12/2017
24 March 2017

wts TAX LEGAL CONSULTING

wts klient newsletter

WTS Klient.
The Bridge.

Dear Readers,

If you are the head or chief accountant of a Hungarian subsidiary owned by an international group that applies IFRS, then preparing your Hungarian annual report under IFRS, i.e. adopting IFRS, may be to your advantage.
If your foreign parent company prepares IFRS financial statements and it has consolidated your Hungarian company, the extra workload generated by operating two reporting systems will cease after switching to IFRS.
This is a very topical issue right now because you have to prepare in time for a switch at the end of the year. A company switching to IFRS on 1 January of a given year has to prepare the previous year's data according to IFRS as well, in order to ensure comparability.
We are happy to help if you need further information on the details. Please take a look at the second part of our video series on switching to IFRS at the following link, where I talk about these issues. Please note that our videos are available only in Hungarian.
wtsklient.hu/2017/03/24/ifrs-atallas-szamvitel/

Anita Toki
manager

Controlled foreign companies – tuned into BEPS

Controlled foreign company

Prior to 18 January 2017	After 18 January 2017
Majority-owned by Hungarian beneficial owners	Direct/indirect share in voting rights/registered capital/profit in excess of 50%
Majority of its income comes from Hungary	
Tax rate less than 10%	Tax is less than half of that calculated based on Hungarian rules
No double taxation treaty	Independent of double taxation treaties

Exception: real economic presence – assets/employees

Author: **Tamás Gyányi**
tamas.gyanyi@wtsklient.hu

Thanks to the **Anti Tax Avoidance Package** developed by the European Commission, the regulation on Hungarian corporate tax and personal income tax affecting controlled foreign companies changed significantly from 18 January 2017. The amendment places the term and the associated sanctions onto completely new foundations. In our summary we would like to shed some light on the most important changes regarding Hungarian corporate tax rules.

Is this because of BEPS too?

The EU's Anti Tax Avoidance Package supports the OECD's BEPS action plan (Base Erosion and Profit Shifting), whilst also supplementing it. The goal of the European Commission's action plan launched in 2015 is to put an end to corporate tax evasion and to ensure fair and efficient taxation within the European Union. It is in this context that the amendments to the regulation on controlled foreign companies were laid down, where the intention is to limit the aggressive tax planning schemes of multinational companies.

continued on page 2

WTS Germany is top employer 2017
WTS Germany has been awarded the TOP JOB 2017 prize for their unique company culture and environment, which proves that they are among the best employers in the country. Wolfgang Clement, former Minister for Economic Affairs and also one of the initiators of the award presented the prize to the consultancy firm in Berlin.

Why does it "hurt" if we have controlled foreign companies at our disposal?

The new EU legislation allows Member States **to tax the profits** of parent companies operating within their borders if such profits were **generated at subsidiaries or permanent establishments** located in other countries where tax rates are lower, or which are tax-free. However, the tax already paid abroad on the given income can be taken into account. The regulation enters into force if the tax payable in this country is lower than half of the payable tax calculated based on the rules of the country where the parent company is resident.

On top of this, Hungarian regulations have already contained limiting or negative rules for transactions concluded with controlled foreign companies (dividends received are taxable; stricter rules on the costs of transactions concluded with controlled foreign companies when assessing corporate tax bases).

Changes in Hungarian corporate tax law

For the purpose of taking successful action against tax evasion, the legislators have retained the punitive Hungarian rules applicable to "off-shore" companies which have their registered offices in states applying non-conventional, low tax rates, and the detailed rules complying with the EU's Anti Tax Avoidance Package have also been integrated into the law on Hungarian corporate tax.

When assessing the status of controlled foreign companies, first we need to check whether the resident taxpayer has a share in the foreign company that exceeds 50% (in respect of voting rights or registered capital), or whether it is entitled to at least 50% of the profit. If this condition is met, the foreign company's tax burden has to be checked. Is the corporate tax that the foreign company would have paid (assuming it is resident in Hungary based on its registered office) equivalent to at least half of the foreign company's actual corporate tax liability? (This calculation has to be performed in the case of the permanent establishments as well).

It is good to know that **a foreign person or a foreign permanent establishment does not qualify as a controlled foreign company if** it is clear that it has appropriate personnel, equipment, assets and premises to **perform substantive economic activities**.

What now?

Due to the new rules we have to check whether Hungarian companies have subsidiaries and foreign permanent establishments where the risk of reclassification into controlled foreign companies may arise. If such subsidiaries or permanent establishments exist, the **surplus Hungarian tax also has to be assessed for the separately specified types of income, based on the detailed rules defined in Hungarian corporate tax law**, and taking any double taxation treaties between the given countries into account. One important transitional rule is that taxpayers may choose to fulfil their tax liabilities based on these new rules for the fiscal year starting in 2016.

