumer or industrial design and a consumer or industrial design protection right,
- deductibility of exchange rate gain realised on investments in small and medium sized enterprises,
- incentive based on the purchase of a work of fine art,
- use of local business tax as an item decreasing the tax base,
- subsidies granted and received,
- modifying items pertaining to 50% of the interest paid/received by related parties.

Of the tax base benefits abolished, the majority of companies could be adversely affected by the elimination of the option to apply local business tax as a reduction item.

Expanding of the concept of "reported shares"

A more favourable rule introduced by the amendment is the option for taxpayers who have already reported their shares exceeding 30% to the tax authority to report any other shares irrespective of their proportions and may apply the tax base benefit to such subsequently reported shares as well.

Subsidies granted and received and donations

Adjustment items related to transactions without consideration (subsidies granted and received, forgiven liabilities, assumed debt) will be abolished. Companies may apply the currently effective rules up until 2012 for income recognised in the tax year (as a result of deferrals) in relation to liabilities forgiven and debt assumed before 31 December 2009, and for income recognised in the tax year in relation to aid and subsidies received.

The current adjustment (increasing and decreasing) item related to donations will also be abolished, but this will not lead to any changes in the taxation of donations eventually since subsidies granted and received do not modify the tax base in the first place.

A portion of aid granted to special public service organisations or based on long-term donation agreements would still be eligible for tax benefits identical to those allowed by the current regulations (appropriate verification documents will still be required).

Research & development

The amendment clarifies the rules of tax base benefits related to research and development activities by allowing only the direct costs of research and development performed by the company to be deducted from the pre-tax profit. In determining the research and development nature of a service, the concept in the Frascati Manual must also be considered in addition to the one provided in the Accounting Act.

Benefits related to the renovation of monuments

The amendment contains a new benefit which allows, in addition to recording the related costs against profit, renovation costs which increase the value of buildings or structures under special local protection to be deducted from the pre-tax profit of the taxpayer who owns the monument or the building or structure under special local protection.

Preferential transformation and preferential exchange of shares

In cases where shares are retired from an entity's records due to an exchange of shares arising from another preferential transformation or preferential exchange of shares, the amendment provides that tax base increasing items which otherwise apply are not applicable.

Costs incurred in the interest of a company

Under the legal amendment, business entertainment and business gifts will be subject to corporate income tax as they represent costs that are not incurred in the interest of the company (however, the same benefits will be exempt from tax for personal income tax purposes). At the same time, the amendment provides that discounts, rebates, products, in-kind benefits and product samples (provided that such samples are not purchased for long-term use and their volume is less than the minimum threshold for distribution) provided publicly, under the same circumstances and for promotional purposes, do qualify as costs incurred in the interest of the company.

Taxes equivalent to corporate income tax

Pursuant to the amendment, taxes paid (payable) abroad based on dividends received qualify as taxes equivalent to corporate income tax, provided that the dividends received or the after-tax profit serving as the basis for the dividends are taxable in the tax year, i.e. in such cases, dividend tax could be taken into account.

Changes affecting personal income tax

Tax base, tax table, solidarity tax

Under the amendments adopted, the method of calculating the consolidated tax base will change as of 1 January 2010 and the tax base will include amounts classified as tax base increasing items under the PIT Act. Thus the consolidated tax base will include an amount determined according to the employer's social security contribution calculated based on earnings (which, according to the Bill, would make up a total of 27% after 1 January 2010, see below) or, if there is no social security liability, an amount calculated based on the health tax liability (which would also be 27% after 1 January 2010), while gross earnings will still be the basis for the social security contributions and the health tax.

The concept of "earnings typical of an activity" and, in relation to this, the concepts of entrepreneurial drawings and personal involvement fee will be introduced. Based on this, for private entrepreneurs and companies where the amount of withdrawals and personal contributions is less than the earnings typical of activities determined based on the FEOR numbers, then such an amount qualifies as income that is part of the consolidated tax base (i.e. arising from independent and non-independent activities) of the private entrepreneur or company. As a result of the above amendments, the rules pertaining to the calculation of tax advances and income certificates etc. will change accordingly from 2010.

