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NAV tightens rules on international temporary agency work – why is it worth the attention?

To enhance efficiency, foreign parent companies often send foreign staff to work at their Hungarian subsidiaries on a temporary basis. The rules regarding Hungarian tax liabilities in such cases are more stringent according to the most recent NAV information[1] than those applied by most companies – we summarise the most important information below.

When do seconded staff pay tax on their income in Hungary?

Tax treaties concluded by Hungary apply rules that are similar to those for the taxation of income earned by foreign tax residents working in Hungary: in simple terms, income earned in Hungary for work performed in Hungary shall not be taxable in Hungary if both of the conditions below are met simultaneously:

» the worker stays less than 183 days in Hungary in the given fiscal year (or in a given period of 12 months); **and**
» **the remuneration is not paid by or on behalf of a domestic employer** (and the costs are not borne by a domestic permanent establishment).

If either of the two conditions is not met, the income earned from work shall be liable to taxation in Hungary. Based on our experience, examining the first condition related to the 183-day-period does not generally cause a problem for our clients. However, the NAV information published on 6 November warns that due care should be taken when examining the second condition (the employer cannot be a domestic employer).

Previous information published on 31 October 2012 by the NAV[2] underlined that while the posting company is formally considered the employer in the case of secondments, in certain cases the domestic company receiving the individual can also be considered the employer in economic terms. In the case of a domestic economic employer **the worker shall be liable to taxation in Hungary irrespective of the length of the period spent in Hungary**.

The present NAV information continues this line of thought, applying the rules to workers sent to Hungary under temporary agency frameworks.

When does a company qualify as an "employer in economic terms"?

To establish whether a company is an employer in economic terms or not, the primary question to answer is whether the Hungarian company bears the responsibility or risk derived from the output of the worker's performance. If so, further criteria must be examined:

» who is authorised to give **instructions** to the employee as regards working methods,
» who is authorised to exercise **control** and is obliged to undertake **responsibility** for the place of work,
» whether the formal employer can shift the responsibility for the employee's **remuneration** directly to the company where the employee actually works,
» who provides the necessary **equipment** and materials for the employee,
» who is in a position to **determine** the number and qualification of the employees carrying out the activity,
» who is authorised to **select** the employee for the job and terminate the contract concluded with said employee for this purpose,
» who is authorised to apply **sanctions** against the employee,
» who determines the rules for **leave** and work schedules.

[1] http://www.nav.gov.hu/nav/ado/szja/A_nemzetkozi_jellegu_20141106.html
[2] http://www.nav.gov.hu/nav/ado/szja/gazdasagi_munkaltato_kettos_adoztatas.html

According to the NAV information, in the context of temporary agency work the **domestic company hiring or receiving the employees shall be considered the employer in economic terms,** i.e. the conditions for exemption are not met; the income earned from the work shall be taxable in Hungary irrespective of the period spent in Hungary, the worker must request a tax identification number as well as pay tax and submit a tax return.

Which employees are affected?

Taking into account that employees seconded for longer than 183 days are liable for taxation in Hungary anyway, the taxation of the following categories of workers should be revised:

» foreign temporary agency employees who have not paid tax in Hungary due to the length of their stay, which was shorter than 183 days;
» short-term seconded employees (less than 183 days) not working as temporary agency employees.

Based on the NAV information, a Hungarian tax liability is highly likely to apply for foreign temporary agency workers, whereas in the case of other employees seconded for a short-term period, a more detailed analysis is necessary to establish the tax liability. Given that the first NAV information regarding the employer in economic terms was published on 31 October 2012, **detrimental taxation consequences may only affect workers seconded as of 1 November 2012**.

Financial requirements for becoming a supplier – what do partners demand in this respect?

Having a good product is necessary, but not enough, to become a supplier. Partners need more than that, since supplier status is often granted for reasons that are not connected directly to the product.

Hungarian **small and medium-sized enterprises** aiming to become suppliers of a larger or even multinational company have to fulfil a good number of criteria. This is because companies with a high opinion of themselves pick and choose their suppliers since they assume joint and several liability vis-à-vis their own buyers and customers for the product or service offered.

Social capital can help the company familiarise potential partners with its products, or even contribute to acquiring supplier status in certain cases, but if the company subsequently fails to meet its contractual requirements (in relation to quality, price or deadline), then the business relationship may worsen despite a good personal relationship, and the company can soon find itself rejected.

A product or service with a competitive parameter – ideally more than one – compared to competitor products and services is essential for becoming a supplier. Of course, this parameter that offers more also depends on product positioning. Experience shows that longer and more harmonious business relationships may be established with partners if businesses not only compete with their prices, but also pay close attention to quality and on-time delivery to push for **reliable supplier status**.

Those who intend to become suppliers must be prepared for the fact that potential buyers will subject their whole manufacturing process to a **supplier audit** just to make sure that the given product satisfies their own quality requirements under all circumstances. A general requirement for the supplier is to have a **quality management system**. In this respect, Hungarian enterprises have undergone significant development recently, devoting particular attention to their manufacturing processes. Other areas and processes are often neglected, however, as they do not even suspect partners would indeed be interested in how these fields operate as well. Potential buyers also like to ensure that besides technical and manufacturing processes, other processes also meet requirements and professional standards, i.e. they want to find out whether the enterprise can keep its own house in order. This is often just as important as the features of the given product.