Labour shortage and increasing salary demands

> "The 4.3% unemployment rate is significantly close to the full employment estimated by economists, which is achieved alongside 2-3% unemployment."

Author: **Zoltán Lambert**
zoltan.lambert@wtsklient.hu

Who doesn't remember one of the main criteria for a positive assessment of 2007-2014 EU grant projects? In addition to a minimum investment amount and a gradual increase in sales revenue, **significant growth in the number of employees** ensured the success of any bid. In our 2013 **study** (published in German and in Hungarian language) on the rationalisation of Hungarian tax laws we highlighted that the investments of companies already operating in Hungary and applying developed technology rarely result in growth in the number of employees, so it is difficult to reconcile them with the frequently emphasised efforts of the government at that time to create jobs.

If we are not talking about a greenfield investment (such projects are increasingly rare these days) and rather just an expansion of existing capacities, this generally entails an automation of processes and further engineering, which often leads instead to a fall in the number of employees. In the meantime, the macroeconomic indices have significantly changed, so the goals of Hungarian economic policy and of those intending to invest in Hungary have been harmonised alongside an unemployment rate of a mere 4.3%. Today, the goal is to employ the highest possible ratio of skilled workers in Hungary, and the significant salary increase as a result is no obstacle to these efforts.

What changed in 2017?

The government's agreement with social partners in Hungary, concluded last November, brought about a significant i.e. **5 percentage point fall in social contribution taxes** in 2017, which will be followed by **an additional 2 percentage point decrease** in 2018. With the significant increase in minimum wages and the guaranteed wage minimum, employers were forced almost automatically to pass on their cost savings from the fall in social contribution tax to their employees in the form of a salary increase, albeit not compulsory.

Although the majority of the employees at larger, primarily multinational companies make more money than the raised minimum wage and the guaranteed wage minimum, market competition and the labour shortage still force even these employers to increase salaries considerably. The other most significant modification of 2017 affecting taxation, i.e. the implementation of the uniform **9% corporate tax rate**, generated further savings for profitable companies which can be spent on raising wages, even if, owing to the corporate tax allowances discussed in an earlier article, these savings were not as spectacular as the abolition of the higher tax rate would imply.

Where are the major workforce reserves?

The 4.3% unemployment rate is significantly close to the full employment estimated by economists, which is achieved alongside 2-3% unemployment. However, compared to the Hungarian population of nearly 10 million people, the number of employees (4.4 million) is significantly below the figures of our regional peers or even more developed Western European countries. Obviously, the high ratio of inactive people can be traced back to demographic reasons, thus, the government's efforts aimed at renewing the ageing society in Hungary are important even from this perspective, although we cannot expect a major breakthrough within a short period. Also, government measures undertaken to channel civil servants into the private sector may equally not produce results from one day to the next, but improving salaries may trigger slow progress in this domain.

Another potential opportunity is bringing home those who are working abroad. We should not forget that only since 2011 have Hungarian citizens been able to work on the German and Austrian labour markets without any particular restrictions, two regions key to our economic embeddedness. Thus, the number of those working abroad, which has gradually increased over the past five years, will slowly peak, while the significantly increasing salaries in Hungary salaries may lure a rising number of those only working abroad temporarily to move back home.

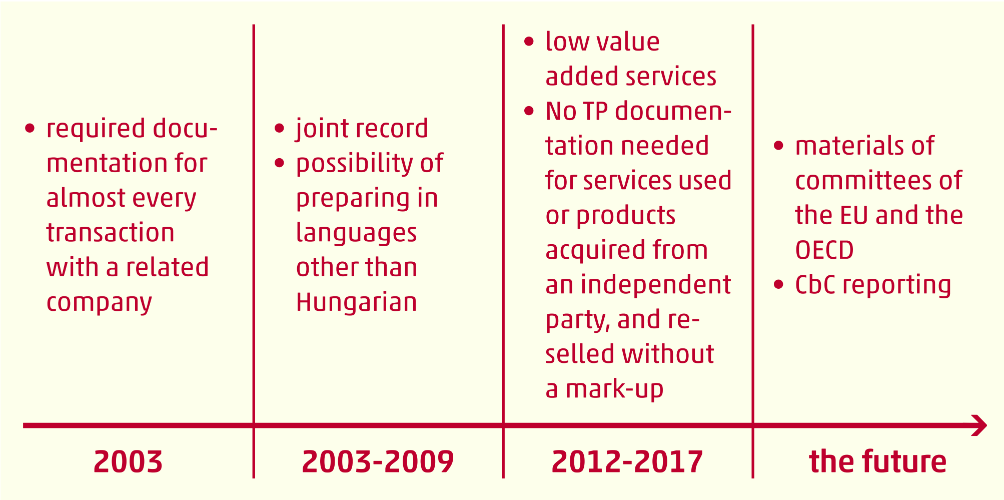
Labour shortage – what threats should be averted in the coming years?

