

wts klient newsletter

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The Bridge.

Dear Readers,

Last Thursday we had two reasons to be cheerful at the **European Tax Awards** ceremony in London organised by the International Tax Review trade journal.

We have been familiar with these awards for some time now because the European Tax Awards have been held every year since 2005 to recognise the leading tax consulting companies on our continent.

We were really excited to take part in the ceremony held at the Savoy Hotel. We waited for the names of the winners to be announced with bated breath, just like at the Oscars. And this year, the WTS name was in the winner's envelope on two occasions. WTS Global won the **European Indirect Tax Firm of the Year 2017** award, while WTS Germany was awarded the title of **German Tax Firm of the Year 2017**.

We received the awards, but this success was not earned alone. Cooperating with you enables us to develop continuously. And we are grateful to you for this!

Further details on the awards ceremony are available here:

wtsklient.hu/en/2017/05/23/wts-wins-two-awards/

Zoltán Lambert
managing director

Taxation of foreigners' income by types of income in Hungary

Treaties on the avoidance of double taxation help make it clear which country taxes should be paid in for different types of income.

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Corporate tax permanent establishment in light of BEPS rules

Having a corporate tax permanent establishment in Hungary means extra administration that requires special expertise.

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Taxation of foreigners' income by types of income in Hungary

Taxation of foreigners' income by types of income

Interest	→	country of residence
Capital gains	→	country of residence
Dividends	→	country of residence, but source country can also levy tax
Immovable property	→	as per location
Employment salary	→	complex examination

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In an [earlier article](#) we outlined how to determine the tax residency of employees. Now, with the help of a **double tax treaty** between Hungary and the other country concerned, we can establish the country employees have to pay personal income tax in for their incomes earned abroad. Of course, this all applies to the cases where there is a double tax treaty between Hungary and the given country (if there is no such treaty, then specific Hungarian rules must be followed).

For the various types of income, the treaties determine precisely which country is entitled to tax the income – the source country or the country of residence. This does not always mean tax is actually paid, because clearly **the given income could be exempt from tax in the country in question**.

Let us take a look at the most common types of income.

Capital gains

The first problem often comes when determining the type of income received. Foreign tax certificates frequently do not indicate what type of income we earned. It is often not clear whether the gain on our foreign security is a dividend or interest. Yet we cannot just decide not to define the types of income because **this influences the taxes and levies payable**. While a dividend generally incurs Hungarian personal income tax of 15% along with a health care contribution (eho) of 14%, the eho payable on interest was just 6% in Hungary until 2016, and from 2017 there is no eho payment liability for interest at all. There is no health care contribution payment liability for securities listed on stock exchanges either.

- ! It is important to know that if a foreign employee does not pay contributions in Hungary because these are paid in another EU Member State (and this is proven), then no eho has to be paid on capital gains either.

In accordance with the double taxation treaties, tax essentially has to be paid in the country of residence on income from interest and exchange gains. This also means that if tax was deducted from interest in the source country, the tax deducted can be reclaimed there. We can avoid the deduction of tax in the first place by submitting a **certificate of residence** to the foreign bank, verifying Hungarian residency.

There are special provisions for dividend income. While income from dividends is also taxed in the country of residence, the source country has the right to tax this income as well to a certain extent. Depending on the treaty this generally means 10 or 15%. Taxes paid abroad must be taken into account in Hungary. This essentially means for example that if we earn dividend income in Germany, then Germany has the right to deduct tax of 15% under the German-Hungarian double taxation treaty. If this tax is indeed paid and 15% is deducted from our dividend, we can deduct this in turn from our tax payable in our Hungarian tax return. As the Hungarian rate of personal income tax is 15%, this means no further tax has to be paid on the German dividend.

Income from use of immovable property

In the case of income derived from immovable property, the treaties award the taxation right to the country **where the property is located**. This means that if a foreign employee lets out his home property while working in Hungary, the rental must be taxed in the country where the property is situated, irrespective of whether or not the individual qualifies as a Hungarian resident during his stay in the country.

The same applies to income derived from the sale of property.

In terms of types of income, we will look at the third main group, income from employment, in our next article.



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"Dividends are no longer reported in the previous year's financial statements, but in the year when the dividend decision is made."

Szabolcs Szeles, WTS Klient Hungary financial advisory director

Source: inforadio.hu



Turn on your radio!



As of 1 January 2016, the date for reporting dividends changed in the Accounting Act. On 25 May in the evening, Szabolcs Szeles, Financial Advisory Director at WTS Klient Hungary, will be speaking about the change and the consequences on InfoRadio. "What is very important is that one of the indicators of a company's profitability is now the profit after tax, not the profit or loss for the year" – revealed the expert in the interview.

Listen to the discussion on the radio, or [click on this link](#). Please note that the conversation is available only in Hungarian.

