



MERGERS AND ACQUISITIONS

Hungary

Taxation of Cross-Border
Mergers and Acquisitions

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TAX

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 on 1 May 2004, new forms of business association have also been integrated into the Hungarian company law legislation, such as the European economic interest grouping and the *societas europea* (SE).

Recent Developments

In June 2009 and November 2009, the Hungarian parliament accepted several tax law changes, effective as of 1 January 2010, which might have implications for M&A transactions in Hungary. The key tax law changes are summarized:

- Corporate income tax rate is increased to 19 percent.
- Solidarity tax on corporations is abolished.
- Capital gains on transfers of shares in a Hungarian real estate company will be taxable under certain circumstances.
- Definition of controlled foreign companies (CFCs) will change significantly and 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.
- Purchase of shares in a Hungarian real estate company will be subject to stamp duty.
- Withholding tax (WHT) of 30 percent is to be imposed on interest, royalties, and certain service fees (such as activities of head offices, management consultancy activities, advertising, or other professional, scientific, and technical

activities) paid by a Hungarian company to a foreign corporation resident in a country with which Hungary has no double tax treaty.

- Some tax base amending items will be abolished (such as local business tax decreasing item).
- Transfer pricing rules should be applied on in-kind contributions.

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 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 the gain is part of the general tax base and was subject to 16-percent corporate income tax and 4-percent solidarity tax. As of January 2010, the corporate income tax was increased to 19 percent, and the solidarity tax was abolished.

In general the sale of assets is also subject to the standard VAT rate, which is currently 25 percent.

In addition, if the assets to be sold include real property the buyer is liable to pay real estate duty. The standard real estate duty rate was 10 percent in 2009, but as of 1 January 2010, it was reduced to 4 percent up to a value of HUF 1 billion and 2 percent of the excess value of the real estate. The maximum amount of the duty will be capped at HUF 200 million per property.

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 Organization for Economic Cooperation 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.

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 income in the following five years in equal amounts.

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 Hungarian legislation, a 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 19-percent corporate income tax (until January, 2010 the corporate income tax was 16 percent plus a now-abolished 4-percent solidarity tax). The transfer pricing rules have to be applied in the case of a sale of assets between related parties.

Value-Added Tax (VAT)

In general, the sale of assets is subject to the standard VAT rate, currently 25 percent, and the sale of a business or part of a business should be regarded as one supply of goods, subject to the standard VAT rate.

Transfer Taxes

If the assets to be sold include real property, as noted above, the buyer is liable for real estate duty. As of 1 January 2010 the standard real estate duty rate is 4 percent (down from 10 percent) up to a value of HUF 1 billion and 2 percent of the excess value of the real estate. The maximum amount of the duty is capped at HUF 200 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 30 percent acquired from 1 January 2007 could be considered as announced participations, which are reported to the tax authority

within 30 days following the acquisition. The capital gain on such participations held for at least one year are exempt from corporate tax and were exempt from the now-abolished solidarity 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.

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.

As of 1 January 2010, capital gains derived from the sale of shares in a Hungarian real estate company will be taxable. A taxpayer qualifies as a Hungarian real estate company, if the value of the Hungarian real properties of the sold company exceeds 75 percent of the value of its total assets or if the value of the Hungarian real properties of the sold company and its Hungarian related parties exceeds 75 percent of the total assets of the taxpayer and related parties and provided in both cases the quota/share holders of the taxpayer or its related party is resident in a country which does not have an effective tax treaty with Hungary or which 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 will transfer with the target company, which means that the target company will keep its tax losses after the sale of shares. Tax losses can be carried forward without time limitation to offset future profits of the taxpayer, provided the negative tax base arose while the taxpayer complied fully with the legislation. Following the recent tax law changes, there is now no need to request permission from the tax authority for the future use of tax losses. The change of ownership or change of activity has no impact on the ability to use the existing tax loss.

Transfer Taxes

As of 1 January 2010, in the case of a purchase of shares in a company owning real estate, real estate duty will be imposed on the value of the real estate owned by the company pro-rated based on the shares purchased in the company, provided the purchaser owns at least 75 percent of the shares. A real estate company is defined as a taxpayer which owns Hungarian real property or 75 percent of the shares (directly or indirectly) of a company which owns Hungarian real property.

