

TaxAlert

June 2009

Tax law amendments for 2010

The modification of certain tax acts and other related laws have been submitted to and accepted by the Parliament. Some of these modifications enter into force during 2009 and in this alert we highlight the main changes.

Personal income tax

In the session on 29 June 2009, the Hungarian Parliament accepted the new tax package. The changes will mostly take effect from 1 January 2010.

From 1 January 2010, the base for personal income tax will be determined using the so-called "super gross income" which contains all dependent, independent, other sources of income and a tax base increasing element.

The tax base increasing element is to be calculated as the total employer's social security contributions (the total rate would be 27 per cent in 2010) or in the absence of Hungarian social security coverage it would be the mandatory health care charge (EHO, the rate of which would also be 27 per cent).

When calculating the tax base increasing element, non-taxable income should not be taken into consideration.

Tax table from 1 January 2010

Consolidated tax base (annual)	Tax rate
HUF 0 – 5 000 000	17%
From HUF 5 000 001	32% + HUF 850 000

The rate of wage tax credit would be modified to 17 percent, the maximum amount would be increased to HUF 15 100 per month; the total amount of tax credit may be deducted up to an annual "super gross income" of HUF 3 188 000, and a decreased amount up to a super gross income of HUF 4 698 000.

Employees will be able to declare to their employers (or a service provider company) the amount of non-taxable income in order to ensure the appropriate tax advance payments are made.

The Cafeteria system has been changed significantly:

The new package would determine a favorable tax rate on a specific group of fringe benefits with a discount tax rate of 25 per cent up to an itemized limit described below:

- National holiday voucher or holidays in a company's resort (paid by the company) to the value of the annual minimum wage,
- Lunch vouchers up to HUF 18 000/month,
- Reimbursement of training and education fees (tuition allowances) up to 250 per cent of the annual minimum wage,
- school starting subsidy up to 30 per cent of the annual minimum wage
- monthly travel pass
- From employer's contribution for employees:
 - private pension fund contribution up to 50 per cent of the minimum wage,
 - voluntary mutual health or pension insurance payments together up to 50 per cent of the minimum wage
 - contribution to employer's pension funds up to 50 per cent of the minimum wage
 - employer's contribution to the employee's private pension fund payments with regard to the Act on Private Pension and Private Pension Funds;

Over the itemized limit, the favorable fringe benefits would be taxed as ordinary benefits in kind.

Business gifts and entertainment costs would be tax-exempt benefits in kind if they should be included in the provider companies' tax base as a corporate income tax increasing item.

Those tax allowances to be deducted from the calculated income tax would be abolished, except family tax allowance and those allowances to provide long-term savings for the individuals such as voluntary insurance and pension funds.

An employee's non-refundable loan for housing purposes provided by an employer certified by a financial institution, should be treated as non-taxable.

A new source of income to be included in the consolidated income tax base is that in relation to a controlled foreign company (CFC). The individual's share of a CFC's income (less dividends paid to them from that income) is to be treated as other income. The individual should be in direct relationship to the CFC or have indirect ownership in the company. The direct ownership of close relatives (with regard to Civil Code 685.§b.) would be treated as indirect ownership.

A private individual, tax resident in a country with which Hungary has no double tax treaty, would be liable for 30 percent tax on interest, royalty and service fee income if such income is paid out by a Hungarian company. The tax should be determined, declared and paid by the Hungarian payer company.

Changes are introduced in relation to the taxation of private entrepreneurs or contributing members of certain enterprises. Personal income tax should be paid based on "usual" income relevant to that specific activity, if the individuals withdraw or receive income for their personal contribution. "Usual" income should be determined by the market (i.e. what individuals in a similar situation, profession or activity would earn) however it should be at least the amount determined by the activity indicated according to the FEOR Number of the National Employment Administration (ÁFSZ).

If an employment activity is undertaken in Hungary, labor and assignment relationships of foreign countries are to be treated as labor and assignment relationships based on the Hungarian law, when applying the social security legislation of Hungary.

From 1 January, 2010, the total employer's social security contributions are to be decreased to 27 percent, consisting of 24 percent pension fund contribution, 1.5 percent in kind and 0.5 percent cash health care contribution. The unemployment contribution is decreased to 1 percent. Contributions for private individuals are not changed.

Health care charge

The percentage based health care charge will be increased to 27 percent from 11 percent. This needs to be taken into consideration when calculating tax advances on income which is part of the consolidated income tax base and in respect of which no employer's social security contributions were paid on the income.

The lump sum health care charge is to be abolished.

