

wts klient newsletter

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The Bridge.

Dear Readers,

It is common at almost every international group that individual companies send employees out to group members located in other countries. These employees can be engineers as well as blue-collar workers, but they have one thing in common: international taxation is not their specialty. Nonetheless, tax issues can arise for several types of tax as a result of their posting.

At the invitation of Penta Unió, on 11 May 2017 my colleague Tamás Gyányi will be delivering a lecture on the conditions affecting expat employees entitled "Managing taxation and social security issues related to international postings".

This presentation is for all those who are heading abroad, or who are HR managers and welcome foreign staff to Hungary, and would like to have the right answers to the issues that arise. We also recommend the lecture for finance managers who would like to know what other impacts the international circulation of labour can have on a company's total tax burden in addition to personal income tax and contribution payments.

If this topic is important for you, click on the link below for further information (in Hungarian).

www.penta.hu/konferenciak/kikuldesek_nemzetkozi_cegcsoporton_belul/

Zoltán Lambert
managing partner

Solving of the capital situation

Due to the requirements regarding equity it can become necessary to make up for losses, but with the right planning, a significant fall in equity can be prevented. » [page 1](#)

Challenges of Hungarian transfer pricing rules

In the case of a management fee a detailed analysis; in the case of non-conventional transactions, all related information should be used to support the transfer price. » [page 2](#)

Solving of the capital situation - how to make up for losses?

How to make up for losses and settle equity issues:

- additional capital payment
- increase share capital and capital reserve
- convert loans into equity
- forgive liabilities
- non-repayable cash transfer (donation)
- making profit

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It is not uncommon for start-up companies in Hungary to make losses in their early years. Due to accumulating losses, a company's equity may fall significantly, and it can even become negative.

Based on the Hungarian Civil Code, if a company's equity falls to half of its share capital, or below the minimum share capital defined by law (HUF 3 million – approx. EUR 9,600 – in the

case of a Ltd.), the managing director must convene the quota holders' meeting without delay. Equity is usually examined when the annual report is approved, and it is advisable then to define the steps needed to make up for the losses, steps which have to be taken within three months.

What are the options for solving of the capital situation?

The most evident solution is an **additional capital payment**, which was designed for this very purpose. One possible difficulty is that this is only allowed if such a provision is included in the articles of association. The advantage though is that if the company turns a profit later on, and the additional capital payment is no longer necessary to cover the loss, this amount has to be paid back to the owners.

Increasing the capital reserve parallel to a capital increase is another possibility. Here, the premium generated upon increasing the share capital, which can either be cash or other permanent asset transfers, is allocated to the capital reserve. So the **solving of the capital situation** issue is resolved, but the drawback is that corporate documents need to be modified. Another difficulty is that if the (liquid) assets made available are no longer needed, they can only be repaid to the owners after modifying the corporate documents again and effecting a simultaneous and proportional decrease of the share capital and the capital reserve.

The role of the loans in the making up for the losses

In many cases, the parent company ensures the funds necessary for the company's operations through loans. If **solving of the capital situation** requires an increase of equity, **loans can be converted into equity** either in share capital, or in the capital reserve with a simultaneous increase of share capital. This requires a modification of corporate documents too, and in this case again, the amount can only be repaid to the owner if the share capital and the capital reserve are decreased simultaneously and proportionally. Given that the share capital and the capital reserve are not increased with a cash contribution, the company has an obligation to prepare transfer pricing documentation.

Forgiving loans or other **liabilities** to the parent company is also an option in Hungary, which is therefore accounted for as income and improves the company's equity through the profit after tax. **Non-repayable cash transfers (donation)** from the owner operate in a similar way. The disadvantage of both is that they might have Hungarian corporate tax implications, and in the case of private individual owners, they may result in a gift duty payment obligation. If the parent company is abroad, it must be examined whether any tax or duty payment obligation arises in another country because of this.

Naturally, the easiest way to make up for losses is the company **turning a profit** again, which can be supported during the year even by preparing an interim balance sheet. In the case of intercompany transactions, it is worth developing standard prices so they provide sufficient cover for operating costs and can be properly supported in the case of a tax inspection.

In light of the various possibilities and the extra costs arising by implementing the individual solutions, it is advisable to plan the method for financing operations when establishing the company in Hungary, and to define the tools for covering any potential losses, because a fall in equity can be **prevented with appropriate planning**.

