



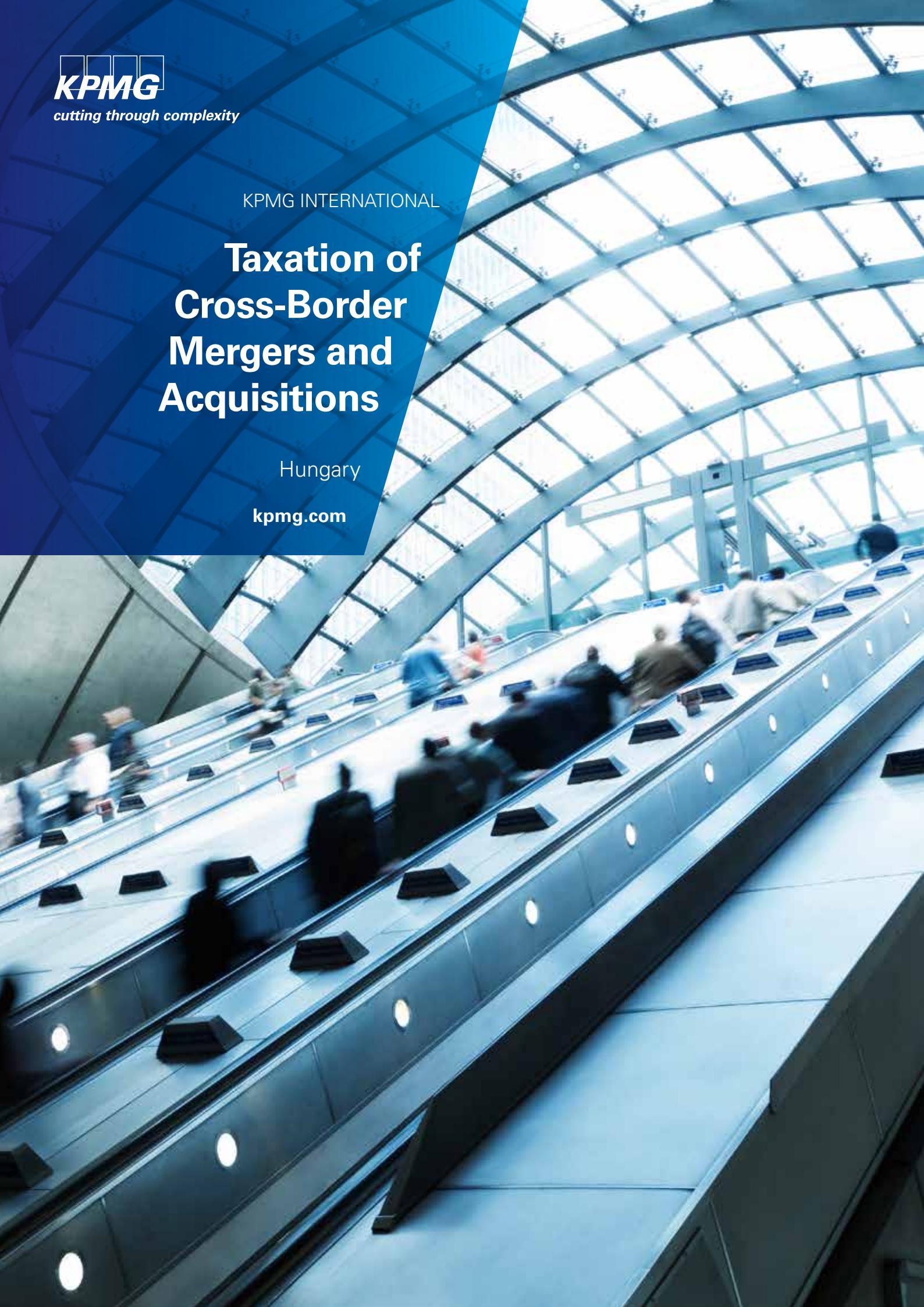
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KPMG INTERNATIONAL

# Taxation of Cross-Border Mergers and Acquisitions

Hungary

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# Hungary

## Introduction

This overview of the Hungarian regime for mergers and acquisitions (M&A) and related tax issues only discusses statutory frameworks for acquisitions in Hungary. It does not consider any specific contractual arrangements that may affect such transactions.

The primary legislation governing the form and regulation of companies is ACT IV of 2006 on Business Associations (the Corporation Act), effective since 1 July 2006. As a result of the accession of Hungary to the European Union (EU) on 1 May 2004, new forms of business associations have been integrated into the Hungarian company law legislation, such as the European economic interest grouping and the Societas Europea (SE). As of 15 March 2014, the Corporation Act is abolished and the primary legislation regarding companies is part of the new Civil Code.

## Recent developments

In the past few years, the Hungarian parliament approved several tax law changes that might have implications for M&A transactions in Hungary. The key tax law changes are as follows:

- As of 1 July 2010, the statutory corporate income tax rate in Hungary is 10 percent up to the tax base of 500 million Hungarian forints (HUF) and 19 percent above this threshold.
- As of 1 January 2012, the provisions on carry forward losses have changed significantly. According to the new rules, tax losses may only be utilized for up to 50 percent of the tax base (calculated without the utilization of the carry forward losses), and further restrictions may apply on changes in ownership structure and/or transformations (mergers, demergers). See this chapter's information on purchase of shares for details.
- The rule on thin capitalization is extended to cover interest-free related party liabilities – however, it is possible to reduce the amount of liabilities with the daily average amount of financial receivables (as of 1 January 2012).

