

# Tax and Investment Facts

A Glimpse at Taxation and Investment in Hungary  
2017



# WTS Klient Hungary

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## WTS in Hungary

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able to offer cross-border and global cooperation frameworks.

Within the group, WTS Klient Tax Advisory Ltd specialises in tax advisory services. The primary objective of our company is to provide our clients with compliance and consulting services with the aim of minimising their tax-related risks. Below are some of the services our tax advisory department offers to our clients:

- Tax planning based on the full scope of Hungarian and international regulations
- Representation of clients vis-à-vis tax authorities
- Obtaining rulings and expert opinions on more complex tax issues;
- Tax audits
- Due diligence reports
- Transfer pricing services
- Preparation and review of tax returns in relation to all taxation categories

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<b>1</b>	<b>Ways of Doing Business</b>	<b>4</b>
<b>2</b>	<b>Corporate Taxation</b>	<b>7</b>
<b>3</b>	<b>Double Taxation Agreements</b>	<b>15</b>
<b>4</b>	<b>Transfer Pricing</b>	<b>16</b>
<b>5</b>	<b>Anti-avoidance Measures</b>	<b>17</b>
<b>6</b>	<b>Taxation of Individuals / Social Security Contributions</b>	<b>19</b>
<b>7</b>	<b>Indirect Taxes</b>	<b>22</b>
<b>8</b>	<b>Inheritance and Gift Tax</b>	<b>24</b>
<b>9</b>	<b>Wealth Tax</b>	<b>25</b>

# 1 Ways of Doing Business / Legal Forms of Companies

A company established and registered in accordance with Hungarian law has the right to acquire property and conclude contracts as well as to file lawsuits and have lawsuits filed against it. In addition, it may engage in a wide range of activities. For certain activities, special permission is needed from the relevant authority. Companies with foreign participation may be set up in any form listed in the Civil Code, which entered into force from 15 March 2014, including the detailed rules for each company form.

The legal forms of companies in Hungary are as follows:

## **Unlimited partnership (Kkt)**

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

## **Limited partnership (Bt)**

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

## **Limited liability company (Kft)**

A limited liability company is established with a pre-determined amount of registered capital provided by its founder(s). As a main rule, the liability of each member in relation to the company extends to their initial contributions, beyond which they are not responsible for the company's liabilities. The rights of the members and the share due to them from the assets of the company are represented in the company's registered capital by so-called quota(s). From 15 March 2014 the minimum registered capital requirement was increased to HUF 3 million. The establishment of a limited liability company can be arranged by means of a

simplified procedure, which is available for most companies provided that the template deed of establishment is suitable for the company's structure; the mandatory duty of the simplified procedure is significantly lower. A limited liability company is managed and represented vis-à-vis third parties by one or more managing directors.

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

- minimum registered capital of HUF 3 million (approximately EUR 10,000);
- duty payable on the registration application is HUF 100,000 (approximately EUR 330);
- duty payable on the simplified registration application is HUF 50,000 (approximately EUR 165);
- disclosure fee for publication in the Company Gazette is HUF 5,000 (approximately EUR 17);
- registration at the Chamber of Commerce and Industry has to be applied for with respect to the location of the company's registered office within 5 days of the company's registration in the Company Register (HUF 5,000 registration fee, approximately EUR 17);
- other charges for signature specimens, official translations and costs for legalising documents that were signed abroad etc. (these out-of-pocket costs vary case-by-case).

### **Company limited by shares (Zrt, Nyrt)**

This type of company is established by issuing shares of a pre-determined total nominal value. As a main rule, the liability of its members is limited to their contribution to the total nominal value of the shares. The shares of a company limited by shares are securities embodying membership rights. A company limited by shares is managed by the board of directors and must have a supervisory board in certain circumstances.

Companies limited by shares can operate in Hungary privately (private company limited by shares – Zrt.) with a minimum capital requirement of HUF 5 million, or open to the public (public company limited by shares – Nyrt.) with a minimum capital requirement of HUF 20 million. A company limited by shares can be established solely as a private company limited by shares and the company may go public upon being listed on the stock exchange. The shares of public companies limited by shares may be traded publicly, in contrast with a private company limited by shares, where the shares are not offered to the public.

