

wts newsletter

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highlights

Accounting and tax treatment of fixed recovery cost payable upon the late payment of creditor invoices – The amendment of the Hungarian Civil Code effective as at 1 July 2013 stipulates, in relation to transactions between business entities, the mandatory payment of default interest on late payments equal to the key interest rate of the central bank plus eight percentage points, and a fixed amount of EUR 40 to compensate for the recovery costs. In our newsletter we take a look at how this rule and its accounting and taxation implications can be applied.

Accounting and tax treatment of fixed recovery cost payable upon the late payment of creditor invoices

The amendment of the Hungarian Civil Code effective as at 1 July 2013 stipulates, in relation to transactions between business entities, the mandatory payment of default interest on late payments equal to the key interest rate of the central bank plus eight percentage points, and a fixed amount of EUR 40 to compensate for the recovery costs. Below we take a look at how this rule and its accounting and taxation implications can be applied.

Which receivables have the fixed compensation for recovery costs and the default interest to be applied to?

must certainly be applied to contracts concluded after 1 July 2013

The reason for the amendment is to ensure creditor invoices are paid on time and to comply with the relevant provisions of the EU directive on fighting late payments. Although the directive permitted Member States – including Hungary – to exclude contracts concluded prior to 16 March 2013 when adopting the provisions, the legislator regulated this only in the reasoning of the act, not at legislative level. The directive must certainly be applied to contracts concluded after the amendment to the Civil Code (1 July 2013); in the case of contracts previously concluded and not amended, default interest as well as the fixed compensation for recovery costs can be justifiably avoided based on general legal principles (such as the ban on the implementation of retrospective liabilities), however, a legal provision would be required to settle this issue definitively.

even in the event of a single day of delay

Unfortunately, this is not the only uncertainty regarding the issue of fixed compensation for recovery costs. What we do know is that a HUF amount equalling 40 EUR is the minimum compensation for costs, which must be converted to HUF using the mean foreign exchange rate of the National Bank of Hungary prevailing on the initial day of the default. The fixed amount of compensation for recovery is payable to the beneficiary, i.e. the creditor, even in the event of a single day of delay: the parties may not exclude such from their contract, and the liability is independent of whether the customer is in default for reasons not attributable to them, and whether any costs associated with recovery are incurred by the creditor.

In addition to the fixed amount of compensation for recovery costs and the default interest, the creditor may naturally claim other legal remedies to tackle late payments too, however, the fixed amount of compensation for recovery costs shall be included in the amount of any damages paid (reimbursement of actual costs incurred in relation to recovery).

Similar to default interest, the fixed amount of compensation for recovery costs is the consequence of conduct breaching the contract, and therefore no VAT payment liability arises and no invoicing is required.

Consequences at party in default (customer late with payment)

The party in default shall account for default interest and the fixed compensation for recovery costs as "other expense" (disallowed item for corporate tax assessment purposes) on the day the liability (default) arises, regardless whether it has been paid or not.

The question is whether the beneficiary may forgive the fixed compensation for recovery costs; this divides even the experts. If the claim may be forgiven, the party in default must account it as extraordinary income.

Consequences at the beneficiary (creditor)

If the fixed compensation for recovery costs and default interest is paid to the beneficiary by the balance sheet preparation date, the beneficiary must account it as "other income", and this is taxable as part of the corporate tax base.

*doubts in the event of
payment less than full*

It is more complicated, however, if the customer pays the underlying debt, but not the fixed compensation for recovery costs or the default interest, or does not pay the same to the beneficiary in full, because then the question arises as to whether the money was received to settle the fixed compensation for recovery costs or the underlying debt. Furthermore, it is questionable whether or not the beneficiary may forgive the fixed compensation for recovery costs and the default interest.

If the beneficiary does not intend to claim the fixed compensation for recovery costs, then it is practical for them to make a decision that the amount received should primarily pay off the underlying principal debt (not the fixed compensation for recovery costs) to avoid detrimental tax implications. However, some interpretation from the legislator would be needed to settle the issue and resolve practical uncertainties definitively.

Recommendations

checking customers

In the event of a large amount of invoices and regular delays by customers, the fixed amount of compensation for recovery costs may mean a significant cost for the entities affected. It is therefore worth checking which customers may regularly cause problems with the fixed compensation for recovery costs, and inspect to what extent the entity may enforce fixed compensation for recovery costs vis-à-vis the given customer, whilst also considering other business and commercial interests.

*monitoring
payment practice*

Compliance with payment deadlines is worth managing as effectively as possible in order to avoid potential extra taxation obligations, and even rethinking payment deadlines applied so far in accordance with current practice.

Unfortunately, the procedure outlined above represents a significant administrative burden for businesses with a large clientele, so where the problem of fixed compensation for recovery costs and mandatory default interest arises with many customers, we recommend consulting tax advisers and lawyers.

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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