Corporate tax permanent establishment in light of BEPS rules

Corporate tax permanent establishment – Hungarian rules:

- Permanent
- Business establishment/equipment, accessories
- Used on whole or in part for business activities
- Exhaustive list
- Exceptions

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Foreign companies wanting to set up operations in Hungary, but without establishing a Hungarian company, generally come to us with two questions. The first is whether their activity creates a permanent establishment (corporate tax permanent establishment) in Hungary from an income tax perspective. The second question is how the OECD’s BEPS actions and the [action by the EU to combat tax evasion](#) will have an impact in Hungary in practice.

Corporate tax permanent establishment – Hungarian definition

In an [earlier article](#) we looked in detail at the definition of a VAT fixed establishment, and what establishing a VAT fixed establishment involves. **The definition in the Hungarian law on corporate**

tax differs from the definition of a VAT fixed establishment. In this case, it means a permanent business establishment, equipment and accessories used by the taxpayer in whole or in part for business activities, irrespective of the legal grounds on which the taxpayer is entitled to use them. If we compare this with the Commentary on the OECD Model Tax Convention, we find that **the Hungarian definition is consistent with the Model Commentary definition** and explanation, and the Hungarian legislation also lists the auxiliary activities that do not create a permanent establishment.

Of course, whether a corporate tax permanent establishment is created depends on the activity carried out by the foreign company in Hungary as well. This is not primarily a tax issue, but it is important to examine whether the nature of the activity necessitates the establishment of a company or at least a branch based on the provisions of the Act on Foreign Investments in Hungary. **Questions** about permanent establishments arise most frequently in relation to **construction activity, sales/agency activity, and warehousing**, together with **goods supplies** made from such storage facilities. In the case of construction, a period of 3 months is sufficient to create a permanent establishment based on Hungarian rules. Activities carried out by agents can require a permanent establishment if they can conclude a contract in Hungary on behalf of the foreign company. However, a warehouse shall not qualify as a permanent establishment if it is only there for the purpose of preparatory and auxiliary activities.

Action 7: permanent establishment

OECD BEPS actions

The definition of permanent establishment (PE) is adapted in the Model Tax Convention to prevent companies from artificially avoiding having a taxable presence.

EU action

The ATA (Anti Tax Avoidance) Recommendation encourages MSs to use the amended OECD approach for Permanent Establishment.

Source: EU Commission

EU and OECD initiatives

The provisions of **international conventions override** Hungarian rules. For example, a German company can carry out construction and assembly activities in Hungary even for 11 months based on the treaty in force on the avoidance of double taxation. The reverse is also true of course, so a Hungarian construction company does not have to pay any income tax either on a construction project lasting 11 months in Germany. The EU Recommendation encourages Member States to revise their definition of permanent establishment in line with the wording agreed in BEPS. The aim is to address the current situation, whereby some companies exploit weaknesses in the definition to avoid having to register a corporate tax permanent establishment in the country where they are active.

In 2016 the OECD put together a Public Discussion Draft – Additional Guidance on the Attribution of Profits to Permanent Establishments 4 July – 5 September 2016, for Action 7 of the BEPS. This 40-page long discussion draft uses examples to present the **stricter position of the OECD**, mainly in relation to commissionaire arrangements and

warehouses. If these new rules have to be applied in practice, the administrative burdens for global enterprises will certainly rise, and it will not be easy to determine how the profit earned on a given transaction, as the tax base, is split proportionally between the parent company and the permanent establishment. In Hungary, we cannot yet tell how these initiatives will be implemented in practice.

What does having a Hungarian corporate tax permanent establishment mean?

First and foremost, it means **more administration**. Once we have determined that a permanent establishment has been created, this has to be reported to the Hungarian tax authority (NAV) alongside requesting a tax number. If registration for corporate tax purposes is required besides an existing [VAT registration](#) in Hungary, this change has to be reported; the foreign company does not receive a new tax number, only one that can be used for corporate tax as well. Registering a permanent establishment means that tax returns have to be filed too. **Failure to register can result in a default penalty**. In principle this means anything up to HUF 500,000, or roughly EUR 1,600, and a separate default penalty can be imposed for unfiled tax returns. When calculating the tax payable by the permanent establishment, attention must be paid to the special tax-base modifying items under Hungarian law, in relation to management costs and expenses, and to [transfer pricing rules](#). **Assessing the tax base properly is crucial**, since no tax authority in any country likes to relinquish tax revenues, and they come down hard on taxpayers who do not pay their taxes. In light of all this, when registering permanent establishments and calculating their tax bases we recommend engaging the help of our tax consultants.

Services of the WTS Klient Hungary:

- » Tax consulting
- » Financial advisory
- » Legal consulting
- » Accounting
- » Payroll

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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