According to the tax table applicable to the consolidated tax base, the personal income tax rate of the lower category will be reduced to 17%, with the relevant limit being raised to HUF 5 million. For earnings exceeding HUF 5 million, the personal income tax rate will be 32%, with the solidarity tax being abolished and incorporated into the tax rate of the upper category of the personal income tax. The changes to tax credit rules will also favour taxpayers as both the monthly limit and the earnings limit for eligibility will be raised, from HUF 11,340 to HUF 15,100 and to HUF 3,188,000, respectively. The tax implications of the above amendments are likely to favour those with monthly gross earnings between HUF 220 thousand and HUF 300 thousand.

As of 2011, as a result of the amendments adopted, the limit of the lower category will increase from HUF 5 million to HUF 15 million, with the tax rates will remaining unchanged.

Tax benefits

Almost all tax benefits will be abolished (including, for example, the tax benefits on insurance and on tuition fees), with the exception of family allowances and benefits related to payments made to voluntary mutual insurance funds and pension savings accounts.

Other income

From 2010, the portion of the after-tax profit of controlled foreign entities under the CIT Act which is not distributed, and which is attributable to the individual as the owner, qualifies as other income for the individual, provided that the individual's direct or indirect share or share of the votes (together with those of his/her close relatives) is at least 25%. The time of receipt of the income is the day when the entity's after-tax profit is approved. Other income will also include interest and dividends paid by controlled foreign companies, provided they are

not taxed as non-distributed profit, along with any exchange rate gains on the sale of the shares of the controlled foreign company.

Furthermore, other income will include any interest obtained by Hungarian resident individuals from countries that have not signed a treaty with Hungary on the avoidance of double taxation.

Benefits in kind and other taxable benefits

The taxation of benefits in kind will become much more stringent according to the act, which will significantly impact - among others - cafeteria systems offered by companies.

Based on the provisions adopted, of the current scope of tax exempt benefits in kind, preferential computer and Internet use will continue to be tax exempt. Liabilities forgiven by credit institutions will also qualify as tax exempt benefits in kind, provided that the liabilities are forgiven in order to prevent the debtor and his/her family from going bankrupt, on the basis of the principle of equal treatment for those in identical circumstances. Benefits taxed "at a preferential rate" will include holiday vouchers (up to the amount of the minimum wage), school training (up to two and a half times the minimum wage), local travel passes, hot meal vouchers (up to HUF 18 thousand a month), school enrolment support (up to 30% of the minimum wage), voluntary mutual pension funds and health care funds (up to 50% and 30% of the minimum wage, respectively), contributions to employer sponsored pension institutions (up to 50% of the minimum wage) and employer's supplements to mandatory private pension funds. From 2010 these benefits will be subject to a 25% tax payable by the provider, but otherwise exempt from social security contributions. Due to the recording obligation associated with benefits in kind subject to preferential and standard tax rates the administrative burden on employers is expected to increase further.

In addition to the foregoing, having regard to the 54% general tax rate, from 2010 taxable benefits in kind will include, among others, cold meal vouchers and gifts of small value.

Some additional, currently tax exempt benefits will also become taxable, such as fuel savings (which, however, will remain tax exempt up to HUF 100 thousand a month). Employer support for housing purposes will become a non-taxable emolument. However, the possibility of treating products or services, provided to private individuals who have not entered into an insurance relationship, as benefits in kind is extended considerably.

Business entertainment and business gifts

Income associated with business entertainment and business gifts will qualify as tax exempt benefits in kind from 2010 provided that they are regarded as items increasing the corporate income tax base of the payer.

Income from interest rate discount

According to the changes in the regulations, the interest rate discount received by private individuals in respect of their dependent activities will also become taxable at flat rate pursuant to the rules applicable to income from interest rate discount. Furthermore, the tax rate applicable to income from interest rate discount will increase from 44% to 54% from 2010.

Tax deduction (tax payment)

The total amount of interest, royalty and management fees paid to non-resident private individuals will be regarded as income subject to 30% withholding tax, provided that Hungary does not have an effective treaty with the private individual's country of residence for the avoidance of double taxation. The tax shall be withdrawn and paid by the payer (or paid in the case of non-cash benefits), however, this liability does not apply to interest paid and credited by credit institutions.

Sale of real estate

The place of gainful activity in the case of income derived by a non-resident private individual from the transfer or lending of his share in a company that owns real estate will be in Hungary. Furthermore, in the case of such income the designation will be changed to "income from the transfer of real estate or rights in immovables", however, it is not possible to apply the rules otherwise modifying income associated with real estate (such as percentage reduction).