- The profit realized during the sale or in-kind contribution of the so-called 'reported intangible assets' (if entitled to royalty income) is exempt from corporate income tax under certain circumstances. Certain profit from non-reported intangible assets may also become tax-exempt.
- The general rate of value added tax (VAT) was increased to 27 percent as of 1 January 2012.
- The concept of real estate investment trusts (REIT) was introduced to the Hungarian legislation as of 27 July 2011.
- Withholding tax (WHT) on interest, royalties and certain service fees was abolished as of 1 January 2011.
- As of 1 January 2013, the transfer of a business unit may be out of scope of VAT if the acquirer meets certain conditions prescribed in the Act on VAT.

## Asset purchase or share purchase

An acquisition in Hungary usually takes the form of a purchase of shares of a company, as opposed to its business and assets, because capital gains on the sale of shares may be exempt from taxation, while the purchase of assets might be subject to valued added tax (VAT). The advantages and disadvantages of asset and share purchases are compared later in the chapter in detail.

### Purchase of assets

According to Hungarian legislation, a gain from the sale of assets is taxable for the company that sells those assets. This means that the gain is part of the general tax base and is subject to corporate income tax at the aforementioned rates (10 percent up to a tax base of HUF500 million and 19 percent above this threshold).

Generally, the sale of assets is also subject to the standard VAT rate, which is currently 27 percent.

In addition, transfers of immovable property, vehicles and rights related to them are subject to transfer tax. The transfer tax base is the market value of the assets transferred. The standard rate of the tax is 4 percent for real estate up to HUF1 billion and 2 percent on the excess amount. The amount of the tax cannot exceed HUF200 million per plot number.

Thus, the transfer of the real estate and any other asset mentioned earlier may trigger a transfer tax liability payable by the purchaser.

## Purchase price

The transfer pricing rules have to be applied in the case of a sale of assets between related parties. In Hungary, the transfer pricing rules broadly comply with the Organisation for Economic Co-operation and Development (OECD) transfer pricing guidelines. The transfer pricing rules allow the tax authorities to adjust taxable profits where transactions between related parties are not at arm's length prices.

## Goodwill

According to the Hungarian Accounting Law, goodwill or negative goodwill arises in the separate financial statements of an acquirer of assets when the acquirer acquires the net assets of a separate entity, branch or business. Goodwill cannot be depreciated, but any extraordinary depreciation is tax-deductible if the book value permanently and significantly exceeds its market value. Badwill has to be booked as taxable income in the following 5 years in equal amounts.

As of 1 January 2012, in relation to company acquisitions, the section on determining the amount of goodwill now also states that if the equity of the acquired entity is negative, the consideration paid must be considered as goodwill.

When negative goodwill is recognized, if the participation underlying the goodwill is derecognized from the books for any reason, the negative goodwill must be set off against other income. Negative goodwill must also be derecognized from the books in the event of corporate restructuring if there is any change in the circumstances that gave rise to it such that its recognition is no longer justified.

## Depreciation

The purchase price of the assets may be depreciated for tax purposes. The Act on Corporate Income Tax stipulates the depreciation rates to be used for various assets. The depreciation rates for tax and accounting purposes may differ for certain assets.

## Tax attributes

According to the Hungarian legislation, any gain from the sale of assets is taxable for the company that sells them. This means that the gain is part of the general tax base and subject to 10 percent corporate income tax up to HUF500 million and 19 percent above this threshold. The transfer pricing rules have to be applied in the case of a sale of assets between related parties.

## Value added tax

In general, the sale of assets is subject to the standard VAT rate, currently 27 percent. As of 1 January 2013, the transfer of a business unit may be out of scope of VAT if the following conditions are met:

- The acquirer acquired the business line with the aim of further operation.
- The acquirer is a Hungarian tax-resident entity (or becomes Hungarian tax-resident as a result of the in-kind contribution).
- The acquirer undertakes an obligation to assume the rights and obligations prescribed under the Act on VAT in connection with the assets acquired (with certain exceptions) at the time of acquisition (e.g. monitoring period regarding properties).
- The acquirer does not have any legal status that would violate the above obligation (e.g. VAT-exempt activity).
- The activity within the frame of the business line is limited to supply of goods and services giving rise to deduct the VAT.
- Where the acquired assets include real estate property, if the seller opted for a VAT-able sale of real estate or the sale of real estate is otherwise VAT-able (e.g. new real estate), the purchaser is obliged to opt for VAT-able sale of real estate.

If these conditions are not met, the transfer of a business unit would be regarded as a single service provision based on the current approach of the Ministry for National Economy and the Tax Authority. Thus, the whole purchase price of the business unit would be subject to VAT on a rate of 27 percent.

## Transfer taxes

If the assets to be sold include real property, as noted earlier, the buyer is liable to pay real estate transfer tax. As of 1 January 2010, the standard real estate transfer tax rate is 4 percent up to a value of HUF1 billion and 2 percent of the excess value of the real estate. The maximum amount of the tax is capped at HUF200 million. No real estate transfer duty liability arises if the transfer is a result of a preferential transformation or preferential exchange of shares as defined by the corporate income tax law.