### Branch and commercial representation office

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

- A **branch** is an organisational unit of a foreign enterprise with no separate legal identity. The branch is authorised to pursue business activities independently. The foreign company must always provide the assets needed for the operation of the branch, and settle its debts. The foreign founder and the branch bear joint and several unlimited liability for debts incurred in the course of the branch's activities. The branch is established and may start its operation when registered by the Court of Registration.
- A **commercial representation office** is not allowed to pursue business activities in Hungary independently; its general purpose is to facilitate the local business activity of the foreign company.

### 2.1 Applicable Taxes / Tax Rates

From 1 January 2017 the standard rate of income tax for Hungarian and in some cases foreign companies decreased – from 10%/19% – to 9%.

Companies only generating royalty income are taxed at 4.5% if certain conditions are met.

#### **Minimum tax**

An "expected" minimum tax is levied on companies whose corporate income tax base does not reach the "expected" minimum tax base, i.e. 2% of total revenue (reduced by certain limited items). The "expected" tax base is subject to tax at the flat corporate income tax rate. Paying corporate income tax on the "expected" tax base can be avoided by filling out a detailed declaration, validating the income generated and costs recognised during a given business year.

#### **Local business tax**

It is important to note that companies are also subject to local business tax within the territory of a given municipality if they have registered seat or permanent establishment in Hungary. Local business tax rate is determined by the municipalities separately but the maximum rate of the local business tax can be 2% of the tax base. The base of the Hungarian local business tax is the net sales revenue decreased by the cost of goods sold, the cost of intermediary and R&D services and material costs. As provided by the Act on Local Taxes, net sales revenue equals the sales revenue accounted for as provided by the Hungarian Act on Accounting decreased by the royalty income and certain taxes.

## 2.2 Resident Companies

A company registered in Hungary is obliged to pay corporate income tax on its worldwide income, bearing in mind the provisions of double tax treaties, which override domestic Hungarian rules.

### 2.2.1 Computation of Taxable Income

Taxable income is based on financial statements prepared in accordance with Hungarian accounting standards. Some items are tax deductible, such as dividends received (with the exception of dividends received from controlled foreign corporations). There are certain items that decrease the tax base (including certain donations, R&D costs, amount of development reserve).

Special corporate tax rules apply from the 2016 tax year for companies preparing their local financial statements based on IFRS regulations.

### 2.2.2 Taxation of Dividends

Dividends received are not taxable in Hungary with the exception of dividends received from controlled foreign corporations.

### 2.2.3 Capital Gains and Losses (including Capital Gains and Losses from Sales of Shares)

There is no separate capital gains scheme in Hungary; such gains are taxed in the course of normal corporate taxation. However, capital gains/FX gains realised as a result of certain investments are exempt from corporate income tax. If the taxpayer holds at least 10% of the shares in a domestic or foreign company continuously for at least one year, and the acquisition of shares was reported to the tax authority within 75 days following the acquisition, the corporate income tax base can be reduced by the capital gain/FX gain derived from the sale or in-kind contribution of the registered stockholding in the year of the disposal/share contribution.

### 2.2.4 Depreciation

Depreciation is set by companies based on their own accounting policy and the provisions of the Hungarian Act on Accounting. Tax depreciation may differ from accounting depreciation.

## 2.2.5 Loss Carry Over (including Potential Loss of Tax Loss Carry Forward in case of Restructuring)

From January 2015, tax losses established in accordance with the good faith business principle may be carried forward in the five tax years following the tax year. When offsetting the current tax year's positive taxable income by losses carried forward, the earliest losses must be used first (according to the FIFO principle). Taxpayers are able to use the accrued losses of previous years up to 50% of the tax base excluding losses used.

### Transitional rule

Previous years' losses incurred up until the last day of the tax year commenced in 2014 and not yet used in the tax base may be written off by the taxpayer according to the rules prevailing when the losses were sustained until no later than the tax year including 31 December 2025.