Rehabilitation contribution

Rehabilitation contribution is increasing by five times to HUF 964 500 per head per year. The mandatory employment level would not be changed.

Solidarity tax

Solidarity tax will be integrated into the personal income tax.

Corporate income tax, solidarity tax

The corporate income tax rate will increase to 19%, however, at the same time the solidarity tax on corporations will be abolished.

This change should be applied first in the tax year beginning in 2010.

Abolished provisions

Some tax-base amending items will be abolished, with appropriate transitional provisions. The most significant items to be abolished are as follows:

- local business tax will no longer be a tax base decreasing item,
- tax base amendments in relation to free of charge transactions,
- provisions created for environmental protection obligations,
- 50% tax base amendment concerning net intercompany interest differences,
- tax base reduction related to CO2 emission quota sales ,
- 50% tax base of stock exchange gains,
- tax base allowance in relation to modern works of art,
- tax base deduction related to capital gains on the sale of shares in small- and medium sized entities.

Changing provisions

- Development reserve: development reserve reported in the 31 December 2008 financial statement can be released over a 6-year period,
- Cost of entertainment and business gifts defined in the personal income tax law will be considered as costs not incurred in the interest of business activity, and so will increase the tax base.
- 20% of the amount of outstanding receivables not settled within 365 days will be considered as irrecoverable, except those which cannot be enforced in court or are obsolete. This provision shall enter into force on the date the new law modification is proclaimed. As a result of the rules, tax on bad debt write offs can be recovered over 5 years.
- The tax base will be decreased by justifiable add back of share write downs that increased the previous years' taxbase.
- The amount of tax base decrease for donations will be capped at 20 or 50%, depending on the circumstances.
- Only direct costs of own research and development activity will be allowed as a tax base decreasing item. The law specifies that R&D definitions should be interpreted in line with the Frascati Handbook.
- Two taxpayers will be considered as related parties not only if one person owns both of them but also if the majority owners are in close relationship. In addition, a taxpayer and its foreign permanent establishment, and the foreign establishment and other related parties of the taxpayer will also be treated as related parties.
- Transfer pricing rules should be applied on in kind contributions.

- Preferential transformations and preferential exchanges of shares: the tax base increasing rules should not be applied in the course of repeated preferential transactions.
- Financial enterprises will use the same rules as credit institutions in relation to write offs of receivables and thin capitalization.
- Credit institutions will be allowed to carry forward tax losses as from 2009.
- Small- and medium sized enterprises will be able to enjoy a new development tax allowance related to investments above 500 million forints.

Taxation of capital gains in connection with real estate

The concept of a so called 'real estate company' will be introduced, which includes the taxpayer and its affiliates owning real estate in Hungary. A company will be considered a 'real estate company' if the following requirements are met: more than 75% of its consolidated total assets are real estate located in Hungary and at least one of their shareholders is resident in a state, with which Hungary has not concluded a double tax treaty or in a State where the double tax treaty allows such gains to be taxed in Hungary.

According to the act, tax liability for the shareholders of a 'real estate company' will arise when the shareholder sells, gifts or contributes the shares of such a company. The tax base is to be the difference between the income from the sale of the shares and the acquisition costs including expenses related to the shares during the shareholding period. The tax rate will be 19%.

Deciding whether or not a taxpayer qualifies as a 'real estate company' could give rise to considerable administrative work. A further complicating factor is that the real estate of affiliated undertakings has to be considered too.

Change in relation to controlled foreign companies

The definition of CFCs will change significantly. A foreign organization will be considered a CFC if: a Hungarian resident individual has at least 25% of the voting rights or ownership, or they have a dominant influence in the company. If the effective tax rate of the foreign company is more than 12,66%, it will not be considered a CFC. If the tax rate is less than 12,66%, and the company can prove real economic presence in the particular jurisdiction it will not be considered a CFC. The possibility to demonstrate real economic presence will only apply to companies that are resident in the EU, in the OECD or in a state with which Hungary has a double taxation treaty.

In some cases, the profits earned by a CFC could become taxable in the hands of the Hungarian shareholder regardless of whether or not the profits were actually repatriated to Hungary.

Withholding tax

Withholding tax is to be imposed again on certain Hungarian source income of foreign corporations resident or seated in a country with which Hungary has no double tax treaty. The withholding tax of 30% will be withheld from interest, royalties and the following service fees: activities of head offices, management consultancy activities, advertising, market research and public opinion pooling, business agency activity or other professional, scientific and technical activities etc.

A foreign person will become a taxpayer based on its income from sale of shares in or capital withdrawal from a 'real estate company'.