## Purchase of shares

As an incentive for the establishment of holding companies in Hungary, domestic or foreign participations of over 10 percent could be considered as announced participations, which are reported to the tax authority within 75 days following the acquisition. (The participation limit was decreased as of 1 January 2014, and the reporting deadline was extended from 1 January 2014.) The capital gains on such participations held for at least one year are exempt from corporate tax. An investment cannot be treated as an announced participation, and thus the special rules cannot be applied, if it is in a controlled foreign company (CFC). The rules applicable to CFCs are discussed later in the chapter.

As of 1 January 2012, no further reporting is necessary if only the value of the reported shareholdings increases but the percentage of these shareholdings remains unchanged.

In a share acquisition, the purchaser may benefit from existing supply or technology contracts of the target company and also from all permits, licenses, and authorizations of the target company, unless the agreement between the parties stipulates otherwise.

Capital gains derived from the sale of shares in a Hungarian real estate company (REC) are generally taxable. Hungarian regulations define a REC as a company that owns among its assets at least 75 percent Hungarian-located real estate. As of 1 January 2014, the book value is considered for this purpose instead of the market value. The capital gains on the sale of the shares of a REC are taxable if the quota/shareholders of the REC or a related party are resident in a country that does not have a tax treaty with Hungary or has a treaty allowing the taxation of capital/foreign exchange gains in Hungary. Of course, any applicable double tax treaty might override this rule.

## Tax indemnities and warranties

In a share acquisition, the purchaser is taking over the target company together with all related liabilities, including tax liabilities. It is common practice for the purchaser to conduct a due diligence investigation of the target company to identify potential risks. In addition, the purchaser may require indemnities and warranties from the seller.

## Tax losses

The tax losses generated by the target company transfer with the target company, so the target company keeps its tax losses after the sale of shares. However, as of 1 January 2012, the transfer of such losses is subject to strict criteria. Tax losses can be carried forward without time limitation to offset the taxpayer's future profits (subject to restrictions discussed below), provided the negative tax base arose while the taxpayer complied fully with the legislation. Following recent tax law changes, there is no need to request permission from the tax authority for the future use of tax losses. As of 1 January 2012, tax losses may only be utilized up to 50 percent of the tax base (calculated without the utilization of the carry forward losses). This rule should also apply to tax losses previously carried forward. However, no time limitation has been introduced in the rules for carry forward losses, and so the available tax losses may be utilized to offset up to the 50 percent of the tax base in any future tax year and future years' tax losses may be carried forward indefinitely.

In the case of a corporate transformation or restructuring, previous losses can only be utilized where the new owner (or an affiliated company) of the legal successor previously had a significant influence (more than 50 percent of the voting rights) in the legal predecessor and where income is realized from the latter's activity (excluding holding activity) for 2 consecutive tax years.

Change in ownership restrictions may apply to losses carry forward in the case of acquisitions. If the new owner was not previously affiliated with the acquired company, losses carried forward can only be utilized where the acquired company carries out its activity for at least 2 years after the acquisition or where the company is listed on a stock exchange. The activity criteria requires the target company to continue and realize income from its activity without significant changes (e.g. holding activity instead of production activity is not allowed).

## Transfer taxes

The purchase of shares in a REC may be subject to real estate transfer tax where the purchaser holds 75 percent or more of the shares.

Real estate transfer tax is payable by the purchaser of the shares. The base of the transfer tax is the market value of the real estate transferred, prorated to the ownership ratio. The rate of the tax is 4 percent up to HUF1 billion and 2 percent on the excess amount. The amount of the tax cannot exceed HUF200 million per plot number. Therefore, if a real estate property is registered under several different plot numbers at the Land Registry, it qualifies as several separate real estate properties for transfer tax purposes. Starting in 2014, only share deals in RECs are subject to transfer tax (those having at least 75 percent real estate asset ratio for accounting purposes) and the activity criteria (i.e. application to only companies carrying on activity in real estate) is no longer relevant.

#### Tax clearances

If an acquisition of shares is deemed a preferential exchange of shares, the gain on the shares may be deferred if all criteria set out in the Act on Corporate Income Tax are met. In a preferential exchange of shares, a company (the acquiring company) acquires an interest in the issued capital of another company (the acquired company) in exchange for issuing to the acquired company's member(s) or shareholder(s) – in exchange for their securities – securities representing the issued capital of the former company and, if applicable, making a cash payment not exceeding 10 percent of the nominal value or, in the absence of a nominal value, of the accounting par value of the securities issued in exchange, provided that the acquiring company obtains a majority of the voting rights in the acquired company, or increases its holding if it already held a majority of the voting rights before the transaction.

As of 1 January 2012, deferred tax treatment of the preferential exchange of shares can only apply if the real economic or commercial rationale for such transactions is underpinned.

#### Choice of acquisition vehicle

A foreign purchaser has various options as its acquisition vehicle for the purchase of assets and shares, each of which might have different tax consequences.

#### Local holding company

The use of a Hungarian holding company might be favorable where the Hungarian company used a loan to finance the acquisition and could deduct interest paid on the debt from its corporate income tax base.

A Hungarian holding company could also be used as a special-purpose vehicle in the case of a privileged transformation.

The Hungarian Tax Office recently started to challenge schemes involving debt push-downs into operations. Pre-clearance in the form of a binding ruling is strongly recommended.

#### Foreign parent company

The use of a foreign parent company generally would not have Hungarian corporate income tax implications at the level of the foreign parent company (unless an applicable tax treaty allows for taxation of the capital gains of RECs).

Hungary does not levy WHT on dividends paid by a Hungarian company.