Social Security

Contribution rates

As of 1 January 2010 the employer's and employee's contributions will be replaced by the labour market contribution. The employer's social security contribution will be 27% of which the pension insurance contribution will be 24%, the health insurance contribution will be 2% and the labour market contribution will be 1%. In the light of the foregoing, this will result in a 5% reduction in employer's contributions overall compared to the current contribution rates. The insured person will still be subject to 9.5% pension insurance, 6% health insurance and 1.5% labour market contribution. Benefits in kind subject to 54% personal income tax will also attract 27% employer's contribution (or 27% health care contribution), while benefits in kind subject to preferential taxation may be provided free of any social security contributions according to the reasoning of the amendment.

Contribution base: the fair market value of the activity

Similarly to the concept of "earnings typical of an activity" inserted in the PIT Act, the concept of the "fair market value of the activity" will be introduced. After the introduction of the aforementioned concept, private entrepreneurs, business partnerships and employers will, as a general rule, be liable to pay social security contributions at least on the market value of the employee's activity. The employer may report any deviation from the foregoing by reporting the income constituting the actual contribution base in the monthly tax return.

The concept of engagement and employment relationships

An engagement or employment relationship subject to foreign law under which the actual work is performed in Hungary is also regarded as an engagement or employment relationship.

Health care contribution

The flat health care contribution will be abolished from 2010. However, the 11% health tax rate will be raised to 27%. The provisions remain unchanged in respect of the 14% health care contribution.

Rehabilitation contribution

As of 2010, without modification of the mandatory employment level (5%), the annual amount of rehabilitation contribution will be multiplied by five, i.e. it will be raised from the current HUF 192,900 to HUF 964,500 per person.

Taxes on certain high value properties

This new tax type will be introduced with respect to the following types of property:

Residential real estate tax

According to the act the tax type is payable on residential real estate (i.e. homes or holiday homes including the land or portion of land belonging to them).

The taxable person is the private individual or organisation that is the owner of the real estate on the first day of the calendar year, or if the real estate is subject to a right in immovables, the beneficiary of such right. In the case of multiple owners / beneficiaries they will be taxable in proportion to their respective ownership ratios / rights.

The regulations allow that if there are multiple taxpayers who own a residential real estate, one of them may undertake the obligation to file a tax return and pay the tax with respect to the entire real estate by making a statement in the tax return to that effect. If the person making such statement fails to comply with this liability and the enforcement procedure ends without result, the taxpayers will be liable to pay the tax debt in proportion to their respective ownership ratios. If the taxpayer is the beneficiary of the right in immovables and the enforcement procedure against him/her is unsuccessful due to the absence of enforceable assets, the tax arrears will have to be paid by the owner in proportion to his/her ownership percentage.

Under the act the tax liability will commence on the first day of the year following the year in which the occupancy or continuation permit issued for the residential real estate enters into force, while in the case of residential real estate constructed or occupied without a permit the tax liability will commence on the first day of the year following the actual occupation of the residential real estate. Any changes in the tax liability will take effect as of the first day of the next year.

The tax liability on the real estate shall terminate on the last day of the year in which the residential real estate is destroyed, pulled down or reclassified as a non-residential real estate. However, suspension of the use of the residential real estate shall not have impact on the tax liability.

Elderly and helpless persons, underage taxpayers acquiring the residential real estate by inheritance and job seekers may request the tax authority to suspend the tax liability under certain conditions, and the former may even be eligible for tax exemption. The refurbishment of a listed building or a building under local protection may be eligible to a three year tax exemption. Parents raising three or more children may be eligible for a tax relief. The tax liability of the residential real estate may be reduced in the tax year, subject to certain other conditions, by the amount of value added tax charged on services or products purchased in relation to the refurbishment of the residential real estate, based on the relevant invoice.

The tax base is the market value of the residential real estate as of the first day of the tax year. The market value of the real estate below 30 million HUF is also part of the tax base.

According to the act the market value is the value expressed in money that could be generally achieved as the purchase price upon the sale of the property, irrespective of any debts encumbering the property.

The tax rate will be 0.25% up to a tax base of 30 million HUF (from the first HUF), 0.35% on the portion of the tax base between 30 million HUF and 50 million HUF, and 0.5% of the part exceeding 50 million HUF, annually. The taxpayer's place of residence - both according to the address register and in real life - shall be exempt from tax if its market value is below 30 million HUF as of the first day of the calendar year, along with another residential real estate of the taxpayer if its market value is below 15 million HUF as of the first day of the calendar year. Furthermore, according to the act, the taxpayer may deduct the amount of any building tax payable on the real estate in the tax year or the

amount of any tourism tax payable on holiday homes from the amount of the residential real estate tax.