Challenges of Hungarian transfer pricing rules

Management fee	
<p>Why do we experience difficulties?</p> <p>→ bundle of uncertain costs</p>	<p>How can we cope with it?</p> <p>→ identify and explore the cost items</p> <p>→ understand the pricing</p> <p>→ identify the allocation rates</p>

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In this article we draw attention to two different but important issues (and we deliberately don't call them problems), which occupy prime positions among the challenges of Hungarian [transfer pricing rules](#) and crop up from time to time. There is a good chance that professionals making decisions on transfer pricing rules will encounter them.

Management fee

Many accountants working at Hungarian subsidiaries are certainly familiar with the feeling of **receiving an annual management fee invoice at the end of the year**. The question is not whether it has to be paid or not, or whether it has to be booked or not, but rather what will happen to the amount of the invoice when calcu-

lating corporate tax: **does it have to be checked for the purposes of transfer pricing and should the tax base be adjusted?** These are the challenges facing professionals.

For a management fee, the problem in many cases is that it is difficult to find out what costs are included in the fee. If we don't know the **individual elements in a bundle of costs**, and how these elements were defined, it is also difficult to establish how they relate to [arm's length prices](#). Accountants working at Hungarian subsidiaries often do not know why the invoice includes the given amount, and what services were provided for it. When we examine a management fee from the perspective of Hungarian transfer pricing rules, one of the first questions is always about **the content of the bundle of costs**. In our experience, the fee often includes the salary of a person posted to the subsidiary as an expert. Other times, the fee for centralised IT solutions (e.g. SAP access) is allocated between the members of the group under this title. **The management fee may also include a portion of central marketing and PR costs**. Finally, the invoice can contain the salary arising in connection with the company's executive/administrative management.

In short, the following questions should be raised when analysing management fees:

- Exactly what costs are included in the management fee?
- Does the management fee contain a surcharge, in the case of recharged wage costs for example?
- If the management fee contains allocated central costs, what principles were used to allocate the cost ratios to the individual subsidiaries? What allocation rates were applied?
- Can the recharged costs be considered recognised costs based on the rules of corporate taxation?

After clarifying the above issues we can start examining the relationship between the arm's length price and the transfer price.

Narrow range of comparative data

Where can we come across with it?

- unconventional business lines
- atypical transactions

What can be the solution?

- internal comparable prices
- potential use of price quotations

Narrow range of comparative data

A good professional not only likes challenges, but also seeks them. It is always interesting getting to know a new customer and we can be sure that the challenges of Hungarian transfer pricing rules will come up during the meetings if **the customer operates in a non-conventional line of business**. It is obviously easier to find comparative data for the transactions of a company engaged in contract work which operates as a supplier for the automotive industry, than in the case of a group that is partly involved in secret military projects and configures military equipment. Equally unconventional is a related transaction where a Hungarian company constructs an entire power station and the **services and products of affiliated companies are also incorporated** into the project.

What guidelines or principles should we use here? The basis for all transfer pricing work is understanding **how the company operates, and what tasks and risks they assume during the related transaction**. How the parties should invoice their work to each other and what pricing they should choose. In the case of individual or rare transactions, the role of internal comparable prices gains in importance, i.e. we should always ask whether the company delivers the product in the related transaction to independent parties as well, or provides a similar service for independent parties. However, we should be careful with using comparative data and it should be understood that supporting the given transaction with proposals may prove to be insufficient during a NAV inspection.

These two examples illustrate that during any work related to transfer pricing even the first phase is very time-consuming (collecting information, analysing and collecting comparative data), but this is vital to be able to offer the necessary support.

"It is worth quantifying the impact of the IFRS switch in respect of local business tax too."

Tamás Gyányi, WTS Klient Hungary partner

Source: inforadio.hu



Have you heard?



WTS Klient partner Tamás Gyányi spoke to InfoRadio about the taxation implications of IFRS. "For the purposes of corporate tax, the IFRS regulation was developed in such a way that it is in fact possible to have your cake and eat it during the transition", said IFRS expert Gyányi on the radio.

[Listen to the conversation at this link!](#)

Please note that the conversation is available only in Hungarian.

This WTS information does not constitute advice and it serves only to provide general information about selected topics.

Any information contained herein shall thus not be considered exhaustive, and nor may it be relied upon instead of advisory services in individual cases. We accept no liability for the accuracy of the content.

Should you have any questions regarding the above or any other professional issues, please do not hesitate to get in touch with your WTS advisor or use any of the contact details below.

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