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TaxAlert

Expected amendments to Hungary's tax legislation

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A draft of interim and tax law amendments for next year ("the Amendment") was submitted to parliament on 19 October 2018. Below, we summarize the most important changes anticipated in line with draft Law No. T/2931.

Corporate Income Tax

Group taxation registration

- According to the Amendment, the concept of group taxation under corporate income tax would be introduced from the 2019 tax year and could be applied by at least two associated Hungarian tax resident companies, with at least 75% direct or indirect majority interest in each other (based on voting rights).
- Group taxation could be opted by those taxpayers, who have the same balance sheet date, and functional currency; furthermore, the financial report of these companies are prepared either according to chapter 3 of the Act on Accounting, or is based on IFRS.
- Based on the Amendment, members of the group would need to determine their tax base, as if they were separate taxable persons for each tax year. Members of the group should prepare stand-alone declarations – equivalent to the tax return – about their tax liabilities to the Tax Authority, for each tax year.
- The Group tax return would be submitted by the appointed representative of the group. The tax base of the group would be the sum of the individually identified, non-negative tax bases of the member companies, which could be decreased by the losses carried forward from previous tax years (to the extent that, upon reductions of the tax base via these losses, the tax base of the taxable group reaches at least 50% of the sum of the individually identified tax bases of the companies in the group).
- For transactions between the members of the group – after the group tax registration has been confirmed – as a general rule, the transfer pricing modifications otherwise applicable to associated parties would not apply when the corporate income tax base is determined. The preparation of supporting documentation requirement based on the Decree of the Ministry should be performed by a representative of the group.
- The taxable group would be considered as a stand-alone taxable person from a tax allowance point of view; it could utilize the tax allowance only if the relevant conditions of the allowance would be undertaken and effectively fulfilled by one of the members of the group.
- The rate of corporate income tax under group taxation would remain 9%, the payable tax in the tax year would be allocated among the group members in proportion to the individually specified positive tax bases.
- According to the Amendment, group taxation registration can be claimed for the first time between 1 and 15 January, 2019, which is a mandatory deadline, i.e. there will be no possibility for application following this period. If the Tax Authority has accepted the request, group tax registration would come into force retrospectively from 1 January 2019.

Interest limitation rules (previous "thin capitalization" rules)

- In compliance with the corresponding Directive of the European Union – from 1 January 2019 – new interest limitation rules would replace the previous regulation related to thin capitalization.

– Based on the Amendment, as a general rule, the exceeding of a taxpayers' borrowing costs (i.e. the amount by which the deductible borrowing costs exceed taxable interest revenues) would be deductible from the tax base up to 30% of the EBITDA (earnings before interest, tax, depreciation and amortisation), or up to HUF 939,810,000 (serving as an upper cap).

– Borrowing costs, as a general rule, would mean interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance. (Please consider this as a non-exhaustive list.)

– As a general rule, the aforementioned provisions would be applicable for financing contracts concluded or modified after 17 June 2016 – in accordance with the requirements of the Directive.

– Furthermore, based on the Amendment – as a favourable rule, exceeding borrowing costs, which could not be utilized in the tax base in a given tax year could be carried forward to subsequent tax years.

– According to the Amendment, interest limitation rules would not apply to firms qualifying as financial institutions, investment firms and alternative investment fund managers, undertakings of collective investment in transferable securities, insurance companies and reinsurance undertakings.

Controlled foreign company (CFC) rules

– In order to be compliant with the European Union Directive, the definition of CFC would be clarified.

– Exemption from CFC status would apply to investment activities where the service is qualified as an active business, therefore holding activity (holding participation) by itself would not give rise to exemption.

– The rule, which provided possible exemption from CFC status for companies and their related parties listed on recognized stock exchanges, would be removed from the legislation.

– However, a non-resident permanent establishment would be exempted from controlled foreign company status, if it is located in a country outside the EEA zone with whom Hungary has concluded an international treaty that provides for exemption on the attributable income of such a permanent establishment from corporate taxation, as long as it qualifies as a permanent establishment based on the international treaty.

Other changes

– Furthermore the Amendment includes the possibility of supporting the financing of utility costs related to real estate used for sport purposes for the 2019/2020 financing period, and further includes technical clarification on the aggregation rule, and termination of housing allowance for mobility purposes. Moreover, the rule on corporate income tax base allowances and the rule on losses carried forward would be modified, in accordance with the social contribution tax allowance related to R&D activities.