A tax return will need to be filed not only for residential real estate subjected to tax, but also for any tax exempt residential real estate which serves as the place of residence in real life, and the calculated value of which (determined as the product of the useful floor space, the standard average square meter price specified for the given town in the schedule to the act and any adjusting factors depending on the characteristics of the property) exceeds 30 million HUF or, in the case of one additional residential real estate which does not serve as the place of residence in real life, 15 million HUF. Naturally, even in such cases only the market value will need to be declared in the tax return.

The taxation of high performance passenger cars

In the case of passenger cars with an engine whose output is equal to or above 125 kW (with the exception of "old-timers", indicated with an OT number plate) a property tax will be payable over and above the otherwise applicable vehicle tax. The taxable person will be the individual or organisation that is the owner of the passenger car indicated in the register kept by the competent authority as of the first day of the calendar year, and in the case of more than one owners they will be taxable in proportion to their respective ownership ratios. If the passenger car is not included in the register kept by the Hungarian authority, the taxable person will be the owner of the car.

Tax rate: in the case of passenger cars with an output equal to or above 125 kW but below 175 kW double the tax amount under the Motor Vehicle Act, in the case of passenger cars with an output equal to or above 175 kW but below 200 kW 2.5 times the tax amount under the Motor Vehicle Act while in the case of passenger cars with an output of at least 200 kW three times the tax amount under the Motor Vehicle Act will be payable as property tax. In order to avoid double taxation, any vehicle tax already paid may be deducted from this tax liability.

Passenger cars with purely electric or hybrid engines will be entitled to a 50% tax relief, and parents raising three or more children are also eligible for a 50% tax relief on one car.

The taxation of watercraft

The tax will be levied on watercraft included in the registry kept by the National Transport Authority as well as on the watercraft of resident private individuals under the Act on Personal Income Tax and of organisations registered in Hungary that meet the technical conditions for registration in the aforementioned registry, but are not included therein or have been registered abroad.

The definition of watercraft shall include large seafaring vessels, inland waterway crafts and engine-driven watersports crafts, provided that the nominal sail surface of (sailed) vessels exceeds 25 m² or in the case of engine-driven craft the combined output of the main engines exceeds 50 kilowatts. However, boats and non-engine-driven watersports crafts are not subject to this tax type.

The taxable person is the person that is the owner of the watercraft on the first day of the calendar year. In the case of more than one owners, they shall be taxable in proportion to their respective ownership ratios.

The tax base varies depending on whether the watercraft is sailed or engine-driven. In the case of sailed watercraft the tax base is the nominal sail surface of the watercraft expressed in square meters. In the case of engine-driven watercraft the tax base is the aggregate output of the main engines of the watercraft expressed in kilowatts.

The tax rate varies depending on the sail surface of the watercraft / the output of the main engines in kilowatts as well as on the age of the watercraft. The regulations also provide for exemptions. Exempt watercraft include, among others, watercraft owned or operated by sports clubs and sports associations

(subject to certain conditions), watercraft registered for the purpose of water rescue activities, original historic vessels and the individual copies thereof.

The taxation of aircraft

The tax will be levied on aircraft included in the registry kept by the competent authority as well as on the aircraft of resident private individuals under the Act on Personal Income Tax and of organisations registered in Hungary that meet the technical conditions for registration in the aforementioned registry, but are not included therein or have been registered abroad.

The definition of aircraft shall only extend to civil aircraft and shall include helicopters, hot-air balloons, zeppelins, hang-gliders, gliders and airplanes whose maximum take-off weight exceeds 100 kilograms.

The taxpayer will be the person that is the owner of the aircraft under the Civil Code as of the first day of the calendar year, and in the case of more than one owners they will be taxable in proportion to their respective ownership ratios. The tax base will be the maximum take-off weight indicated in the operating licence of the aircraft issued by the competent authority and the tax rate will be dependent on the same figure and the age of the aircraft.

The act also provides for exemptions. Exempt aircraft include, among others, aircraft owned or operated by sports clubs and sports associations (subject to certain conditions) as well as aircraft owned or operated by an organisation holding an air operator's certificate.