In addition to the economic growth of the next few years fuelled by the disbursement of the 2014-2020 EU grants, the labour shortage will pose a serious challenge because it will be ever more difficult for employers to find appropriately qualified employees. Thus, the market laws of supply and demand could generate further significant salary increases. However, higher salaries must bring productivity growth as well, otherwise Hungary could lose its regional competitiveness. Together with the significant fall in EU grants after 2020 this could bring progress to a shuddering halt. So in the next three years it will be crucial for players of the Hungarian economy to take deliberate and coordinated action on the path specified by last November's agreement.

Transfer pricing documentation

Author: **András Szadai**
andras.szadai@wtsklient.hu

It was 2003 when the first decree of the Ministry of Finance was issued that summarised Hungarian regulations on transfer pricing documentation based on authorisation granted in the Act on Corporate Tax. There have been several modifications until 2017, and there will certainly be more under the aegis of the BEPS.



At the outset

As it was fourteen years ago, the Hungarian regulation required documentation for almost every transaction with a related company. Under the decree, in addition to the full documentation it was also possible to prepare simplified transfer pricing documentation for low-value transactions. Taxpayers affected in Hungary had to prepare the transfer pricing documentation by the submission date for their corporate tax returns at the latest, but it did not have to be submitted to the tax authority, it only had to be made available for the tax inspectors in the event of an inspection. The HUF 50 million threshold fulfilled an important role from the beginning in defining the documentation obligation.

The mandatory content of the full transfer pricing documentation did not really change over the years; the most important parts are the description of related parties, related transactions and the related market along with a functional analysis and the depiction of comparable transactions.

The simplified transfer pricing documentation is a short administrative record, it does not substantively review the relationship between the price applied among the related companies and the arm's length price.

Major changes over the years

MoF Decree No. 18/2003 developing the initial regulation was in force until 2009, with only a few modifications made. The new MoF Decree No. 22/2009 was issued in Hungary in 2009, and it redefined the rules for preparing transfer pricing documentation in a few areas.

One of the most important changes was including in the decree the possibility of preparing a joint document. The joint document allows for the preparation of a document consisting of two parts, similar to the international master file.

Another important change or easing in the new decree was that it allowed the preparation of documents in languages other than Hungarian (English, French and German). Regardless of this, during an inspection the Hungarian tax authority could still request a Hungarian extract or the translation of documentation prepared in a foreign language.

The situation today

The decree currently valid in Hungary has changed in many respects over the years. The simplified documentation has disappeared completely from the regulation (it was actually renamed, see low value added services below), below the HUF 50 million (EUR 160,000) threshold it is not necessary to prepare transfer pricing documentation at all. The notion of **low value added services** was added to the decree in 2012 as an important new element (it was already applicable as an amendment for the 2011 fiscal year). Accordingly, in the case of certain services (such as IT) reinvoiced with a low surcharge (5 and 10%), the taxpayer can prepare simplified documentation with the data previously required in the simplified record. **One significant relief is that if the taxpayer uses services or acquires products of an independent party, and resells them to its related company without a mark-up, it does not have to prepare documentation.** The latest changes provide guidance for the use of databases.

The future

The committees of the EU and the OECD continually search for tools and methods to make the development of transfer prices more transparent. Hungary also participated in the OECD's working committee when they worked out the data supply concept for country-by-country reporting (CbC), but only joined those committed to implementing the data supply as a signatory later on. Starting from the early summer of 2017 the EU prescribes a reporting obligation for its Member States in a directive that is strikingly reminiscent of the

OECD data supply. Several European countries (such as Germany) have already included country-by-country reporting in the documentation as a mandatory element. In light of the above, the new direction is clear: transfer pricing documentation will summarise even more information in the future and it will provide more detailed information and more efficient controlling criteria for national tax authorities.

Services of the WTS Klient Hungary:

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

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.

WTS Klient Hungary
1143 Budapest • Stefánia út 101-103. • Hungary
Telephone: +36 1 887 3700 • Fax: +36 1 887 3799
info@wtsklient.hu • www.wtsklient.hu