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 by the Act on Corporate Income Tax are met. Preferential exchange of shares shall mean an operation whereby a company (the acquiring company) acquires an interest in the issued capital of another company (the acquired company) in exchange for issuing to the member (members) or shareholder (shareholders) of the latter company – 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.

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 if 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 privileged transformations.

Foreign Parent Company

The use of a foreign parent company would generally not have Hungarian corporate income tax implications at the level of the foreign parent company. Hungary does

not levy WHT on dividends paid by a Hungarian company.

However, as of 1 January 2010, Hungary levies WHT of 30 percent on interest, royalties, and certain service fees (such as activities of head offices, management consultancy activities, advertising, or other professional, scientific, and technical activities) paid by a Hungarian company to foreign corporations, resident or based in a country with which Hungary has no effective double tax treaty.

Non-Resident Intermediate Holding Company

An intermediate holding company might be favorable, if the intermediate holding company is resident in a country which has a more favorable tax treaty with Hungary and thus 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

Non-residents can, in most cases, conduct business in Hungary through branches registered with the Hungarian Court of Registration, if they do not wish to establish a Hungarian-resident company. 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 will be subject to Hungarian corporate income tax at the standard tax rate, currently 19 percent (as of 1 January 2010). The tax base of a branch is calculated based on the accounting profit of the branch modified by the decreasing and increasing items determined by the Act on Corporate Income Tax. The profit before tax of the branch should also be adjusted as follows:

- decreased by the indirect head office costs (up to a maximum pro-rated 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; and
- 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. In the case of a debt financing 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 taken into consideration (see Deductibility of Interest).

Deductibility of Interest

All interest-bearing liabilities, except those from financial institutions, are subject to thin-capitalization rules in Hungary. According to the current rules, the average daily amount of the equity must be compared with the average daily amount of loans that are not from financial institutions. Under these rules, liability means the average daily balance of outstanding loans, outstanding debt securities offered privately and bills payable, with the exception of bills payable on suppliers' debts. Equity means the average daily balance of subscribed capital, capital reserve, profit reserve, and tied-up reserves. This means that the thin-capitalization regulation covers interest on loans granted by both 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 will be 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.

According to the tax rules for 2009, a Hungarian company could deduct 50 percent of the difference between the interest received from and paid to its related parties provided the difference is positive. As a result, only 50 percent of the interest so received was taxable. The amount of interest deducted, together with the 50 percent deduction for capital gains and royalties could not exceed 50 percent of the taxpayer's pre-tax profit.

On the other hand, if the related-party interest received is lower than the related-party interest paid (that is, the difference is negative), the pre-tax profit had to be increased by 50 percent of the difference. Further, the amount of this increase was not taken into account for thin-capitalization purposes. However, the taxpayer was not required to increase its pre-tax profit if it informed (in writing within 30 days from the end of the tax year) all of its related parties that were Hungarian residents or qualified as foreign entrepreneurs for corporate income tax purposes and to which it paid or from which it received interest, that it did not intend to make the adjustment (that is, increase its pre-tax profit by the negative difference). As a consequence, the taxpayer's related parties were not required to take into account the amount of interest paid to or received from the taxpayer when applying the above rules with respect to their own pre-tax profits.

The 50-percent deduction rules did not apply to small and medium-sized enterprises, insurance companies, financial institutions, and investment enterprises.

As of 1 January 2010, the 50-percent deduction rule was abolished and as a result 100 percent of the interest received from a related party will be taxable. In addition, if the interest received from related parties is lower than the interest paid to related parties (that is, the difference is negative), the pre-tax profit was not increased by 50 percent of the difference.

If the interest payment is not at arm's length the corporate income tax base of the company should be modified accordingly. If the 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. For corporate income tax purposes 75 percent of the interest received from foreign sources can be exempted from Hungarian corporate income tax.

Interest income is calculated as the difference between the amount of interest received – capped at 75 percent – and decreased by the costs incurred directly in relation to the generation of such income.