### Legal succession

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

In the case of company mergers, the legal successor can utilise the legal predecessor's corporate tax losses generated in the year of the merger from the year when the transformation took place.

### Change in ownership of the companies

Similar restrictions apply regarding the utilisation of tax losses in the case of changes in the ownership of companies. The rules have been eased going forward since the two-year condition does not have to be met if the acquired company is terminated without legal succession within two fiscal years of the acquisition. As regards losses carried forward assumed in the course of restructuring or acquisitions, such losses can only be used in each tax year up to the proportion of the tax-year sales revenue or income from the continued activity relative to the average sales revenue and income in the preceding three years.

## 2.2.6 Group Taxation

There is no group corporate taxation in Hungary. However, there are special rules for offsetting R&D costs within Hungarian group companies.

## 2.2.7 Relief from Double Taxation (Tax Credit / Tax Exemption)

Tax credits and tax exemptions may apply depending on the relevant double tax treaty. Income realised outside Hungary is generally exempt from Hungarian taxation but has to be taken into account when calculating the Hungarian tax liability.

## 2.2.8 Incentives

As Hungary is a member of the European Union, various financial sources for investment or development supported by the EU are available for companies. There are certain tax credits available for companies.

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

Besides the development tax allowance there are additional tax allowances or tax credits for companies providing support for cultural, sport and film-making purposes.

From 25 June 2015 a new savings opportunity was introduced for certain growing companies. This allowance improves the liquidity of enterprises by enabling the taxpayer to pay tax on the amount of the actual pre-tax profit exceeding the pre-tax profit of the previous fiscal year (growth tax credit) during the two subsequent fiscal years.

## 2.3 Non-Resident Companies

A non-resident company is taxed on its Hungarian income, as well as on income taxable in Hungary based on double taxation treaties.

### 2.3.1 Concept of Permanent Establishment / Doing Business

Permanent establishments of foreign enterprises and foreign organisations may also, under certain circumstances, be liable to pay corporate income tax and local business tax in Hungary. The Hungarian PE definition follows the definition described in the OECD Model Commentary.

### 2.3.2 Withholding Taxes

There is no withholding tax regime in Hungary. This means that dividends, interest, royalties and service fees (e.g. management fees) can be paid outside Hungary without applying withholding taxes.

### 2.3.3 Capital Gains

If realising capital gains upon the sale of their shares in companies holding Hungarian real estate, foreign entities, under some circumstances, may also be subject to Hungarian corporate income tax.

## 2.4 Tax Compliance

### Tax assessment

Companies are assessed on a calendar-year basis or on a business-year basis. The business year may only differ from the calendar year if the Hungarian company is a fully consolidated subsidiary or branch of a foreign parent company that follows a business year other than the calendar year.

### Tax filing

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

### Top-up liability

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

### 3 Double Taxation Agreements

Hungary has concluded double tax treaties with 80 countries.

Albania	India	Portugal
Armenia	Indonesia	Quatar
Australia	Iran	Romania
Austria	Ireland	Russian Federation
Azerbaijan	Israel	San Marino
Bahrain	Italy	Saudi Arabia
Belarus	Japan	Serbia
Belgium	Kazakhstan	Singapore
Bosnia and Herzegovina	Kosovo	Slovak Republic
Brazil	Kuwait	Slovenia
Bulgaria	Latvia	South Africa
Canada	Liechtenstein	South Korea
China	Lithuania	Spain
Croatia	Luxembourg	Sweden
Cyprus	Macedonia	Switzerland
Czech Republic	Malaysia	Taipei
Denmark	Malta	Thailand
Egypt	Mexico	Tunisia
Estonia	Moldova	Turkey
Finland	Mongolia	Turkmenistan
France	Montenegro	Ukraine
Georgia	Morocco	United Arab Emirates
Germany	Netherlands	United Kingdom
Greece	Norway	United States
Hong Kong	Pakistan	Uruguay
Iceland	Philippines	Uzbekistan
	Poland	Vietnam

## 4 Transfer Pricing

### General rules

Transfer pricing principles have to be taken into account and documentation has to be prepared for contracts between related parties to support the market price. The related company concept was broadened from 2015, in that parties shall also qualify as related companies if there is controlling influence over business and financial policy between the companies based on overlaps in the respective management teams. Transfer pricing documentation rules cover transactions between a foreign company and its Hungarian branch as well as transactions between taxpayers and their foreign branches. Transfer pricing rules also refer to establishing companies by way of contributions in kind, if the founder becomes a person with a majority interest upon establishing the company. Use of statistical methods (interquartile ranges) is compulsory during database filtering.