Hungarian WHT on interest, royalties and certain service fees was abolished as of 1 January 2011.

#### Non-resident intermediate holding company

An intermediate holding company might be favorable where the intermediate holding company is resident in a country that has a more favorable tax treaty with Hungary such that the tax on capital gains or dividends might be deferred or eliminated. Hungary has an extensive treaty network. The table at the end of the chapter shows the WHT rates agreed in the tax treaties concluded with Hungary.

#### Local branch

In most cases, non-residents who do not wish to establish a Hungarian-registered company can conduct business in Hungary through branches registered with the Hungarian Court of Registration. Hungarian branches are treated similarly to any other corporate income taxpayer. Accordingly, profit transfers from the branch to the headquarters are considered as dividends, although they are not liable to WHT.

A Hungarian branch is subject to Hungarian corporate income tax at the standard tax rate, currently 10 percent up to the tax base of HUF500 million and 19 percent above this threshold (as of 1 July 2010). The tax base of a branch is calculated based on the accounting profit of the branch, modified by the additions and deductions set out in the Act on Corporate Income Tax.

The before-tax profit of the branch should also be:

- decreased by the indirect head office costs (up to a maximum prorated based on the ratio between the turnover of the branch and the turnover of the foreign entity)
- increased by 5 percent of the income not attributed to the branch but earned through the branch
- increased by operating costs and expenses and overhead of the branch charged to the pre-tax profit or loss.

Relevant double tax treaties may override these rules.

#### Joint ventures

There are no special tax rules for joint ventures in Hungary.

### Choice of acquisition funding

A company may consider the following ways of financing the acquisition:

- equity financing
- debt financing through a loan (either provided directly by a shareholder or via a related or unrelated third party)
- a combination of equity and debt financing.

#### Debt

The main advantage of using debt for funding an acquisition as opposed to equity is the potential tax-deductibility of interest payments (see below). The debt might be borrowed from a related party or from a bank. If the debt is borrowed from a related party, thin capitalization and transfer pricing rules should be considered.

#### Deductibility of interest

All interest-bearing liabilities are subject to thin capitalization rules in Hungary, except those from financial institutions and – as of 1 January 2012 – interest-free liabilities against related parties. According to the current rules, the average daily amount of the equity must be compared with the average

daily amount of loans. Under these rules, liability means the average daily balance of outstanding loans, outstanding debt securities offered privately and bills payable (except for bills payable on suppliers' debts and bank loans), and interest-free related-party liabilities.

As of 1 January 2012, the amount of liabilities could be decreased by the daily average amount of financial receivables. As of 1 January 2013, receivables from supplied goods and services are not considered against liabilities. Equity means the average daily balance of subscribed capital, capital reserve, profit reserve and tied-up reserves. Thus, the thin capitalization regulation covers interest on loans granted by related and unrelated parties and also extends to bonds and other loan securities issued exclusively to one party (closed securities).

If the ratio computed exceeds 1:3, the portion of the interest exceeding the limit is non-deductible for corporate income tax purposes. There are no other restrictions regarding interest payments. As a result, all interest not subject to thin capitalization rules on the external debt borrowed by an entity is deductible for tax purposes on the same basis recognized for accounting purposes. However, general transfer pricing rules should also be taken into account; the interest applied between related parties should be at arm's length.

As of 1 January 2010, the special tax treatment of related party interest was abolished. As a result, 100 percent of interest received from a related party is now taxable.

If the interest payment is not at an arm's length level, the corporate income tax base of the company should be modified accordingly. If the payable interest rate applied is higher than the arm's length interest rate, the corporate income tax should be increased by the difference.

Taxpayers are obliged to prepare detailed transfer pricing documentation. This documentation should be prepared by the deadline for the submission of the company's annual corporate income tax return. These records do not have to be filed with the tax return itself but must be available at the time of the tax authority investigations.

Interest income is exempt from local business tax in all cases (except for banks and licensed financial service providers).

Recently debt pushdowns have been subject to increased scrutiny by the Hungarian Tax Office, and many cases are now pending before the office and/or Hungarian courts. Before entering any such transaction, it is highly recommended to apply for a binding ruling as there still remains (for now) a relatively good chance for a positive result.

In line with the accounting practice changes, foreign taxes that correspond to corporate tax do not have to be added to pre-tax profits since these taxes are not accounted for as expenditures in the profit and loss.

### Withholding tax on debt and methods to reduce or eliminate it

Hungary has concluded a comprehensive network of bilateral tax treaties for the avoidance of double taxation, based mainly on the OECD Model Convention. These treaties set reduced rates of WHT for dividends, royalties and interest income. For royalties and interest paid from Hungary, domestic legislation provides unilateral exemption, irrespective of double tax treaties.

Between 1 January 2004 and 1 January 2010, no WHT applied on interest paid to foreign companies, regardless of the residence of the interest recipient.

WHT on interests, royalties and certain service fees was re-introduced to the Hungarian legislation in 2010 but then abolished as of 1 January 2011.

As noted earlier, WHT on dividends was abolished from 1 January 2006.

### Checklist for debt funding

- Consider whether the level of profits would enable the deductibility of interest.
- Consider the debt-to-equity ratio for the purposes of thin capitalization rules.
- Set arm's length interest rates and prepare transfer pricing documentation.