Withholding Tax on Debt and Methods to Reduce or Eliminate

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. Furthermore, for royalties and interest paid from Hungary, domestic legislation gives unilateral exemption, irrespective of double tax treaties. This means that since 1 January 2004 there has been no withholding tax on interest paid to foreign companies, regardless of the residence of the interest recipient. As noted earlier, dividend WHT has also been abolished as from 1 January 2006.

As of 1 January 2010, interest paid by a company registered in Hungary to a foreign entity is subject to WHT at the rate of 30 percent, provided the foreign entity is registered or based in a country which has no effective double tax treaty with Hungary. The payment of lease fee of securities is deemed as interest payment for the purposes of WHT (fee payable for the lease of shares; that is, a company does not purchase shares but lease them for a certain period).

Checklist for Debt Funding

- Consider whether the level of profits would enable the deductibility of interest to be effective.
- Consider the debt-to-equity ratio for the purposes of thin-capitalization rules.
- Use of arm's lengths interest rate and prepare transfer pricing documentation.
- As of 1 January 2010, WHT of 30 percent will apply on interest payments to non-Hungarian entities, provided the foreign entity is resident or based in a country which has no effective double tax treaty with Hungary.

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.

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 criteria of the preferential transformation prescribed by the Act on Corporate Income Tax and Solidarity Tax are met.

Other Considerations

In Hungary, there has been a significant growth in M&A in recent years. Mergers can provide further tax planning opportunities in Hungary in addition to pure share deals and asset deals. 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 will be 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 will be 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, but it is possible to defer the taxation of the revaluation difference, if the merger is deemed to be preferential in line with the European Mergers Directive.

Another advantage of a merger is that the losses of the legal predecessor can be carried forward during a transformation, taking into account the general rules. Based on the current VAT legislation, a merger or division should not be treated as having any VAT consequences.

Concerns of the Seller

As noted earlier, in general capital gains are subject to 19-percent corporate income tax (before 1 January 2010 the rate was 16 percent plus the now abolished 4-percent solidarity tax), but exemption from taxation might apply if the capital gain is realized on announced participation and all other criteria for the exemptions are met.

In general, 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 will not be 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 19 percent in certain cases, unless the company selling those shares is registered in a country with which Hungary has an effective double taxation treaty.

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

Company Law and Accounting

The Company's Act includes the provisions on how companies may be formed, operated, re-organized, and dissolved in Hungary. The Company's Act recognizes four basic legal forms for carrying out business activities.

Business associations without legal personality are unlimited partnerships in the form *Közkereseti társaság* (Kkt.) and *Betéti társaság* (Bt). Business associations with legal personality are limited liability companies (*Korlátolt felelősségű társaság – Kft.*) and companies limited by shares (*Részvénytársaság – Rt.*). The most common type of companies in Hungary is the limited liability company and the company limited by shares. Generally, when a company changes company form (such as transformation from Kft. to Rt.), 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 Company's Act there are four types of transformation of business associations: mergers (amalgamation and assimilation) and de-mergers (division and separation). In assimilation, the target business association will terminate and its assets will 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 will be the general legal successor of all properties, rights, and obligations (liabilities) of the former companies.

In respect of 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 which is set out in the Corporation Act.

Pursuant to the Company's Act, a de-merger may take the form of a division or a separation. The supreme body of a business association may divide the de-merged business association into several business associations.

In respect of division, the business association being divided shall terminate and its assets shall 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 will continue to operate in its previous form following alteration of the articles of association, while a new business association shall be established with the participation of the separating members (shareholders) and use part of the assets of the business association.

The supreme body of the business association will examine which legal successor business association the members of the business association intend to become members of. Members of the original business association can become members of one or all the legal successor business associations. The executive officers of the business association will prepare the draft terms of the de-merger with content required by the Company's Act.