### Language

Transfer pricing documentation can also be prepared in English, German or French.

### Exemptions

In some cases, there is no need to prepare transfer pricing documentation at all, while certain transactions qualifying as low-value intercompany services can be documented by means of simplified documentation. No transfer pricing documentation has to be prepared for related-party transactions with a net transaction value up to HUF 50 million (without VAT) in the corresponding tax year and for small taxpayers.

### 5.1 General Anti-avoidance Rule

The Hungarian Act on the Rules of Taxation and the Act on Corporate Income Tax include general anti-avoidance and substance over form rules.

### 5.2 Thin Capitalisation Rules

There is a three-to-one debt to equity ratio in Hungary. Interest on the excess amount is not tax-deductible. Another limitation is that these provisions are applicable for all loans (except for those from financial institutions), including non-public bonds and certain notes. The provisions are also extended to interest paid by companies in a cash pool structure.

When applying the rules on transfer pricing, the liabilities that are to be taken into account when identifying thin capitalisation not only include liabilities where the taxpayer must pay interest charged against its profit, but also interest-free liabilities, if the taxable entity reduces its tax base by the amount of arm's length interest in accordance with transfer pricing rules ("deemed interest adjustment"). When calculating thin capitalisation, the daily average volume of liabilities is reduced by the total daily average volume of financial receivables reported among invested financial assets, receivables or securities. Commercial liabilities and receivables should not be taken into account for the purposes of the calculation.

### 5.3 Controlled Foreign Company Provisions

A foreign company is classified as a “controlled foreign corporation” if it has a beneficial owner who is a tax resident in Hungary or generates mainly Hungarian revenue, if the effective ratio of the paid (payable) corporate tax for the given year is less than 10%, or if the foreign company does not pay corporate tax despite making a profit, because its tax base is zero or less. This provision is not applicable if the foreign company’s registered headquarters or tax residency is in the EU or an OECD member state, or any other state having concluded a double taxation treaty with Hungary and the company has a real business presence.

Personal income tax is an obligation imposed on all private individuals in relation to income derived from sources within Hungary as well as to any foreign income of private individuals resident in Hungary. From 1 January 2016 a flat 15% personal income tax rate is levied on incomes that are subject to tax as part of the consolidated tax base (e.g. employment income) as well as for income taxed separately (e.g. interest, dividend income).

### 6.1 Residency Rules

Based on the Hungarian domestic rules Hungarian residency is determined based on the following factors:

- Hungarian citizenship,
- a private individual spends at least 183 days in the territory of Hungary in a calendar year, including the day of entry and the day of exit.

Beyond these factors, the following points are decisive for determining residency: place of permanent home, centre of vital interest. Treaty rules override the Hungarian domestic rules.

### 6.2 Income Liable to Tax

Income realised by private individuals (employment income, independent activity, interest, dividend, other sourced income) is subject to personal income tax. There are certain exemptions, e.g. housing allowances of foreign private individuals posted to Hungary, certain company donations to private individuals to buy/construct residential property, etc.

## 6.3 Allowable Deductions

### Family tax benefit

A significant family tax benefit system has been introduced to personal income taxation.

In the case of:

- one dependant, the deductible amount from the tax base is HUF 66,670 per eligible dependant per month
- two dependants, HUF 100,000 is deductible from the personal income tax base per eligible dependant per month (tax allowance per dependant per month in the case of two dependants will be gradually increased by 2019)
- at least three dependants HUF 220,000 is the deductible amount from the tax base.