Local business tax

From 1 January 2010, the Hungarian Tax Authority will take over responsibility for local business tax administration. As a consequence, from 1 July 2010, the tax advance will have to be self-assessed and declared. The tax return and payment deadlines will not be changed. Accordingly, commencement of business activities subject to local business tax should be reported to the tax authority within 15 days (by indicating the respective local municipality). A further consequence is that municipalities are not allowed to pass different rules on local business tax payment deadlines.

Tax base of local business tax

The tax base for permanent activities will be the net sales revenue, less direct costs or R&D, in addition to the costs of goods sold, the value of mediated services and material costs that are currently possible.

That part of the tax base of taxpayers having a permanent establishment (PE) abroad which can be attributed to the PE, will be exempt from local business tax.

A further amendment is that the activity of the general electricity and gas providers, traders and distribution authorized network operators will be subject to local business tax in those municipalities where at least 75% of their net sales are derived from the sale or distribution of electricity and gas to end customers.

Act on Duties

According to the new tax law package, the stamp duty rules will be amended for property acquisitions reported for dutiable purposes or that become known to the tax authority after 1 January 2010.

Assets received by a company without consideration and receivables provided to an other company free of charge will be exempted from gift duty if they are also not subject to transfer duty. Forgiveness of receivables and assumption of liabilities are within the scope of this exemption.

The acquisition of shares in a company, which holds immovable property situated in Hungary, is subject to stamp duty if the shareholding of the acquirer is at least 75%. In determining the percentage, the shares of an individual beneficiary, their spouse, a domestic partner, children as well as parents should be added together. Additionally, the shareholding of a company and its related parties should be jointly considered for this purpose. The basis for the stamp duty liability is the market value of the immovable property (without reduction for debts) in proportion to the shareholding ratio.

The rate of transfer duty will be decreased from 10% to 2-4%. The transfer duty liability is to be 4% up to THUF 1 million, and 2% on the market value exceeding this threshold. The total duty is capped at HUF 200 million per item of immovable property.

The duty on residential property is levied on the market value of the property at a rate of 2% up to HUF 4 million and 4% on the excess value over this amount.

Property acquired in the course of a privileged merger or preferential exchange of shares remains exempt from transfer duty.

With regard to land reported for stamp duty exemption purposes between 1 October 2004 and 31 May 2009, the deadline for the residential building construction obligation is increased from 4 years to 6 years at the request of the property acquirer submitted within the deadline.

The terms for applying 2% stamp duty on property acquired for re-sale purposes and reported in the above period are also extended. At the request of the acquirer, the deadline for selling the immovable property could be extended from 2 years to 4 years.

Value added tax

Besides central heating, a reduced 18% VAT rate will also be applicable for hotel services. This amendment came into effect on 9 July 2009.

As already known, the standard VAT rate increased from 20% to 25% from 1 July 2009. The act provides special rules for the supplies of residential property. The 20% VAT rate still applies if the document based on which the title to the property is transferred was submitted to the land registry by 30 June 2009, even if the date of supply defined by the VAT Act falls after 1 July 2009. According to the above, the supply of residential property is subject to 20 % VAT if the related agreement was submitted to the land registry by 30 June, even if the title to the property had not passed at that time.

The VAT Act in relation to the license for self-assessing import VAT is amended. The value of tax exempt supplies of goods and services required for obtaining the license is reduced to the 2008 level: i.e. 10 billion and 20 billion forints. Contrary to the former rules, it will be possible to submit an application for the license at

any time during a year based on data of the previous year, and the licence will be valid for 12 months from the day when the resolution comes into force.

There will be no application threshold for the licence if the applicant is an Authorized Economic Operator or has a license for simplified procedure of release for free circulation. In this case the license is valid for an indefinite period.

The act also provides rules for obtaining this licence for VAT groups: certain conditions for the licence will have to be fulfilled by the members of a VAT group jointly, while other conditions apply to each member individually.