The legal successors of de-merging business associations will be liable for the obligations of the original business association prior to de-merger in accordance with the de-merging 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 on condition that 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, he/she or it remains liable on an unlimited basis for the obligations of the legal predecessor acquired before the transformation for five 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 five 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 and an inventory of assets, and draft articles of association of the business association being established through the transformation; and
- 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 eight days of the second decision, the business association shall make a public announcement of the 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 two consecutive years, and the members (shareholders) of the business association do not provide for the necessary equity within a period of three 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.

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 shall be

entitled to the rights of the legal predecessor and the obligations of the legal predecessor shall pass to the legal successor, including the obligations contained in any collective agreement concluded with the employees.

Within a period of 90 days after registration of the business association established through transformation, a final source and application of funds statement and inventory of assets shall be prepared as at the date of registration, both for the legal predecessor business association and its legal successor.

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 book-keeping.

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 six 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 have to 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 which 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

In Hungary, the transfer pricing rules broadly comply with the 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. 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 the alternative method suits the purpose.

Since 2005, these rules should also be applied to transactions where registered capital is provided in the form of non-cash items, the reduction of registered capital, and in-kind withdrawal in the case of termination without successor, if this is provided by or provided 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 for transfer pricing purposes. The following can be regarded as related parties:

- The taxpayer and the entity in which the taxpayer has a majority interest, whether directly or indirectly, according to the provisions of the Act on Corporations, which means that it controls more than 50 percent of the votes.
- The taxpayer and the entity that has a majority interest in the taxpayer, whether directly or indirectly, according to the provisions of the Act on Corporations.
- 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 Company's Act.

- A foreign enterprise and 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 which is in the relationship defined above with the foreign enterprise.

Majority interest shall also mean 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 will be taken into account jointly.

The default fine for not preparing the transfer pricing documentation is HUF 2 million for each missing or incomplete document set. According to the recent changes to the transfer pricing rules in Hungary, the requirements for the transfer pricing documents have been simplified from 2010. Under certain specified circumstances the use of EU master-files will also be accepted and the transfer documentation can be prepared in a language other than the 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 two thirds of the Hungarian corporate tax rate (that is, less than 12.67 for 2010). A company with a seat, permanent establishment, or tax residence in the European Union, an OECD member country, or in a state with which Hungary has an effective double taxation treaty, cannot be a CFC. Hungary has double tax treaties with every member of the European Union and all OECD member countries, except for Mexico and New Zealand.

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

- foreign entities in which a Hungarian resident individual owns at least 10 percent of the shares or voting rights or if the resident individual exerts dominant influence (referred to as ownership test); or

- foreign companies which derive the majority of their income from Hungarian sources (referred to as income-source test).

Further criteria under both tests are that the effective corporate tax rate is less than two thirds of the Hungarian corporate tax rate (that is, less than 12.67 percent as of January 2010) or 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 European Union, an OECD member country, or a state with which Hungary has an effective double taxation 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 which has been listed on a recognized stock exchange for at least five years and which 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. For example, dividends distributed by a CFC cannot benefit from the participation exemption and thus are included in the Hungarian company's corporate income tax base. Furthermore, capital gains derived from the sale of participations in a CFC cannot benefit from the available participation exemption for corporate income tax purposes and are, therefore, fully taxable in Hungary.

Also, 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.

As of 1 January 2010, the undistributed profit of a CFC is subject to corporate income taxation at the level of

the taxpayer owning the holding in the CFC, provided that no individual resident in Hungary has a direct or indirect participation in the taxpayer.

Comparison of Asset and Share Purchases

Advantages of Asset Purchases

- No assets other than those specifically identified by the purchaser would be transferred.
- No employment or contractual relationships would need to be taken over from the seller unless the purchaser wishes to do so. This means the purchaser could offer employment to the people it needs under revised salary and working conditions.
- The purchase price may be depreciated for tax purposes.
- Historic tax liabilities of the seller are not inherited.

Disadvantages of Asset Purchases

- Possible need to renegotiate supply, employment, and technology agreements.
- The transaction would be subject to real estate transfer tax, if real estate is transferred.
- The consideration paid for the selected assets between related parties should be at arm's length.
- 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

- Lower capital outlay potentially (purchase net assets only).
- May benefit from tax losses of the target company.
- May gain benefit of existing supply or technology contracts.
- No real estate transfer tax.
- No VAT to pay.
- The purchaser may benefit from all permits, licenses, and authorizations, unless stipulated otherwise.