In the case of high-performance passenger cars, watercraft and aircraft the tax liability is incurred on the first day of the year following the year in which ownership of the vehicle is acquired. Any changes in the tax liability (e.g. sale of the vehicle) will take effect as of the first day of the year following the year of the change. The tax liability will cease on the last day of the year in which the vehicle is sold or destroyed.

Procedural provisions

According to the regulations all property tax liabilities levied on taxable property will be subject to common procedural rules. The taxpayer will determine, declare and pay the tax to the state tax authority having competence at his place of domicile by self-assessment. The taxpayer shall declare his tax liability in the income tax return to be filed by him (personal income tax return, corporate income tax return, simplified entrepreneurial tax return) until the applicable deadline for filing. If the person subject to property tax is not obliged to file any of the aforementioned tax returns, he will be required to meet his property tax return filing obligation on the form specifically designed for this purpose until 20 May of the tax year.

The taxpayer shall pay his tax liability twice annually, in two equal instalments: the first instalment shall be paid by the deadline for filing the tax return, and the second instalment shall be paid by 30 September of the tax year.

Changes concerning business tax

The competence of the state tax authority

Competencies associated with local business tax will be exercised by the state tax authority with respect to the tax years commencing on or after 1 January 2010. Regarding the tax years preceding the above date municipal tax authorities will remain competent, i.e. the business tax liabilities relating to the tax years before 1 January 2010 shall be paid by taxpayers to the municipal tax authorities. Under the transitional measures the local business tax advance due on 15 March 2010 shall also be paid to the municipal tax authority.

The dates for paying taxes and tax advances will remain unchanged, however, taxpayers will be required to meet their local business tax advance liabilities also by self-assessment. Thus it will be the responsibility of taxpayers to determine and declare the two tax advance instalments payable in the tax year. According

to the general rule, the tax advance payment period is the 12 month period commencing on the first day of the second calendar month following the deadline for filing the tax return. The first instalment shall be determined on the basis of the positive difference between the tax liability of the previous tax year and the tax advance instalment already declared as of the 15th day of the third month of the current tax year, while the second instalment shall be half of the tax liability of the previous tax year.

Taxpayers commencing their taxable activities during the tax year and taxpayers established through transformation are required to register themselves with the tax authority and at the same time declare their tax advance using the form specifically designed for this purpose for the tax advance payment period. Dissolving enterprises will not be required to declare and file tax advances.

R&D expenses

When determining the base of the local business tax, net revenues are reduced by the direct costs of basic research, applied research and experimental development recorded during the tax year, as provided in the Corporate Income Tax Act.

The concept of permanent establishment

The concept of permanent establishment in the Act on Local Business Tax is amended in a way that for the general providers and distribution licence holders of natural gas and electricity as well as for electricity and natural gas traders the town where the consumers are located will only become a permanent establishment if at least 75% of their revenues in the tax year preceding the current tax year derive from the sale or distribution of natural gas and electricity to the end-consumers.

Foreign permanent establishment

From 2010 the part of the tax base derived from activities pursued at foreign permanent establishments will be exempt from business tax, irrespective of whether the taxpayer is subject to a tax liability in the territory of the foreign state that corresponds to the Hungarian business tax.

Amendments relating to the rules of taxation

Based on the amendments to the Act on the Rules of Taxation (ART), among others, the competency rules of business tax would be amended as well as the related procedural rules in line with the substantive tax law amendments, and the fees payable for advance pricing agreements would also be reduced.

Changes in the business tax competency rules

Under the act the taxation operations relating to local business tax will be transferred to the competence of the state tax authority as of 1 January 2010. Taxpayers will be required to file their business tax returns to the APEH electronically and also to pay their tax liability to the state tax authority. Taxpayers with several permanent establishments will not be required to file separate tax returns for each of their permanent establishments or to separately transfer their tax payments, but will rather be able to meet their filing obligation on one tax return (broken down to municipalities) and to pay the total amount of their tax liability by one wire transfer transaction to the local business tax account of the state tax authority. The amounts paid will be forwarded by the state tax authority to the respective municipalities within 30 days of receipt of the tax returns, allocated on the basis of the ratios indicated in the tax returns. According to the act the net late charges calculation method would not be applicable to business tax payments and the basis for late charges would have to be determined and charged separately for each municipality concerned. This means that an overpayment with one municipality could not be used to offset any underpayment with another municipality for the purpose of calculating late charges.