### Equity

In certain cases, the use of equity might be more advantageous for the purchaser to fund an acquisition. For example, if the company has a high debt-to-equity ratio (above 3:1), the use of debt would be disadvantageous because, under the thin capitalization rules, interest payments in excess of the allowed ratio would not be deductible for tax purposes.

### Hybrids

There are no special tax rules for hybrid financing structures in Hungary. Deemed deductions are arguably available on certain hybrid instruments, although we highly recommend seeking a Hungarian binding ruling before the transaction.

### Discounted securities

There are no special tax rules for the treatment of discounted securities in Hungary. The tax treatment of such securities follows the accounting treatment.

### Deferred settlement

The taxation of capital gains derived from preferential transformation may be deferred, if all prescribed criteria for the preferential transformation in the Act on Corporate Income Tax are met.

### Other considerations

In addition to pure share and asset deals, mergers can provide further tax planning opportunities in Hungary. According to the Hungarian accounting rules, a merger may take place at book value or market value. In the case of a merger at book value, the value of the assets and liabilities of the dissolving party is the same in the books of the legal successor. In this case, there are no tax consequences. In the case of a merger at market value, the assets and liabilities of the dissolving party are re-valued to market value.

According to the corporate tax law, any revaluation difference is taxable in the final tax return of the dissolving party. It is possible to defer the taxation of the revaluation difference where the merger is deemed to be preferential in line with the EU Mergers Directive.

A former advantage of a merger was that the losses of the legal predecessor could be carried forward during a transformation, taking into account the general rules; however, as of 1 January 2012, the aforementioned restrictions should be considered, and so the amount of carry forward losses would be limited.

### Concerns of the seller

As noted earlier, capital gains generally are subject to 10 percent or 19 percent corporate income tax (depending on the tax base), but exemption from taxation might apply if the capital gain is realized on an announced participation and all other criteria for the exemption are met.

Generally, Hungary does not tax gains realized by non-resident companies, so a capital gain realized by a non-resident on the sale of shares in Hungarian company is not subject to corporate income tax. However, as of 1 January 2010, if the shares qualify as shares in a real estate company, capital gains on the sale of such shares will be subject to corporate income tax of 10 percent or 19 percent in certain cases, unless the selling company is registered in a country with which Hungary has a tax treaty.

If the seller of the shares is an individual, the capital gain on the sale of shares probably is subject to personal income tax.

### Company law and accounting

As of 15 March 2014, the new Civil Code includes the general provisions on how companies may be formed, operated, reorganized and dissolved in Hungary. A separate act (also as of 15 March 2014) includes detailed rules regarding transformations, mergers, demergers and termination without legal successor of legal persons (hereinafter referred as Act on Transformations).

The Civil Code recognizes four basic legal forms for carrying out business activities.

According to the new Civil Code, business associations with legal personality are unlimited partnerships in the form *Közkereseti társaság* (Kkt.) and *Betéti társaság* (Bt.), companies with limited liability such as limited liability companies (*Korlátolt felelősségi társaság* – Kft.) and companies limited by shares. There are two types of companies limited by shares in Hungary: private limited companies (*Zártkörűen működő részvénnytársaság* – Zrt.) and public limited companies (*Nyilvánosan működő részvénnytársaság* – Nyrt.).

The most common types of companies in Hungary are limited liability companies and private limited companies. Generally, when a company changes company form (such as transformation from Kft. to Zrt.), the accounting and tax rules for mergers are applicable, including the rule that allows the assets and liabilities of a transforming party to be revalued to market value during the transformation.

According to the Civil Code, there are five types of transformation of business associations: changing company form, mergers (amalgamation and assimilation) and demergers (division and separation). In assimilation, the target

business association terminates and its assets devolve to the surviving business association as legal successor. The company that survives the merger becomes the general legal successor of the non-survivor. An amalgamation is a process in which two companies merge into a newly formed company and simultaneously the merging companies cease to exist. The new company is the general legal successor of all properties, rights, and obligations (liabilities) of the former companies.

For all forms of business associations, if the business association's supreme body has resolved in favor of the merger, the executive officers of the combining business associations have to prepare the draft merger agreement. The required content of this agreement is set out in the Civil Code and the respective rules of the Act on Transformations.

Pursuant to the Civil Code, a demerger may take the form of a division or a separation. The supreme body of a business association may divide the demerged business association into several business associations.

In a division, the business association being divided terminates and its assets devolve to the business associations being established as legal successors through transformation.

In the course of a separation, the business association from which separation is effected continues to operate in its previous form following alteration of the articles of association, and a new business association is established with the participation of the separating members (shareholders) and use of part of the assets of the business association.

The supreme body of the business association examines which members intend to become members of the legal successor business association as well. Members of the original business association can become members of one or all of the legal successor business associations. The executive officers of the business association prepare the draft terms of the demerger with content required by the Civil Code and the respective rules of the Act on Transformations.

The legal successors of demerging business associations are liable for the obligations of the original business association prior to demerger in accordance with the demerging agreement.

There is no pre-company period in respect of a new business association coming into being through transformation. The business association coming into existence may choose any corporate form for operation provided the requirements on the subscribed capital concerning the given corporate form are met.

The members (shareholders) of the legal predecessor business associations may be declared liable for the obligations of the successor if the legal successor was unable to meet them. Should an unlimited liability member of a business association become a limited liability member in the course of the transformation, that member remains liable on an unlimited basis for the obligations of the legal predecessor acquired before the transformation for 5 years after the transformation.