Personal income tax

In-kind benefits and tax free benefits (Cafeteria system)

– Based on the Amendment – in contrast to what had been expected – modifications accepted in the summer regarding the cafeteria system remained unchanged, i.e. many in-kind benefits (fringe and special, defined benefits) and tax free items will be abolished as of 1 January 2019.

Taxable risk insurance

– According to previous law amendments, the risk insurance provided by an employer after 31 December 2018 will be considered as taxable income of an individual. In accordance with this modification, some related provisions would be modified, e.g. the definition of risk insurance. Based on the Amendment, the proportional part of the group insurance fee would be considered as taxable income of the individual. However, if the portion related to the individual cannot be determined, the group insurance fee could be regarded as a special defined benefit (and taxable at the company's level).

Tax base allowance

– The family tax base allowance cannot be split for those months when the individual or his/her spouse applies for higher family allowance due to single parenthood according to the prevailing legislation. Based on the Amendment, in such a case, if certain conditions are met, the family tax base allowance could be split.

– According to the Amendment, the declaration on tax advance regarding the split of the family tax base allowance and the newlyweds' allowance should indicate the following: the parties' decision about the split claim, the name of the other party, his/her tax ID, the name and tax ID of the other party's employer or disburser. The modification shall be applicable as of 1 January 2020, in accordance with the launch of the electronic system for tax advance declarations.

Tax-free benefits

– The definition of lodging provided for workers would be amended. Accommodation where an individual is entitled to use only one room (e.g. lodging in accommodations of a commercial nature (excluding hotels), could also be regarded as lodging provided for workers.

Social security contributions

– The Amendment would slightly modify the definitions of the "social security base" and "income excluded from the social security base". Based on the Amendment, the income that is paid to the individual with respect to his former activity – when he/she was covered by the Hungarian social security system – should be regarded as Hungarian social security base, irrespective of the date of payment. E.g., in case of an employee who was covered by the Hungarian social security system, but whose coverage ended and then he/she receives income which is (partially) related to his Hungarian social security coverage period, this part of the income should be booked as Hungarian social security base. (The Amendment only clarifies the previous interpretation of the legislation. However, we note that double social security liabilities could occur in case the income in question is also considered as social security base in the state where the individual is insured at the time of payment.)

– In addition to the above, it would also be specified that the income which relates to a period when the individual was not covered by the Hungarian social security system should not be considered as Hungarian social security base.

Social tax (employer part of the social security liabilities)

– The Amendment would not modify the social tax rate, i.e. it would remain 19.5% (flat rate).

– In connection with the amended definition of social security base, the definition of the social tax base would be modified as well, i.e. the income – which is paid with respect to a period when he/ she was not covered by the Hungarian social security system – would not be considered as Hungarian social tax base, irrespectively from the date of payment. (Consequently, the Hungarian social security base and social tax base would be aligned in case of such income.)

– According to the Amendment, if an individual receives income from a non-Hungarian disburser in case of self-employment activities and this income is not considered as Hungarian social security base, then the individual would be obligated to pay the related social tax. (This rule is in line with the Act on Healthcare Charge which will be replaced by the new Act on Social Tax.)

– The Amendment would introduce a new social tax allowance in connection with R&D activities. The allowance would be applicable to researcher-developer employees and its rate would be 50% of the social tax liability on the employees' gross wage income.

– Based on the Amendment, the employment of former civil servants who have reached the age of 60 years on or before the day when their civil servant employment was terminated would be financially incentivised. In such cases, the new employer would be exempted from the social tax and training fund contribution (up to four times the minimum wage).

Employee Participation Plans ("MRP")

– The Amendment would clarify the financial instruments which can be included in such plans. Not only ordinary shares can be included, but also other securities that bear similar potential risks and proprietary rights for the owner.

– Based on the Amendment, the minimum vesting period of the financial instrument would be 12 months (as of 2021 it would be extended to 24 months). Furthermore, the Amendment suggests further restrictions in the near future.

Value Added Tax

– With respect to the deduction of input VAT on the purchase of car rental services – similar to the deductibility of VAT imposed on services related to vehicle operation and maintenance – the Amendment would stipulate a 50% deduction rate. This rate would be applicable to the settlement period starting after 31 December 2018 and if the right to deduction arises after that date. In case, however, the taxable person would not wish to apply that deduction rate – so long as the required documentation is provided – the taxable person may exercise his right to a deduction in proportion to the actual use and exploitation for the purposes of his business activities which entitles the taxable person to the right of deduction.