In relation to the foregoing, from 2010 taxpayers will be required to pay the business tax advance to the state tax authority by means of self-assessment rather than through a warrant for payment. However, the business tax advance falling due on 15 March 2010 will need to be paid to the municipal tax authority according to the Bill. Another change is that in tax years commencing in 2010 and thereafter taxpayers will be required to file a return containing the amount of the local business tax advance supplement ("top-up") until the 20th day of the last month of the current year.

Under the transitional measures taxation operations associated with business tax concerning the tax years before 1 January 2010 will be performed by the municipal tax authorities, thus the 2009 tax return due on 31 May 2010 will also need to be filed with the municipalities, and the tax years preceding 2010 will also continue to be audited by the municipalities. In order to close the transitional period characterised by parallel competencies as soon as possible, the right to assess tax with respect to filing periods preceding 2010 will lapse on 31 December 2011 at the latest as opposed to the normal 5 years.

The amendment act would grant municipalities independent decision-making authority in relation to requests for mitigation or requests for instalment or delayed payment concerning local business tax. This means that if the notary of the municipality involved approves the taxpayer's request and, on the basis of the taxpayer's request, notifies the state tax authority within three working days of the date of the state tax authority's receipt of the request, then the state tax authority shall be obliged to approve the request without further consideration.

Reporting by companies that own real estate

In line with the proposed amendment of the CIT Act, taxpayers would be required to report annually, within 90 days following the due date of the corporate income tax return, if they qualify as a so-called "company that owns real estate" under the CIT Act or if they lose this status. In the report the company that owns real estate would be required to declare – for the tax year to which the filed corporate income tax return relates – whether the company's foreign members sold their shares, the date of such sale, the nominal value of the shares sold and the members' country of residence. Based on the aforementioned reports the state tax authority would publish the list of companies that own real estate on its website by 30 September of each year (where the deadline for filing the corporate income tax return of the company that owns real estate is other than 31 May, the state tax authority shall meet the publication obligation within 120 days from the otherwise authoritative deadline for filing the corporate income tax return).

Data supply for the payment of stamp duty by companies that own domestic real estate

Under the act a new data supply obligation would need to be introduced in relation to making the acquisition of an existing share in a company that owns domestic real estate subject to stamp duty. Pursuant to Schedule No. 3 to the ART, in the case of domestic companies the Registry Court would supply data to the state tax authority until 31 January if a member acquired a qualified majority influence in the previous year in any of the companies registered by it, or if a change occurred in the ratio of shares owned by the members of a company under a qualified majority influence, or if a sole shareholder member is registered.

The procedural rules of withholding tax

The provisions amending the CIT Act provide for a withholding tax obligation on interest, royalty and service fee payments to non-resident private individuals from 1 January 2010. The related procedural rules would be provided for in Schedule No. 4 to the ART, for instance that the payer is obliged to pay to the tax authority the tax withheld until the 12th day of the month following payment.

Changes in fees payable for advance pricing agreements

The fees payable for advance pricing agreements (APA) will be reduced as follows:

- in the case of a unilateral procedure the fee range will be between HUF 500 thousand and HUF 5 million, provided that the arm's length price may be determined with the comparable prices method, the resale prices method or the cost plus method.
- in the case of a unilateral procedure the fee range will be between HUF 2 million and HUF 7 million, provided that the arm's length price may be determined with an other method,
- in the case of a bilateral procedure the fee range will be between HUF 3 million and HUF 8 million,
- in the case of a multilateral procedure the fee range will be between HUF 5 million and HUF 10 million.

In the event that the arm's length price (price range) may not be quantified, the fee will correspond to the lower end of the range, depending on the type of procedure.

Amount of tax penalty levied on qualified taxpayers for the first time

Pursuant to the amendment act, in the case of a taxpayer registered as a qualified taxpayer, should the tax authority reveal tax arrears for the first time after being registered as qualified taxpayer, the amount of the tax penalty would be 20% of the tax arrears, except if the tax arrears arise from an infringement on which a 75% tax penalty is to be levied.

Amendment of the regulations pertaining to payments related to public procurement

A new provision in the ART, effective 1 January 2009, is that, in order for payments for subcontractors' work exceeding a net amount of HUF 200,000 a month to be made, the subcontractor will be required to present a zero aggregate tax certificate not older than 30 days and, in the absence of such a tax certificate, the contractor may put payment on hold. Furthermore, the same provision also requires the contractor to inform the subcontractor in writing if the public procurement contract and, subject to its performance, payments are subject to the above regulation.