Limited liability members (shareholders) leaving a business association in the course of a transformation remain liable on a limited basis for the obligations of the legal predecessor for 5 years after the transformation.

The business association's supreme body shall pass a resolution on the transformation on two occasions. On the first occasion, based on the proposal of the executive officers and the supervisory board, the business association's supreme body shall establish whether the members of the business association agree on the intention to transform and decide into what form of business association the business association shall transform. If the business association's supreme body agrees on the transformation, the executive officers shall prepare:

- the draft balance sheet and an inventory of assets of the business association undergoing transformation
- the draft (opening) balance sheet, an inventory of assets and draft articles of association of the business association being established through the transformation
- the proposal on rendering accounts with the persons not intending to take part in the legal successor business association as members.

The business association's supreme body shall then resolve to approve these drafts. Within 8 days of the second decision, the business association shall publicly announce its decision on its transformation.

A business association undergoing transformation may revalue its assets and liabilities as shown in the balance sheet of the report prepared pursuant to the Accounting Act.

If a business association does not possess equity corresponding to the minimum subscribed capital prescribed for its form of business association in 2 consecutive years and the members (shareholders) of the business association do not provide for the necessary equity within a period of 3 months after approval of the report prepared pursuant to the Accounting Act for the second year, the business association shall be required to resolve for transformation into a different business association within 60 days of the expiration of the deadline.

The transformation is effective as of its date of registration by the companies' court. The business association being established through transformation is the legal successor of the business association undergoing transformation. The legal successor is entitled to the rights of the legal predecessor and the obligations of the legal predecessor passes to the legal successor, including the obligations contained in any collective agreement concluded with the employees.

Merging companies must prepare balance sheets and inventories of assets on two occasions: drafts must be prepared to support the decision of the owners on the merger, and final documents must be prepared on the date of the merger. The date of the merger is the date when the merger is registered by the court.

Companies ceasing operations (which merge into others) as a result of the merger must prepare annual financial statements on the date of the merger. The date of the merger constitutes a year-end for such companies, such that all closing procedures must be carried out with reference to this date.

The date of the merger does not constitute a year-end for companies continuing to operate in the same company form after the merger, so they must not close their books – the transformation must be accounted for in the normal course of bookkeeping.

A balance sheet prepared pursuant to the Accounting Act may be accepted as the draft balance sheet of the business association undergoing transformation if the reference date is no more than 6 months earlier than the second decision on the transformation.

Pursuant to the Accounting Act, a business association undergoing transformation may revalue its assets and liabilities as shown in the balance sheet of the report prepared. The draft balance sheet and an inventory of assets must be examined by an auditor and, if a supervisory board operates at the business association, by the supervisory board. The usual auditor of the business association is not entitled to conduct this examination. The value of the assets of the business association and the amount of its equity may not be established at a value that is higher than the value accepted by the auditor.

### Group relief/consolidation

There is no tax-consolidation regime in Hungary for corporate income tax purposes. Group taxation can be chosen only for VAT purposes.

### Transfer pricing

Hungary's transfer pricing rules broadly comply with the OECD transfer pricing guidelines. The rules allow the tax authorities to adjust taxable profits where transactions between related parties are not at arm's length level. The current legislation prescribes not only the methods applicable for determining a fair market price but also the way in which these must be applied. The taxpayer may calculate the fair market price using any method, provided it can prove that the market price cannot be determined by the methods included in the Act on Corporate Income and Dividend Tax and that the alternative method suits the purpose.

Since 2005, these rules should also be applied to transactions where registered capital or capital reserve is provided in the form of non-cash items, reduction of registered capital, or in-kind withdrawal in the case of termination without successor, if this is provided by or to a shareholder that holds majority ownership in the company.

Taxpayers are obliged to produce detailed transfer pricing documentation. This documentation should be prepared by the deadline for the submission of the annual corporate income tax return of the company. These records do not have to be filed with the tax return itself but must be available at the time of the tax authority investigations.

Related parties are defined in the Act on Corporate Income and Dividend Tax to include the following parties for transfer pricing purposes:

- the taxpayer and an entity in which the taxpayer has a majority interest, whether directly or indirectly, according to the provisions of the Civil Code, which means that it controls more than 50 percent of the votes
- the taxpayer and an entity that has a majority interest in the taxpayer, whether directly or indirectly, according to the provisions of the Civil Code
- the taxpayer and another entity if a third party has a majority interest in both the taxpayer and such other entity, whether directly or indirectly, according to the provisions of the Civil Code
- a foreign enterprise, its domestic place of business, and the business premises of the foreign enterprise; the domestic place of business of a foreign enterprise and the entity that is in the relationship defined earlier with the foreign enterprise
- the taxpayer and its foreign place of business, and the foreign place of business of the taxpayer and such entity that is in the relationship defined earlier.

Majority interest also occurs where any party has the right to appoint or dismiss the majority of executive officers and supervisory board members. The voting rights of close relatives are taken into account jointly.

The default penalty for not preparing the transfer pricing documentation is HUF2 million for each missing or incomplete document set. As of 1 January 2012, such default penalty could be of a higher amount in case of repeated transgression.

Recent changes to Hungary's transfer pricing rules have simplified the requirements for the transfer pricing documents as of 2012. Under certain specified circumstances, the use of EU master files will be accepted and the transfer pricing documentation can be prepared in a language other than Hungarian.

## Dual residency

There are no special rules for dual resident companies in Hungary.

