

wts klient newsletter

WTS Klient.
The Bridge.

Dear Readers,

The changed labour market creates an environment that is full of challenges, we are ready to tackle these challenges.

Thanks to the collaboration over many years between the Budapest Business School (BGE) and WTS Klient, some 30% of our staff joined us as trainees, and several of them now occupy key positions at the company.

Alongside the compulsory placements for third-year students, last year we successfully launched our **Scholarship Programme** and **Dual Training Programme**, while this year saw the start of our **Express Career Programme**, which targets students who excel in higher level vocational training. Alongside the BGE and Corvinus University, we are also experimenting with new platforms outside of Budapest to reach and involve talented young people from generations Y and Z, since for us, they are the **experts of the future**.

Our efforts have been warmly received by employees too; in 2016 at the Colibri Internship Awards, in the **Finance and Business category**, WTS Klient was voted the **most attractive** employer among business consulting companies.

You can read more about our career programme on our website at wtsklient.hu/en/career/.

Krisztina Bézi
Head of HR

Due diligence

During an acquisition, a due diligence greatly reduces the purchase risks for the buyer, and also helps in pricing these risks.

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Local business tax

Local authorities themselves decide on the rate of local business tax, tax exemptions and tax allowances to apply within the set limits.

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Taxpayer ratings

Taxpayer ratings form part of the NAV's customer-friendly concept, enabled the tax authority to apply targeted rules for risky and reliable taxpayers.

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The need for a due diligence

During a due diligence, we should pay sufficient attention to the following areas at the target company:

- harmony with **tax laws**
- compliance of system of **accounting**
- **legal** operational environment
- environmental activity
- **IT** structure
- manufacturing processes

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A due diligence is typically a process during which a potential buyer establishes and quantifies the value of the company (hereinafter: target company) or the assets it intends to buy based on information made available by the seller or other sources, **prior to the acquisition**.

Why is a due diligence necessary?

Conducting a due diligence is naturally not mandatory in Hungary, and indeed, it can

imply a significant cost, but if we neglect to do so this means that we are blindly trusting the other party; which it may sound very philanthropic, but business relationships do not work like this. There is significant **information asymmetry** between the seller and the buyer because the seller has much more information about the target company than the buyer. Additionally, since significant amounts may depend on this, the seller has an interest in making the reality nicer and better than it actually is, or to gloss over information that is insignificant in itself, but if the buyer were aware of such information, it would find itself in a completely different bargaining position, or would perhaps even withdraw from the transaction.

The possibility of a due diligence generally arises when the seller and the buyer have already conducted one or more negotiations, and they are by and large in agreement with regard to the main framework of the sales transaction, though without any commitments, not including the purchase price and the potential guarantee withholdings and warranties. In this phase, the seller has to understand that sharing the information it has does not violate its business interests, but is rather, the buyer needs to be well informed with a view to closing the deal successfully.

Although the starting point of the evaluation is generally an accounting document such as an **annual report**, or a general ledger, a well-performed due diligence audit is more than just a simple accounting due diligence. In order for the buyer to make a well-founded decision that serves its interests the best, in addition to an accounting due diligence it is also worth reviewing the company's legal, environmental, IT or even manufacturing processes.

So a due diligence is a multi-faceted project, and carrying it out professionally requires thorough knowledge of the individual specialist fields. It is advisable to use professionals for this.

What to expect from professionals?

First and foremost, they need to be prepared in the relevant field, perform thorough work, cooperate with the team auditing another area, and keep the buyer **informed** on a regular basis, or in the case of a significant finding, **immediately**. However, this framework has to be specified by the buyer. It is important to indicate the thresholds beyond which the negotiations are terminated automatically, or the sensitive issues, which, if uncovered, result in the termination of the negotiations with the seller, regardless of their size.

A due diligence only leads to the right result if **the seller provides all the necessary information**. If the professionals do not receive part of the information requested, it is their task to judge what kind of risks the lack of such information may represent for the buyer later on.

The end product of the due diligence should be a due diligence report which, based on the information made available and that not shared, estimates the risks related to the key individual fields, thus helping the buyer's management in making a **thorough and informed decision** and in defining an advantageous and rational purchase price.

Take our advice: if a seller is hesitant about or refuses to sanction a due diligence audit, they have a good reason for it, and the buyer should therefore start looking for a different acquisition target.

Local business tax can change each year, and depending on where you are

Local business tax

business activity	period	maximum local business tax
permanent	annual	2 %
temporary	daily	HUF 5,000

The precise rate depends on the decision of the local government.

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Local business tax is an issue arising every year that we have to deal with during the preparatory and closing work preceding annual reporting. Act C of 1990 on Local Taxes, which in accordance with the tax type in question is often commonly "just" referred to as the **local business tax act**, includes the requirements regarding local business tax among others.

Local business tax

- » for a permanent business activity, the annual rate of local business tax is a **maximum 2%**
- » for a temporary business activity, the local business tax is a **maximum HUF 5,000** per calendar day.

With due consideration of these limits, local authorities can decide what rate of tax they intend to apply in the given year for the given municipality. Accordingly, local business tax varies depending on where you are.

In the case of an enterprise with several places of business, it can take a lot of time to collect together all the local decrees and track the changes. The "Information on rules for local taxes" published in Hungarian on the website of the Hungarian State Treasury at <https://hakka.allamkincstar.gov.hu/> provides a lot of help in this respect. The information on individual municipalities can even be downloaded in table format.