Pursuant to the amendment act, the above provisions would not be applicable to payments to be made based on public works contracts under the Public Procurement Act and subcontractors contracts (under the Public Procurement Act and civil law) concluded in relation to such public works contracts, provided that the debt indicated on the requested tax certificate was incurred after 30 September 2008, and payments are to be made after the amendment has entered into force. However, for any other payments, the above provision is applicable.

The entry into force of the amendments

The aforementioned provisions concerning the rules of taxation would enter into force on 1 January 2010 while the changes in the fees payable for advance pricing agreements and the amendments to the regulations concerning payments related to public procurement would enter into force on the day following the promulgation of the amendments.

Changes to the Accounting Act

Bookkeeping and reporting in a currency other than HUF

From 2010 the Accounting Act allows that accounting records are kept in EUR without any further conditions. Businesses are required to set forth this decision in the accounting policy prior to the first day of the business year, and the deed of foundation also needs to be modified accordingly. Businesses will only be allowed change their reporting currency from the 5th year following the decision, unless they prepare their financial statements in a currency other than the EUR.

The conditions applicable to financial statements prepared in the functional currency (other than EUR) will become even more lenient from 2010: businesses will be entitled to prepare their financial statements in the currency in which more than 25% of their financial assets and liabilities as well as more than 25% of their revenues, costs and expenses are incurred in the current year and in the previous year.

Accounting for uninvoiced discounts

Subsequent uninvoiced discounts granted/received on the basis of a contract and indirectly associated with a supply of products, materials, goods or service provision shall be accounted for pursuant to the general rules from the business year commencing in 2010. The actual financial settlement of the amount of the discount is not a pre-condition for the recognition thereof, it is sufficient to stipulate such discounts in the contract. Due but financially unsettled discounts shall be recognised against other receivables or other short-term liabilities, as the case may be. This provision may be applied to financial statements for business years commencing in 2009 as well.

Other changes

The act also contains some conceptual clarifications and additions to take account of common business practices. It contains a provision that if a credit institution quotes several exchange rates within one day, the last quoted exchange rate shall be used to record business transactions. Furthermore, the amendment specifically adopts to the increasing elements of the retained earnings the portion of the tied-up reserve used to offset the negative retained earnings. Under the act identical accounting treatment would apply to advances settled by the way of bank transfer, offset, exchange deal, etc. Furthermore, the act amends the threshold for dividend payment in respect of the repurchased own shares and quotas. The book value of the repurchased own shares and quotas should be posted to the tied up reserve from the retained earnings balance instead of accounting for the repurchase value of the same shares and quotas. Thereby such accounting considers any changes in value since the repurchase happened (e.g. impairment).

Stamp duties

Stamp duty rates, stamp duty liability related to companies that own real estate

As we have already noted in our previous newsletter, the general stamp duty rate on the transfer of property for consideration will be reduced from 10% to 4%. If, however, the basis of stamp duty exceeds HUF 1 billion, the excess amount will be subject to 2% stamp duty only and its total amount may not exceed HUF 200 million per real estate. The preferential stamp duty rate in the case of apartments will remain 2% up to HUF 4 million per apartment while the current 6% rate will be reduced to 4% on the amount of the market value above HUF 4 million.

According to the amendments, the acquisition of a share in a company that owns domestic real estate will become subject to stamp duty.

A new element compared to the original proposal is that companies engaged in financial leasing activities will no longer be required to calculate what percentage of their revenue arises from the leasing of real estate and/or vehicles, and will therefore be eligible for preferential stamp duty (2%) on acquiring real estate and be eligible for exemption from stamp duty on acquiring vehicles or trailers, provided that at least 50% of their net revenues for the prior tax year came from financial leasing activities (as a result of the amendments, the definition of a company that is engaged in the financial leasing of both vehicles and real estate will no longer be valid).

Exemptions

The scope of exemptions and benefits will also be modified after the legal amendments. According to the proposed amendments, instead of the general exemption applicable to the transformation of economic organisations, the acquisition of property within the framework of a preferential transformation under the CIT Act will become exempt from stamp duty. It is a new basis for exemption that the acquisition of property in the framework of an exchange of shares under the CIT Act will become exempt from stamp duty on the transfer of property for consideration, and the acquisition without consideration of movable property between companies that would not be subject to stamp duty on the transfer of property should it be acquired in a transaction for consideration will become exempt from stamp duty on gift, and no stamp duty on gift will be payable on the assignment of receivables and the assumption of debts.