## Foreign investments of a local target company

The Act on Corporate Income Taxation includes CFC provisions, which aim to prevent Hungarian companies from transferring their profits to low-tax jurisdictions. CFCs are entities in which a Hungarian taxpayer or any of its related parties hold an equity interest and which have their seat, permanent establishment or tax residence in a country where the effective corporate tax rate is less than 10 percent. A company with a seat, permanent establishment or tax residence in the EU, an OECD member country or a state with which Hungary has a tax treaty cannot be a CFC. Hungary has tax treaties with every member of the EU and all OECD member countries, except New Zealand.

As of January 2010, the definition of CFC changed significantly. Accordingly, CFCs are exclusively either:

- foreign entities in which a Hungarian-resident individual owns at least 10 percent of the shares or voting rights or over which the resident individual exerts dominant influence (ownership test)
- foreign companies that derive the majority of their income from Hungarian sources (income-source test).

Additional criteria under both tests are that the effective corporate tax rate is less than 10 percent or that the foreign entity did not pay corporate income tax because it had a zero or negative tax base, although a positive pre-tax profit. A company with a seat, permanent establishment or tax residence in the EU, an OECD member country or a state with which Hungary has a tax treaty cannot be a CFC, provided the company proves that it has real economic presence in that country.

Real economic presence includes producing, processing, agricultural, service or investment activity performed by the foreign company and its related parties in the relevant country, with the use of its own assets and employees, and provided at least 50 percent of the total income is derived through such activity.

If, on the first day of the tax year, the foreign company has a shareholder that has been listed on a recognized stock exchange for at least 5 years and has a participation of at least 25 percent in the foreign company, such foreign company may not qualify as a CFC.

The application of Hungarian CFC rules may trigger various tax consequences. Hungary introduced a new anti-deferral rule as of 2010 for any undistributed profits in the CFC at Hungarian individual and/or corporate shareholder level.

Additionally, dividends distributed by a CFC cannot benefit from the participation exemption and thus are included in the Hungarian company's corporate income tax base. Further, capital gains derived from the sale of participations in a CFC cannot benefit from the available participation exemption for corporate income tax purposes and so they are fully taxable in Hungary.

Realized capital losses and expenses related to a reduction in the value of a holding in a CFC, or from the disposal of such holding, increase the corporate income tax base of a resident company insofar as the losses and expenses exceed the income booked in relation to the same transaction.

Payments made to CFCs may be not deductible for corporate income tax purposes unless the taxpayer proves they are directly related to the operation of its business.

## Comparison of asset and share purchases

### Advantages of asset purchases

- No assets other than those specifically identified by the purchaser are transferred.
- No employment or contractual relationships need to be assumed from the seller unless the purchaser wishes to do so; thus the purchaser could offer employment to the people it needs under revised salary and working conditions.
- Purchase price may be depreciated for tax purposes.
- Historical tax liabilities of the seller are not inherited.

### Disadvantages of asset purchases

- Possible need to renegotiate supply, employment and technology agreements.
- If real estate is transferred, real estate transfer tax applies.
- Arm's length consideration should be paid on the transfer of selected assets between related parties.
- VAT is due on the asset acquisition, which can lead to cash flow timing issues and, in the worst case, a VAT cost.

### Advantages of share purchases

- Potentially lower capital outlay (purchase net assets only).
- May benefit from tax losses of the target company (subject to certain criteria as of 2012).
- May gain benefit of existing supply or technology contracts.
- No VAT to pay.
- Purchaser may benefit from all permits, licenses and authorizations, unless stipulated otherwise.

### Disadvantages of share purchases

- Purchaser automatically acquires any liabilities of the target company (including tax liabilities).
- Liable for any claims or previous liabilities of the target.
- Very limited tax deduction possibilities for goodwill in relation to the purchase price.
- Could be subject to real estate transfer tax as of 2010.

## Hungary – Withholding tax rates

This table sets out reduced WHT rates that may be available for various types of payments to non-residents under Hungary's tax treaties. This chart is based on information available up to 1 March 2014.

Source: *International Bureau of Fiscal Documentation, 2014*

	Dividends		Interest <sup>1</sup> (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies <sup>2</sup> (%)		
<b>Domestic rates</b>				
<i>Companies:</i>	0	0	0	0
<i>Individuals:</i>	16	N/A	0/10/16	0
<b>Treaty rates</b>				
<i>Treaty with:</i>				
Albania	10	5	0	5
Armenia	10	5	10	5
Australia	15	15	10	10
Austria	10	10	0	0
Azerbaijan	8	8	8	8
Belarus	15	5	5	5
Belgium	10	10	0/15 <sup>3</sup>	0
Bosnia and Herzegovina <sup>4</sup>	10	10	0	10
Brazil	15	15	10/15 <sup>5</sup>	15/25 <sup>6</sup>
Bulgaria	10	10	10	10
Canada	15	5	10	0/10 <sup>7</sup>
China (People's Rep.)	10	10	10	10
Croatia	10	5	0	0
Cyprus	15	5	10	0
Czech Republic	15	5	0	10
Denmark	15	0 <sup>8</sup>	0	0
Egypt	20	15	15	15
Estonia	15	5	10	5/10 <sup>9</sup>
Finland	15	5	0	0/5 <sup>10</sup>
France	15	5	0	0
Georgia	5	0 <sup>12</sup>	0	0
Germany	15	5 <sup>13</sup>	0	0
Greece	10	10	10	0/10 <sup>10</sup>
Hong Kong <sup>14</sup>	10	5 <sup>15</sup>	5	5
Iceland	10	5	0	10