Disadvantages of Share Purchases

- The 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.

Withholding Tax Rate Chart

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies ² (%)		
Albania	10	5	0	5
Australia	15	15	10	10
Austria	10	10	0	0
Azerbaijan	8	8	8	8
Belarus	15	5	5	5
Belgium	10	10	15	0
Bosnia and Herzegovina ³	10	10	0	10
Brazil	15	15	10/15 ⁴	15/25 ⁵
Bulgaria	10	10	10	10
Canada	15	10	10	0/10 ⁶
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	5	0	0
Egypt	20	15	15	15
Estonia	15	5	10	5/10 ⁷
Finland	15	5	0	0/5 ⁸
France	15	5	0	0
Germany	15	5	0	0
Greece	10 ¹⁶	10 ¹⁶	10	0/10 ⁸
Iceland	10	5	0	10
India	10	10	10	10
Indonesia	15	15	15	15
Ireland	15	5 ⁹	0	0
Israel	15	5 ⁹	0	0
Italy	10	10	0	0
Japan	10	10	10	0/10 ⁸
Kazakhstan	15	5	10	10
Korea (Rep.)	10	5	0	0
Kuwait	0	0	0	10
Latvia	10	5	10	5/10 ⁷
Lithuania	15	5	10	5/10 ⁷
Luxembourg	15	5	0	0
Macedonia	15	5	0	0
Malaysia	10	10	15	15
Malta	15	5	10	10
Moldova	15	5	10	0
Mongolia	15	5	10	5
Montenegro ¹⁰	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	15 ¹⁷
Poland	10	10	10	10
Portugal	15	10 ¹¹	10	10
Romania	15	5 ¹²	15	10
Russia	10	10	0	0
Serbia ¹⁰	15	5	10	10
Singapore	10	5	5	5
Slovak Republic	15	5	0	10
Slovenia	15	5	5	5

Country	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies ² (%)		
South Africa	15	5	0	0
Spain	15	5	0	0
Sweden	15	5	0	0
Switzerland	10	10	10	0
Thailand	20	15 ¹³	10/25 ¹⁴	15
Tunisia	12	10	12	12
Turkey	15	10	10	10
Ukraine	15	5	10	5
United Kingdom	15	5	0	0
United States	15	5 ¹⁵	0	0
Uruguay	15	15	15	15
Vietnam	10	10	10	10

Notes

1. Most treaties provide for an exemption for certain types of interest, such as interest paid to the state, local authorities, the central bank, export credit institutions, or in relation to sales on credit.
2. In general, recipient companies qualify for the reduced rates if they own at least 25 percent of the capital or the voting power in the Hungarian company, as the case may be.
3. The treaty of 1985 concluded between Hungary and the former Socialist Federal Republic of Yugoslavia.
4. The 10-percent rate applies to interest from loans and credits granted by a bank for at least eight years in connection with the selling of industrial equipment or the installation of industrial and scientific units and with public works.
5. Royalties include technical fees. The higher rate applies to trademarks.
6. The lower rate applies to cultural royalties, excluding films.
7. The lower rate applies to equipment rentals and royalties for transmission by satellite, cable, optic fiber, or similar technology.
8. The lower rate applies to copyright royalties, including films.
9. This rate applies if the recipient company owns directly at least 10 percent of the capital of the Hungarian company.
10. The treaty of 2001 concluded between Hungary and the former Federal Republic of Yugoslavia.
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 two years.
12. This rate applies if the recipient company owns directly at least 40 percent of the Hungarian company.
13. This 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.
14. The lower rate applies to interest received by any financial institution.
15. This rate applies if the recipient company holds at least 10 percent of the voting stock in the Hungarian company.
16. The rate is 45 percent if the company making the distribution is a resident of the Hellenic Republic.
17. Lowest rate may apply if the lowest rate of Philippine tax that may, under similar circumstances, be imposed on royalties derived by a resident of a third state is less than 15 percent.

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