Sale and leaseback, transitional provisions

The amendment act contains some favourable provisions for sale and leaseback transactions as well, as it provides for a stamp duty exemption for a transitional period (until 31 December 2012) for lessees involved in a sale and leaseback transaction that sell and lease back their own real estate under a closed-end financing leasing transaction. Furthermore, the deadline for building a residential property and to re-sell real estate is prolonged by 2 years in cases which were reported for stamp duty assessment or became known to the tax authority between 1 October 2004 and 31 May 2009 (this deadline was given in the previous bill as 30 September 2008), provided that the parties acquiring the property file a request to that effect prior to the expiry of the deadline. The deadline for selling the real estate or financial leasing the real estate (resulting in a change of ownership upon expiry) and thus for applying the preferential (2%) stamp duty on the transfer of property for consideration is also prolonged by 2 years, provided that the acquisition of property was reported between 1 October 2006 and 31 May 2009 (the bill originally contained 30 September 2008 as the final date) or became known to the state tax authority during this period.

Another new regulation in the act is that Document Service Centers ('Okmányiroda') will have to be able to accept credit card payments after 1 January 2010 only, as opposed to the previous deadline of 1 July 2009.

Value added tax

As explained in our previous newsletters the conditions for determining the import VAT by means of self-assessment will become more favourable.

A new provision of the amendment act which affects the VAT Act is that commercial accommodation services will be subject to a preferential tax rate of 18%.

A further important amendment is that a VAT rate of 20% will have to be applied for the sale of residential real estate, instead of the general 25% tax rate applicable otherwise, if the document serving as the basis for registering the ownership (e.g. sale and purchase agreement) is filed with the land register no later than 30 June 2009. The amendment act provides separate regulations for the transitional period between 1 July 2009 and the entry into force of the act, having regard to the fact that the general VAT rate increased to 25% as of 1 July. Under these regulations, the 20% tax rate may still be applied during this

transitional period. If, however, invoices on sales of residential real estates are indeed made out using a 25% VAT rate during this period, such invoices will have to be amended subsequently and, if self-revision is required as a result, then such self-revision shall be exempt from self-revision fee.

Excise tax

In accordance with the original amendment proposal, the excise tax of certain fuels and firing materials, tobacco products as well as the energy tax of coal, electricity and natural gas will increase from 1 January 2010.

Vehicle tax and company car tax

Vehicle tax rates will be raised by 15% according to the amendments. Exceptions include, as provided by the final amendment act, trucks (including trailers and semitrailers) and buses with air cushion or equivalent shock absorption systems, which are to be taxed according to the tax rate in effect prior to the increase in the vehicle tax rate. (The amendment also explains the concept of air cushion cars.)

An amendment regarding company car tax is that a provision has been abolished under which, if an entrepreneur accounts for flat rate costs for company car purposes, the date of the recording of costs - and, as such, the day that the tax liability arises - shall be the first day of the month. According to the reasoning attached to amendment, the legislators' intention was to avoid company car tax liabilities in the case of passenger cars regarding which the entrepreneur accounts for flat rate costs only (the cost of 500kms of travel a month instead of using mileage records).

Amendment of the Energy Tax Act

Tax rates

The current tax rates of Act LXXXVIII of 2003 on Energy Tax will be modified as of 1 January 2010. The energy tax will be raised from HUF 252 to HUF 295 per megawatt hours for electricity, while the GJ price of natural gas will be increased from the current HUF 75.60 to HUF 88.50, and the price of coal will grow from the current HUF 2,040 to HUF 2,390 per kilogram.

In the case of continuous supply of goods and services, the rate of the new energy tax will have to be applied from the date of the first reading of meters where the entire meter reading period is after 31 December 2009 or, if the accounting periods are shorter, the above tax rate will have to be applied proportionally to the part of the subject period which begins on 1 January 2010.

Scope of taxable persons

Public utility companies and distribution companies will not be subject to energy tax if they use energy for their own purposes.

No energy tax liability will arise on sales made by energy traders to distribution companies between 1 July 2009 and 31 August 2009.

Tax deductions and tax refunds

Pursuant to the current rules, natural gas stockpiled in order to maintain the level of cushion gas will be exempted from energy tax through tax refunds. Under the new regulations, cushion gas reserves and natural gas used to fill up transmission or distribution lines are also exempted as above. Furthermore, distribution companies will be able to reclaim taxes on natural gas used for covering network losses only subsequently.

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