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Taxing income from employment in Hungary in the case of foreigners

Income from employment is essentially taxable in the country of residence, but this has to be decided based on a complex investigation.

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Why is outsourcing payroll useful?

Companies typically decide on outsourcing payroll to cut costs, increase security, and be able to focus on core activities.

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Dear Readers,

Summer silly season. No stress, just a few hours' work a day. One holiday after the other!

I tried to beguile my colleagues with this illusion during the intense period until the end of May, when sometimes we worked well into the night. Although we are certainly enjoying the holidays now, legislators in Hungary are doing their best to ensure we have plenty to do in the summer as well.

So it is not by chance that besides our regular professional articles we have had three very topical news items to report on in the last one and a half weeks. We had just finished our summary about the 2018 tax laws and reporting member shares when a few days later we presented the key elements of the draft legislation on online invoicing.

Our weekly newsletter also includes some interesting articles, and so I hope we have provided you with enough to read.

Zoltán Lambert
managing partner

Taxing income from employment in Hungary in the case of foreigners

> **"When reviewing the 183-day rule, not only working days have to be taken into account but all the days present, including weekends and paid holidays."**

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In an earlier article on the income taxation of foreigners we outlined that if there is a **double taxation treaty** between Hungary and the other country concerned, then with the help of this treaty we can establish the country employees have to pay personal income tax in for their incomes earned abroad.

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. Among the most frequent types of income we reviewed capital gains and income from the use of immovable property in the aforementioned article; now, we are focusing on one of the most significant items, income from employment.

In which year and where should the income from employment be taxed?

Special rules apply to income derived from employment activities. Income from employment and similar benefits is essentially taxable in the **country of residence**. The situation is different if the employee works in a country other than the country of residence, because he then has to pay taxes as a general rule in the **country of employment**.

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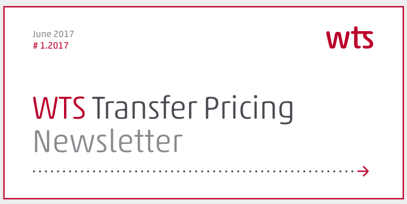
The latest edition of the WTS Global Transfer Pricing Newsletter has been released



The newsletter summarizes new developments in the field of transfer pricing for 10 countries and has been prepared by local TP experts within the global network of WTS. This issue focuses especially on developments resulting from the BEPS project.
You can download it in PDF format here:
WTS Global Transfer Pricing Newsletter #1/2017

If the salary of the foreign employee arriving at the company is not paid by the Hungarian company, it is not charged to the Hungarian permanent establishment of the foreign company, and the emp-loyee does not spend more than 183 days in Hungary, he pays tax in his country of residence. For the **183-day rule** it is important to have accurate information about the wording of the treaty. Some of the treaties link the period to be reviewed to the fiscal or financial year, while others tie it to the calendar year. For newer treaties, any period starting or ending in the given year must be taken into account.

So for example, if an employee came to Hungary in October 2016 and stays until May 2017, **whether he will have a tax liability** on his salary in Hungary **depends on which treaty has to be taken into account**. In the case of the **German-Hungarian** treaty, the salary for the Hungarian activity will be taxed in Hungary in both 2016 and 2017 because there is a 12-month period starting in 2016 and ending in 2017 in which a German tax-resident employee spent more than 183 days in Hungary. So although it seems that the employee only spent a short period in Hungary in 2016, and therefore no Hungarian tax arises, he still has to file a Hungarian tax return and pay Hungarian taxes based on the special provision of the treaty. However, if the person is resident in France, he will have no tax payment liability on his salary in Hungary in either 2016 or 2017, since based on the French-Hungarian treaty, the fiscal year has to be reviewed, and his stay in Hungary did not exceed 183 days in either of the affected years.

When reviewing the 183-day rule it is important that **not only working days have to be taken into account** but all the days of present, including weekends and paid holidays. However, the days when the employee qualifies as a Hungarian resident do not have to be considered.

On the working days when our French-resident employee works abroad, in France or even in Spain, the income from employment will be taxable in France.

Who qualifies as the economic employer?