Excise duty

As a consequence of the weaker Hungarian currency and the new tax minimum for diesel fuel, excise duty rates will be increased as from 1 January 2010 in order to meet the EU requirements. The rates will vary according to the following:

- In the case of diesel fuel, the excise duty will be increased by HUF 6.85 per liter (increase of 7.6%).
- The excise duty on leaded petrol and petroleum will be increased by 5.9% to 124.20 HUF / liter, on LPG used off-road by 15.2% to 12.095 HUF/kg, on compressed gas fuel, by 6.5% to 26.10 HUF/ nm³, on heavy fuel oil, by 13.5% to HUF 4.425, on the extra light heating oil by 13.7% to 116 HUF/kg. The tax rate for compressed gas fuel may be lowered to nil on the basis of a future decision of the European Commission.
- The itemized duty on cigarettes will be increased to 9350 HUF / thousand items (the value related duty will not change). The new rate will cause an 8.9% tax increase in the most popular price category and approximately HUF 29 tax increase per packet. In parallel, the minimum tax on cigarettes will be 17 330 HUF / thousand items. The minimum duty rate for smoking tobacco will also be increased by 8.3% to 7280 HUF / kg.

Besides the above - mainly because of state revenue requirements – a 10% increase will take place regarding unleaded gasoline, as well as alcoholic beverages (spirits, beer, fruit wine, sparkling wine, liquors). The new tax rate for unleaded gasoline will be 120 HUF/liter.

Energy tax

As from 1 January 2010, the energy tax on coal will be increased by 17.2% to 2390 HUF/ton. In the case of electricity, the tax increase will be 17.1% to 295 HUF/MWh and for natural gas 17.1% to 88.50 HUF/GJ.

Special rules will be applied for the change of tax rate regarding continuous supplies.

Due to the significant development of underground gas storage facilities and networks, as from 1 September 2009 the rules on gas usage will change, allowing tax refund for those users which contribute to cushion gas reserves or substitute for network losses. The are transitional rules to be considered from 1 January 2009 and 1 July 2009.

New Act on Taxation of certain valuable properties

The new act on Taxation of certain valuable properties (hereinafter 'property tax act') will apply to residential real estate worth over HUF 30 million, watercraft, aircraft and high-powered passenger cars, as of 1st January 2010.

Real estate for residential purposes

According to the new act, residential real estate with a market value exceeding HUF 30 million will be subject to property tax. The tax base will be the market value of the property without allowance for liabilities on the property. Simultaneously, the act defines the calculated value of the real estate as follows:

The act determines the average value per usable area by location and type of the real estate, which shall be corrected by other factors determining the value of the property.

Residential real estate with a market value not exceeding HUF 30 million shall be tax exempt, as well as another residential real estate of the same owner not exceeding a market value of HUF 15 million. Tax shall be calculated with the following tax rates: up to HUF 30 million of the taxable market value 0,25%, between HUF 30 million and 50 million 0,35% and on the remaining part of the tax base 0,5%.

The new act will allow deferment of the property tax for taxpayers over 62 years, disabled persons and taxpayers receiving rehabilitation allowance. Temporary deferment shall be allowed for infants on inherited real estate and for taxpayers seeking employment. The later collection of the tax will be guaranteed through a mortgage on the real estate, specified in the land registry.

Monumental buildings and buildings protected by local decree would be temporarily tax exempt within 3 years of their renewal permission, and an amount of HUF 10 million of the residential real estate (assuming market value is less than HUF 50 million) owned by persons older than 62 years or disabled persons will also be exempt. Allowance will be provided for large families, from the third child the tax shall be decreased by 15% for each additional child.

Passenger cars

Passenger cars having engines with a power of at least 125 kilowatts will become taxable under the new act. The tax shall be calculated based on the multipliers

determined in the new act and rates determined in the vehicle tax act according to the age and performance of the vehicle. 50% tax allowance will be provided to owners having electronic or hybrid vehicles, and to parents owning one car and having three or more children.

Watercraft

The taxation of watercraft will cover those craft registered with the Hungarian authority, belonging to resident individuals and organizations (even when they are registered abroad or not registered but fulfil the criteria for registration). The tax on sailing boats will be calculated based on age and nominal sail surface while for non-sailing boats it will be calculated based on the age and capacity of the engine of the watercraft.

Aircraft

The tax on aircraft would cover those registered with the Hungarian authority, belonging to resident individuals and organisations (even when they are registered abroad or not registered but fulfil the criteria for registration). The tax shall be calculated at different rates for motorized and non-motorized vehicles, based on the age and the maximum weight during take off.

Other regulations

The new act on Taxation of certain valuable properties allows deduction for local tax / general vehicle tax arising under the local tax act / vehicle tax act in relation to real estate and cars, to preclude double taxation.

Property Tax shall be declared in the Personal Income Tax, Corporate Income Tax or Simplified Entrepreneurial Tax return by the general deadline of these returns. Taxpayer who are not obliged to file any of the above returns shall declare the Property Tax by 25th February. Tax shall be paid in two equal amounts, by the deadline of the declaration and by 30th September.