	Dividends		Interest <sup>1</sup> (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies <sup>2</sup> (%)		
India	10	10	10	10
Indonesia	15	15	15	15
Ireland	15	5 <sup>15</sup>	0	0
Israel	15	5 <sup>15</sup>	0	0
Italy	10	10	0	0
Japan	10	10	10	0/10 <sup>16</sup>
Kazakhstan	15	5	10	10
Korea (Rep.)	10	5	0	0
Kuwait	0	0	0	10
Latvia	10	5	10	5/10 <sup>9</sup>
Lithuania	15	5	10	5/10 <sup>9</sup>
Luxembourg	15	5	0	0
Macedonia (FYR)	15	5	0	0
Malaysia	10	10	15	15
Malta	15	5	10	10
Mexico	15	5 <sup>13</sup>	10	10
Moldova	15	5	10	0
Mongolia	15	5	10	5
Montenegro <sup>17</sup>	15	5	10	10
Morocco	12	12	10	10
Netherlands	15	5	0	0
Norway	10	10	0	0
Pakistan	20	15	15	15
Philippines	20	15	15	10
Poland	10	10	10	10
Portugal	15	10 <sup>18</sup>	10	10
Qatar	0/5 <sup>19</sup>	0/5 <sup>19</sup>	0	0
Romania	15	5 <sup>20</sup>	15	10
Russia	10	10	0	0
San Marino	5/15 <sup>21</sup>	0	0	0
Serbia <sup>17</sup>	15	5	10	10
Singapore	10	5	5	5
Slovak Republic	15	5	0	10
Slovenia	15	5	5	5

	Dividends		Interest <sup>1</sup> (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies <sup>2</sup> (%)		
South Africa	15	5	0	0
Spain	15	5	0	0
Sweden	15	5	0	0
Switzerland	10	10	10	0
Taiwan	10	10	10	10
Thailand	— <sup>22</sup>	15/20 <sup>23</sup>	10/25 <sup>24</sup>	15
Tunisia	12	10	12	12
Turkey	15	10	10	10
Ukraine	15	5	10	5
United Kingdom	10/15 <sup>25</sup>	0 <sup>26</sup>	0	0
United States	15	5 <sup>13</sup>	0	0
Uruguay	15	15	15	15
Uzbekistan	10	10	10	10
Vietnam	10	10	10	10

**Notes:**

1. Most treaties provide for an exemption for certain types of interest, e.g. interest paid to the state, local authorities, the central bank, export credit institutions or in relation to sales on credit. Such exemptions are not considered in this column.
2. Unless stated otherwise, the reduced treaty rates given in this column generally apply if the recipient company holds directly or indirectly 25 percent of the capital or the voting power in the Hungarian company, as the case may be.
3. The lower rate applies, *inter alia*, to interest on bank deposits (conditions may apply). In addition, the lower rate applies, *inter alia*, to interest on current accounts and on advance payments between banks.
4. The treaty of 1985 concluded between Hungary and the former Socialist Federal Republic of Yugoslavia.
5. The 10 percent rate applies to interest from loans and credits granted by a bank for at least 8 years in connection with the selling of industrial equipment or the study, the installation of industrial and scientific units and with public works.
6. 'Royalties' include technical fees. The higher rate applies to trademarks.
7. The lower rate applies to cultural royalties, excluding films.
8. This rate applies if the beneficial owner is (i) a company that has owned directly at least 10 percent of the capital in the Hungarian company for at least 1 year; or (ii) a pension scheme.
9. The lower rate applies to (a) equipment rentals and (b) royalties for transmission by satellite, cable, optic fiber or similar technology.
10. The lower rate applies to copyright royalties, including films.
11. This rate applies if the recipient company has owned directly at least 25 percent of the capital in the Hungarian company for at least one year (under conditions).
12. This rate applies if the recipient company holds at least 10 percent of the voting stock in the Hungarian company.
13. Effective from 1 January 2012.
14. This rate applies if the recipient company owns directly at least 10 percent of the capital in the Hungarian company.
15. The lower rate applies to cultural royalties.
16. The treaty of 2001 concluded between Hungary and the former Federal Republic of Yugoslavia.
17. This rate applies if the recipient company has owned directly at least 25 percent of the capital in the Hungarian company for at least 2 years.
18. The zero rate applies if the beneficial owner is a company.
19. This rate applies if the recipient company owns directly at least 40 percent of the Hungarian company.
20. The lower rate applies if the recipient company holds directly less than 25 percent of the capital in the Hungarian company. The higher rate applies in all other cases.
21. The domestic rate applies; there is no reduction under the treaty.
22. The lower rate applies if the recipient company owns directly at least 25 percent of the capital in the Hungarian company, which is engaged in an industrial undertaking.
23. The lower rate applies to interest received by any financial institution.
24. The higher rate applies if the dividends are distributed by an investment vehicle that derives income directly or indirectly from immovable property, distributes most of this income annually, and such income is exempted from tax.
25. This rate applies if the beneficial owner is (i) a company that controls, directly or indirectly, at least 10 percent of the voting stock in the Hungarian company (other than where the dividends are paid by an investment vehicle subject to the 15 percent rate on dividends) or (ii) a pension scheme.

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