In addition to the above, the "**economic employer**" has to be scrutinised too. This is because, in an economic sense, it can happen that it is not the company that qualifies as the employer of the private individual with whom the labour contract was concluded. To determine who the economic employer is an "integration test" has to be performed to identify the extent to which the seconded employee was integrated into the host company's organisation. During this test various criteria have to be examined, including, who is authorised to define the employee's work procedures or approve paid holidays, who can give instructions regarding the employment, who bears the responsibility and risks connected to the employee's work, etc.

If it is found based on the **integration test** that the host company qualifies as the economic employer of the employee, the employee will have to pay taxes on his salary in the country of employment even if he receives his salary from the country he came from and does not spend more than 183 days in the recipient country.

Why is outsourcing payroll useful?

Outsourcing payroll is a decision that can be made for the following reasons:

- cost cutting
- increased security
- technical costs
- saving time
- reassurance

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Payroll is an increasingly complex process, which is just as indispensable for business administration at companies as bookkeeping, tax consulting or audit.

Company owners and managers typically decide on outsourcing payroll for the following reasons.

Cost cutting

In the case of small and medium-sized enterprises, companies have a good chance of saving costs if they decide to outsource payroll. Costs fall because the salary of the **payroll administrator** is no longer charged to the company. The company does not have to ensure cover in the event the person is on holiday, is ill or dismissed, like in the case with their own employees. No **office equipment** has to be provided, such as desks and computers, no office has to be rented for the payroll administrator, no payroll **software** is needed and there are no **training costs**. On annual basis these costs can be significant.

Expertise

Small and medium-sized enterprises often do not have the time and capacity to keep track of the frequent changes in law and integrate them into their systems at the right time. If payroll is handled internally, the appropriate training of staff and keeping their knowledge up-to-date represent huge costs. When outsourcing payroll, the payroll company has the necessary expertise, qualifications, experience, practice and wide-ranging knowledge. A good service provider always monitors the changes in law, notifies the company of the changes, and applies them at the right time and place. It provides advice and makes proposals for decreasing and optimising costs. Since a company specialised in payroll has much wider experience, during tax inspections any **penalties, fines or sanctions** can be minimised or **avoided** altogether.

Increased security

Payroll is a complex and potentially risky business. When carrying out payroll internally, risks can arise in respect of the **secure and encrypted storage of salary data**. Due to the confidential nature of incomes, using and ensuring sophisticated security systems is important in internal systems, so that unauthorised persons and employees cannot access secret and confidential information. Guaranteeing this enhanced security requires a lot of attention and energy on behalf of the management. With outsourcing, risks can be minimised.

Technical costs

Managers always ask whether they are using appropriate payroll software, and whether they are applying current rules during their internal payroll or not. The use of **payroll software** that is reliable and tracks legal changes in an appropriate and timely fashion **is a costly investment and involves continuous monitoring and maintenance fees**. Payroll outsourced to the right service provider constitutes a guarantee that the applied payroll software is up-to-date and that the sources of errors derived from an inappropriate technical background are excluded.

Saving time

Payroll **requires time and a lot of administration**. Company managers and owners often do not see what types of task have to be performed to deadlines during payroll activities. The majority of these tasks have to be performed by the service provider when outsourcing payroll. If these activities are outsourced, managers save time and can focus on a different business line.

Reassurance

When services are outsourced to an experienced company with a high degree of professional competence, payroll tasks can be performed **quickly, precisely and without errors**. Managers can focus on other tasks, and do not have to worry about payroll activities.

It is not good for management to make a decision on outsourcing payroll simply based on the price per person. It has to be reviewed what type of payroll and other tasks are included in the cost per person, and what other services may arise as separate costs. Costs can be planned better and are more predictable after outsourcing. When the laws are complied with the quality of the work improves, and in possibly significant savings for the company.

"Records have to be kept in Hungarian forints to prepare VAT returns, so items in separate periods cannot be converted to forints at the same rate."

Béla Kovács, WTS Klient Hungary senior manager

Source: inforadio.hu

Turn on your radio!

Béla Kovács, senior manager at WTS Klient Hungary, will be discussing the tax aspects of changing to accounting in a foreign currency on InfoRadio on 6 July. "Although exchange-rate differences cannot be totally avoided, they can be minimised if amounts in contracts are defined in the given foreign currency, and invoicing and payments are carried out accordingly" – says the expert.

Listen to the conversation at this link!

Please note that the conversation is available only in Hungarian.

This WTS information does not constitute advice and it serves only to provide general information about selected topics.

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