Act on the Rules of Taxation

Procedure concerning local business tax

Under the modification of the Act on the Rules of Taxation, the responsibility for collection of local business tax will become that of the State Tax Authority instead of the Local Authorities. The taxpayer should report to the State Tax Authority the start or end date of business activity giving rise to local business tax within 15 days (referring to the competent local government).

Real estate company

The tax payer should report within 90 days of the due date for submission of the tax return that it is a "Real estate company" (new definition) according to the Act

on Corporate and Dividend Tax amendments, and should declare, whether the non-resident shareholders of the "Real estate company" have alienated their shares. Based on the declarations, the Tax Authority will publish on its web-page the name, seat and tax number of the tax payers qualifying as Real estate companies each year by 31 August.

Other

Companies registered abroad should list the name, place of residence (seat) and ownership ratio of the shareholders, in their reports of building and land tax (local taxes).

The fees for the arm's length price determination procedures of the Authorities (APA) will be decreased.

The amnesty rule in relation to income received from a controlled foreign company will be applicable up to 31 December 2009.

The certified taxpayers who meet the criteria could be subject to a lower (20%) tax penalty (except where a 75% penalty is applicable).

Accounting

Amendments in relation to annual reports prepared in foreign currencies

According to the proposed amendments of the Act C of 2000 on Accounting, companies can prepare their annual reports in euro, if they specify this before the first day of the business year in their accounting policies. Their decision can not be changed for 5 years thereafter.

The rules in relation to annual reports prepared in foreign currencies (except euro) will be changed. Currently, 50 percent of the income and expenditure and also 50 percent of the assets and liabilities should arise in the chosen currency. The new rule will require a 25 percent minimum amount in the chosen currency.

Cultural Contribution

Based on the enacted tax law changes, cultural contribution will be abolished from January 1, 2010. Therefore products that are currently subject to cultural contribution will not be subject to cultural contribution from 2010.

Should you have any questions regarding the above, please do not hesitate to contact Bálint Gombkötő (tel: 887-7159, balint.gombkoto@kpmg.hu) at the tax department of KPMG Advisory Ltd. or your regular tax advisor.

Partners

Michael Glover

Partner
+36 1 887 7405
michael.glover@kpmg.hu

Gergely Demetrovics

Partner
+36 1 887 7366
gergely.demetrovics@kpmg.hu

dr. Csaba László

Partner
+36 1 887 7420
csaba.laszlo@kpmg.hu

Philippe Norré

Partner
+36 1 887 7449
philippe.norre@kpmg.hu

Mergers & Acquisitions Group

Gábor Beer

Director
+36 1 887 7329
gabor.beer@kpmg.hu

dr. Zoltán Kádár

Manager
+36 1 887 7404
zoltan.kadar@kpmg.hu

Indirect Taxes, Customs and International Trade Group

Balázs Földes

Senior Manager
+36 1 887 7232
balazs.foldes@kpmg.hu

Ian McNicholls

Senior Manager
+36 1 887 8902
ian.mcnicholls@kpmg.hu

dr. Tamás Kosztolányi

Manager
+36 1 887 7256
tamas.kosztolanyi@kpmg.hu

Péter Pataky

Manager
+36 1 887 7409
peter.pataky@kpmg.hu

Tax Advice for the Financial Services Sector

Gábor Farkas

Senior Manager
+36 1 887 7415
gabor.farkas@kpmg.hu

Bálint Gombkötő

Senior Manager
+36 1 887 7159
balint.gombkoto@kpmg.hu

International Tax Structures Group

Tamás Mlinárik

Director
+36 1 887 7498
tamas.mlinarik@kpmg.hu

Personal Income Tax Group

Kornélia Mitrik

Senior Manager
+36 1 887 7410
kornelia.mitrik@kpmg.hu

dr. Katalin Boncsér

Manager
+36 1 887 7321
katalin.boncser@kpmg.hu

Gabriella Joó

Manager
+36 1 887 6630
gabriella.joo@kpmg.hu

Corporate and International Taxation Group

Mihály Gerhát

Manager
+36 1 887 7180
mihaly.gerhat@kpmg.hu

Tibor Járolí

Manager
+36 1 887 7416
tibor.jaroli@kpmg.hu

Enikő Vadon

Manager
+36 1 887 7359
eniko.vadon@kpmg.hu

Transfer Pricing Advisory Group

Mónika Mindszenti

Senior Manager
+36 1 887 7170
monika.mindszenti@kpmg.hu

Balázs Pethő

Manager
+36 1 887 7368
balazs.petho@kpmg.hu

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