Hungarian small and medium-sized enterprises still tend to pay scant attention to the above, concentrating resources almost entirely on their manufacturing. It is highly recommended that they engage the help of consultants, who can support the enterprise with process assessments, efficiency analyses, optimisation or even new process designs to prevent financial and accounting processes as well as internal documentation from hampering new business relationships.

The enterprise must stand on a firm financial footing since nobody is willing to conclude a supplier contract with a loss-making company if they are not sure the supplier can meet its contractual liabilities in the long run. It is well worth reviewing financing in such cases, but even when there is no intention of becoming a supplier, because the majority of companies choose an inappropriate mix of funding to attain their objectives, or finance their activities using the wrong resources. In many cases this generates additional cost for no reason, which can hinder further growth. Experienced consultants can be a great help for enterprises in mapping optimal financing structures, identifying potential financiers or even supporting negotiations with chosen financiers. Moreover, we can also rely on them to find and prepare resources and tenders promoting market access.

It is likewise very important to have a thorough and credible business plan outlining the corporate vision. Those preparing a business plan for the first time make some typical mistakes – e.g. underestimating costs and overestimating revenue, assessing risks without due care – which makes their business plan more like a marketing tool instead of a thorough and realistic vision supporting their decision. So if you do not have any experience in this field, it might be worth contacting an expert to assist in preparing a business plan that helps to achieve the company's short, medium and long-term objectives, detect certain hidden risks in good time and identify adequate answers for them.

Fancy developing your business at half the price?

Following the signature on 11 September 2014 of the Partnership Agreement between Hungary and the European Commission for the period 2014-2020, the first invitations to tender appeared on 10 October 2014, amounting to a total funding volume of HUF 116.5 billion. Further tender invitations are expected in due course.

Economic Development and Innovation Operational Programme (GINOP)

Under the GINOP, small and medium-sized enterprises currently have two tailored tenders to choose from, offering total funding of HUF 10 billion. The main objective of **improving SME competitiveness** is the common thread between the two tenders, but while one focuses on this goal through increasing high added value manufacturing capacity, the other concentrates on helping companies set foot on foreign markets. The assessment process has been accelerated, and so we know whether a project proposal is eligible for funding within 30 days of submitting all the necessary documents.

Only SMEs are permitted to apply for this funding. The tenders aim to help existing companies prospering on the market, and so one of the criteria for applying for funding is at least three years of operations, i.e. three completed financial years. The tender conditions include further requirements on size, operation and industry, which applicants definitely have to take into account because failure to comply results in automatic disqualification.

Another common feature of the tenders is the territorial restrictions alongside the industry conditions. The tenders **do not support** projects in the **Central Hungary region**, which essentially means that funding is not available for projects implemented in Budapest or Pest county.

Expanding production capacity of micro, small and medium-sized enterprises (fund allocation: HUF 8.5 billion)

Companies in industries producing advanced products for end-consumption (with the exception of the services sector and construction) which have high added-value growth potential or export growth potential may apply for funding. The invitation to tender lists the activities which are eligible for funding under this tender, broken down by TEÁOR numbers.

The total eligible cost of projects may not exceed HUF 300 million, while the non-repayable funding that can be claimed may not exceed 50% of the total eligible cost, no less than 10 million and no more than **100 million forints**.

Besides the purchase of new production machinery, it is encouraging that funding can be applied for acquiring equipment to move and package materials, for infrastructure and property investments, to purchase IT equipment and for manufacturing licences. What is important though is that such investments cannot be supported alone, only alongside the purchase of new production machinery.

Support of SME market entry investments (fund allocation: HUF 1.5 billion)

This tender supports the use of services, **marketing activities**, websites in foreign languages and market research helping companies **set foot in foreign markets**. This can include participating in **foreign exhibitions** or fairs, as well as organising product demonstrations abroad. What is important is that one funding application can include participation in more than one fair and in more than one country.

The total eligible cost of projects may not exceed HUF 300 million, while the non-repayable funding that can be claimed may not exceed 50% of the total eligible cost, no less than 3 million and no more than **7.5 million forints**. While there is a wide range of eligible costs (rental fee for exhibition space, costs related to creating and operating stands, etc.), there are some costs inevitably incurred in relation to an exhibition abroad (e.g. accommodation) that are not supported.

It is worthwhile considering that **these two types of funding complement each other well**, and since neither of the invitations state that participating in the other tender is grounds for disqualification, there is, in theory, nothing preventing a company from obtaining funding in both tenders for a carefully planned project.

Anyone intending to submit a project proposal for the funding outlined above is well advised to make haste, for various reasons, even though proposals cannot be submitted before 10 November 2014 at the earliest. Firstly, the applications must be submitted no later than 31 December 2014; secondly, and perhaps more importantly, the applications are assessed in order of receipt until the allocated funds are exhausted.

Since further significant invitations to tender are expected in the near future, companies yet to find an appropriate opportunity under the funding options published so far are advised to keep monitoring related news. What is more, provided the new invitations do not include previously awarded funding as grounds for disqualification, those who have already applied and won funding will have another opportunity to raise additional resources.

The newsletter accurately reflects the statutory provisions as they stand at the time of its issue.
The authors of the news articles have endeavoured to provide general information that both reads well and is professional. Given the general nature of the content and possible changes to legal regulations, please contact us if you require this information tailored to your personal circumstances.

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