– Starting on 1 January 2020, the standard VAT rate of 27% will once again apply to the sale of new residential property. According to the temporary provisions in the Amendment, the reduced VAT rate of 5% would still apply to the sale of residential property for which the documentation required for registration of ownership in the land registry (especially the sales contract) is submitted to the real estate authority by 31 December 2019, provided that the property is deemed at least structurally complete by that time, and that this is declared to the Tax Authority by the vendor via the relevant form.

– The scope of employee leasing services to which the reverse charge mechanism applies will be reduced from 1 January 2021. The Amendment states that the reverse charge mechanism would still apply to employee leasing for the purpose of all types of construction or construction-related assembly works (including where no construction permit is required).

– The provisions set forth in Council Directive 2016/1065/EC on the harmonization of the treatment of vouchers were implemented by

the Act XLI of 2018 amending various tax laws. Vouchers issued after 31 December 2018 are deemed either single- or multi-purpose vouchers, each subject to different VAT-treatment. While VAT on multi-purpose vouchers will still be chargeable upon the utilization of the voucher, single-purpose vouchers – where the place of supply of the goods or services embodied by the voucher is known at the time the voucher is issued – entail that VAT is chargeable upon the sale of the voucher. The sale of the single-purpose voucher for consideration qualifies as the sale of goods or supply of services embodied by the voucher. As the Directive does not set out provisions on the supply of single-purpose vouchers free of charge, the Amendment would expand upon the implemented provisions: the supply of single-purpose vouchers free of charge would fall within the same scope as the treatment of sale for consideration, provided that the taxable person is wholly or partly entitled to the right of deduction at the time voucher is issued.

- Opting for taxation based on the "designated position number-based method" would no longer be available for travel agent services from 1 January 2020. Furthermore, the special VAT scheme for travel agents would also apply if the buyer intends to re-sell the services.
- The Amendment would raise the threshold for opting for VAT exempt status for small enterprises from HUF 8 Million to HUF 12 Million.
- Effective 1 January 2019, in case the taxable person fulfils his tax liabilities through the single window system in a member state in which his place of business is not established, the invoicing regulation of the member state in which it is registered to the single window system would apply, rather than the member state of the place of supply.

Special tax on financial and credit institutions

- According to the Amendment, the upper limit of the tax rate of surtax on credit institutions (bank tax) would be decreased to 0.2% in the next year.

Procedural rules on taxation

- The Amendment would clarify that the statute of limitation for the right of tax assessment would be suspended from the opening of the right to bring a claim to the court right up until the day when the court's decision becomes final. In case of a judicial review request, the limitation period for the right of tax assessment would be suspended until the final conclusion of the judicial review.
- The Amendment would restore the provision of the previous Act on the Rules of Taxation related to the Tax Authority's right of imposing a penalty in cases when the taxpayer acts in a different manner than set out in its accounting policy, which should be indicated in accordance with the Accounting Act. Moreover, the Tax Authority would be able to impose penalties if the published financial report of the taxpayer does not include essential information related to the financial report or when the information included is incorrect.
- From 1 January 2019, the maximum rate of default penalty related to failure to fulfil the top-up liability, which is applied when the tax advance paid does not reach 90% of the actual tax liability of the tax year, would be decreased to 10% (from its current 20% rate).
- The possibility of a fee-related preliminary consultation before filing a binding tax ruling request would be abolished in the future.
- The currently exemplary listing of administrative deadline extension would become exhaustive, and the time related to supply missing documents, clarification of the facts and the trial procedures would no longer be considered in determining the administrative deadline.
- The Amendment would abolish the provision that a new procedure ordered by the Administrative Court could not be initiated by the Tax Authority, in case there was a retrial or a judicial review claim submitted against the court's decision.
- The compulsory elements of the Tax Authority's decision would be defined, including, among others, evidence, recognized or not, submitted by the taxpayer.
- From 1 January 2019, it would be obligatory to conduct a tax audit at firms having net sales revenues in each year equal to at least HUF 60 billion in two consecutive financial years, where the profit after taxation was zero or negative in both years. It is important to note that newly established companies (without a predecessor) would be exempted from this newly introduced tax inspection procedure in their first four years.
- In case of an appeal against a Tax Authority decision regarding a tax audit, the taxpayer would not be allowed to refer to a new fact, if it was aware of the fact before the due date of the remarks.
- In future, employees of a foreign company could also represent their branch office in Hungary.

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