Certain additional documents are needed to benefit from this deduction. From 1 January 2014, private persons who are unable to fully utilise the family tax allowance during a certain calendar year for lack of a sufficient tax base are entitled to utilise the remaining amount of the tax allowance in the form of relief from individual health insurance and pension contributions payable. To claim family allowance, children of the Hungarian and also of the foreign citizens should have a tax identification number.

### Limitations

There are limitations on family allowances claimed by non-resident foreign individuals to protect the taxable base. On one hand, the allowance may only be claimed if the same or a similar allowance is not utilised in the other country for the same period, while on the other hand, at least 75% of the private individual's total income must be taxable in Hungary to qualify for this allowance.

### Newlywed allowance

People getting married for the first time may apply for a "newlywed allowance". Here, spouses can claim a collective monthly tax base allowance of HUF 33,335 for a period of no more than 24 months from the month following their marriage. Once in possession of the allowance statement, spouses can claim the tax deduction when calculating tax advances (via payroll).

## 6.4 Tax Rates

There is a flat rate of 15% in Hungary.

## 6.5 Tax Compliance

There is a self-assessment system in Hungary meaning that private persons have to prepare and submit a Hungarian personal income tax return by 20 May of the following year. Private persons have to pay quarterly tax advances provided they are not on the payroll of a Hungarian payer (e.g. a company).

## 6.6 Social Security Contributions

As of 1 January 2017, the rate of the employer social security contribution has been reduced from 27% to 22%. Social security contribution rates for employees remain the same: each employee is subject to a 10% pension contribution and an 8.5% health care contribution on earnings from their principal employment. The upper daily limit for pension contributions paid by employees was abolished from 1 January 2013, meaning that the 10% pension contribution is payable regardless of the level of income.

## 7 Indirect Taxes

### 7.1 Valued Added Tax / Goods and Services Tax

From 1 January 2012, the standard rate of VAT is 27%. A reduced VAT rate of 5% is applicable for certain preferential products (medicines, books, large livestock, fresh milk, poultry, etc.) and with respect to the sale of new residential properties. There is another preferential VAT rate (18%), which applies to dairy products and bakery products for example. From 1 January 2017 the 18% preferential rate can be applied when providing internet access services.

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

#### Compliance

As a general rule, VAT-registered taxpayers are required to file a VAT return quarterly (newly registered taxpayers are subject to monthly VAT returns filing in the first two years of their operation). From 1 July 2017, taxpayers have to report domestic transactions where the amount of value added tax charged is at least HUF 100,000. Road transport with road vehicles of over 3,500 kg can only be undertaken in possession of a special number (called an EKAER number). In addition, an EKAER number must also be requested for transporting with smaller vehicles if the total weight of the vehicle and the cargo exceeds 3,500 kg, or if the goods delivered qualify as risky goods as per the regulations. In the case of risky goods, a security deposit is also payable by the taxpayer.

## 7.2 Transfer Taxes

The general rate of transfer duty payable on property transfers is 4%. If the market price of the property exceeds HUF 1 billion, the duty rate is 2% on the portion in excess of this, although the total amount of transfer duty payable per property cannot exceed HUF 200 million. In the case of companies buying and selling properties, the duty rate is 2%, provided that the company complies with the related statutory regulations. The acquisition of a participation (shares, equity interest, co-operative share, investment share) in a company holding properties in Hungary may be subject to transfer tax (and a reporting obligation).

## 7.3 Others

Excise tax is levied on items such as mineral oils, alcohol and alcoholic beverages, beers, wines, sparkling wines, intermediate alcoholic products and tobacco products, manufactured within the country or imported into Hungary.

## 8 Inheritance and Gift Tax

The general inheritance and gift tax rate in Hungary is 9% in the case of apartments, 18% in the case of other properties. Special rules apply in the case of vehicles. Inheritance tax liability is incurred as at the day when the testator died.

There is no inheritance or gift tax in Hungary between direct line relatives (e.g. if the beneficiaries are the children of the deceased person) and for the surviving spouse (for spouses in the case of a gift).

### 8.1 Taxable Base

The base for inheritance tax and gift (duty) is the fair value of the asset, which can be decreased with certain costs.

There is no wealth tax in Hungary.

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