However, it should be borne in mind that theoretically the most up-to-date data is available on the website in 2017, so **the local business tax for 2016 may differ from the information on the website**. You should always check the latest information on the local authorities' own website.

Local business tax rate in "KATA" and "EVA" systems

The above tax rates are applicable for payers of both the flat-rate tax for small taxpayers (KATA) and the simplified entrepreneurial tax (EVA), but **special rules** apply to the calculation of the tax base.

Local business tax in Budapest

For Budapest, the local business tax is the **highest possible rate**, i.e. 2% and in the case of temporary business activity, HUF 5,000 per day.

However, the tax exemptions and tax allowances provided by local authorities should not be ignored. For example, local business tax will be HUF 0 in Budapest if the enterprise-level tax base does not exceed HUF 1,000,000.

Tax exemptions, tax allowances provided by local authorities

Local authorities may provide tax exemptions and tax allowances for entrepreneurs in a decree. These only apply to entrepreneurs whose enterprise-level tax base does not exceed the amount specified by the local authorities, but no more than HUF 2,500,000, and in the case of general practitioners and health visitors, HUF 20 million. The <https://hakka.allamkincstar.gov.hu/> website contains related information on the individual local authorities. The local business tax act sets forth the tax exemptions and allowances in respect of which local authorities have no decision-making authority.

Taxpayer ratings

The NAV rates taxpayers quarterly:

- **reliable taxpayers – more favourable penalty rates and other rules**
- **risky taxpayers – less favourable penalty rates and other rules**
- **"average" taxpayers – general penalty and other rules**

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The rating of taxpayers was the big new thing in 2016. Basically, the NAV evaluates taxpayers based on various statutory parameters and can rate them as either reliable or risky. Depending on the rating, taxpayers are subject to more favourable or less favourable rules, with regard to sanctions imposed after a NAV inspection. The rules for taxpayer ratings changed in the Act on the Rules of Taxation from 2017.

Taxpayer ratings – nothing new under the sun

In its interpretative provisions, the Act on the Rules of Taxation has **included** a definition of **rated taxpayer** for quite some time now.

The related conditions are very similar to those applied when establishing the reliable taxpayer status introduced from 2016. One marked difference, however, is that the taxpayer has to request its inclusion in the records of rated taxpayers maintained and published by the tax authority, while **recording someone as a reliable taxpayer is essentially automatic** if the conditions are fulfilled.

The rated taxpayer status was defined for the same purpose as the category of reliable taxpayers introduced in 2016. Namely, the objective is to enable the tax authority to differentiate between groups of taxpayers eluding and intentionally violating taxation rules, and those acting in good faith, striving to comply fully with the law.

In 2010 and 2011 a penalty rate of 20% was ensured for taxpayers who were added to the database of rated taxpayers. From 1 January 2012, however, this favourable assessment was removed from the sanctions of the Act on the Rules of Taxation. According to the related justification from the legislator, the favourable tax rates applied for rated taxpayers were abolished due to the confusion arising in respect of applying the rates in practice, and the intention to adopt a tougher approach to levying fines.

Currently, rated taxpayer status entitles companies to an accelerated procedure regarding payment relief requests and those taxpayers who are listed in the database of rated taxpayers are **exempted from providing EKAER collateral**. It is a question, whether the database of rated taxpayers shall lose its significance due to the creation of the reliable taxpayer status, or remain an important information for the business community (e.g. for evaluating tender and credit applications).

Taxpayer ratings from 2016

The new provisions of the Act on the Rules of Taxation introducing the notion of reliable and risky taxpayers entered into force in 2016 to define more favourable rules for preferential taxpayers in terms of tax policy (i.e. reliable taxpayers), and less favourable rules for those who are more likely to jeopardise budgetary revenues (i.e. risky taxpayers).

Taxpayers not falling into either category continue to fulfil their obligations according to the general rules. The NAV reviews the conditions for ratings quarterly, and sends notification about this at the first instance; thereafter, notification is only sent if there is a change. Ratings can be retrieved through the government portal and appear among the master data too.

In an **earlier newsletter**, we touched upon the conditions of reliable/risky taxpayer ratings. It is important for the special rating to apply as of when any violation of law is occurred or recorded (i.e. date of inspection minutes) in order to be able to apply the more favourable tax penalty conditions related to the reliable taxpayer rating. However, please note that the upper penalty limit of 25% that practically related to the reliable status cannot be applied instead of the general 50% limit in cases where tax shortfalls are identified that result in the loss of the reliable taxpayer rating. (The reliable taxpayer rating is subject to the total tax difference of the taxpayer determined by the NAV in the reporting year and in the five preceding years not exceeding 3% of the taxpayer's tax performance determined for the reporting year.)

Important changes connected with taxpayer ratings from 2017

The list of parameters applicable to reliable taxpayers was supplemented with the requirement that the tax performance of the taxpayer should be positive in respect of the reporting year (the tax authority wants to rule out so-called dormant companies from the favourable rating). The scope of risky taxpayers was also expanded, with those whose registered office is registered at a provider of registered office services and who received a legally binding default penalty for hindering tax authority procedures in the reporting year or in any of the three prior years.

It is important to note that the tax authority will fulfil VAT reclaims of reliable taxpayers of more than HUF 1 million within 45 days from 2017, regardless whether the invoices have been paid or not (it used to be even 75 days). Even more favourable rules apply to reliable public companies limited by shares. In their case, the deadline for disbursement is a standard 30 days (it should be noted that the conditions for ratings are also more favourable for such companies).

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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