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Dear Readers,

Last week we launched our fourth and last video series for the year, in which we focus on **comprehensive tax inspections**. In the first video we looked at the strategic aspects behind the challenges of preparing for a tax audit, while in this week's episode we analyse the **tax implications**. Which tax obligations of our company might be inspected? Which tax types are examined the most thoroughly? What are the main risks? How can we avoid subsequent misunderstandings?

I answer all these questions in the one-and-a-half-minute video, which you can watch at the following link: wtsklient.hu/en/2017/12/06/comprehensive-tax-audit/

Please do not forget to switch on the English subtitle by clicking on "settings" in the right-hand corner of the video.

Next week we will deal with the legal aspects, followed in the week thereafter by a discussion of the accounting dimensions. Alongside our videos, we hope our articles about preferential transformations and the rules for wage deductions will also provide you with plenty of useful information.

Tamás László
manager

## Tax implications of a preferential transformation

**Preferential transformations:**

- → Transformation at market value
- → Preferential transformations at carrying value
- → Role of commitment

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In our article entitled Taxation of transformations, and preferential transformations we touched in general upon the tax issues arising during the transformation of companies. Now we will discuss the practical aspects.

When transforming a company, if we consider whether the transformation meets the conditions for a preferential transformation there are several other steps that need to be taken to claim tax allowances, or as a consequence of those.

### What should you look out for when choosing a preferential transformation?

If we want to claim the tax allowance available during this process, we have to look at the general and special conditions of Act LXXXI of 1996 on Corporate Tax and Dividend Tax (hereinafter referred to: "Corporate Tax Act"). If there is nothing preventing us from choosing a preferential transformation, the following steps should be taken.

The special rules of the Corporate Tax Act on adjusting the tax base prescribe two important rules for legal successors if a preferential transformation is selected. Firstly, the legal successor's **articles of association must contain** a **commitment** to assess its tax base following the transformation as if the transformation had not taken place, and to keep the revalued assets and liabilities separate.

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**New taxation proposals on the Tax Strategy Day**

Tax experts from the government and businesses – Audi, E.On, Magyar Telekom, MOL, Robert Bosch and Kirchhoff Hungária – as well as professional advisers discussed numerous proposals aimed at decreasing tax administration and improving the competitiveness of the Hungarian tax regime at the **Tax Strategy Day 2018** conference.

Read our detailed report with photos at the following link:
wtsklient.hu/en/2017/12/07/tax-administration/

Secondly, the legal predecessor (or in the event of a demerger, the legal successor) must **notify the tax authority** of the decision in its tax return on the fiscal year of the transformation.

### Which tax type do we want exemption for?

It is important to consider the burdens that individual tax types will represent during the transformation. We have to deal with the following issues here:

- During the transformation, does the company have property and/or movables subject to a **duty payment**?
- Do we want to **measure** our assets and liabilities **at market value** during the transformation?

Based on the responses to these questions we have to differentiate between cases where we would like to claim the tax benefits available during a preferential transformation for corporate tax as well, or where the goal is only to claim the duty exemption that arises during the transformation.

In our earlier article we highlighted that it is enough to meet the general conditions for preferential transformations in order to obtain the duty exemption; the special rules on tax base adjustments in the Corporate Tax Act do not have to be complied with.

Thus in reality, if the legal predecessor (or in the event of a demerger, the legal successor) notifies the tax authority of the decision in its tax return on the fiscal year of the transformation, then depending on whether the articles of association contain the aforementioned commitment it will have both a corporate tax allowance and a duty exemption, or, if the commitment is not included, it can only claim the duty exemption. Below we look at the significance of this in respect of items adjusting the legal successor's future corporate tax base.

### What basic scenarios can arise for future tax base adjustment items as a result of the transformations?

Depending on which tax type(s) we would like to claim the allowances for during a preferential transformation, the following cases may arise:

- non-preferential transformation at carrying value,
- non-preferential transformation at market value,
- market valuation during preferential transformation,
- preferential transformation at carrying value with commitment,
- preferential transformation at carrying value without commitment.

Since the change is most visible in the case of tangible assets, through this group of assets we will present the effects of the assets taken over at the legal successor.

- If the non-preferential transformation takes place at carrying value, the change compared to the former status is that the write-down of the asset re-starts, with the difference that **the net value** as of the transformation **will be the asset's new gross value**, similar to an asset purchase.

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"In the case of reliable taxpayers, a tax authority inspection may not exceed 180 days."

**Andrea Potássy, WTS Klient Hungary partner**

Source: inforadio.hu

## Turn on your radio!

"As business events arise we continually need to be prepared for any tax authority inspection" – says Andrea Potássy, partner of WTS Klient Hungary. On the evening of 7 December, the expert will be detailing how to prepare for a comprehensive tax audit as well as outlining the possible reasons for and the process of such inspections in the "Companies and markets" programme on InfoRadio.

Listen to the conversation at this link!

Please note that the conversation is available only in Hungarian.

- If it is a non-preferential transformation, and the transforming party applies a market valuation method, the revaluation difference i.e. the difference between the new gross value and the carrying value as per the tax law, will be taxable during the transformation. In this case, the accounting and tax depreciation of the asset will start on the **new, changed gross (market) value**.

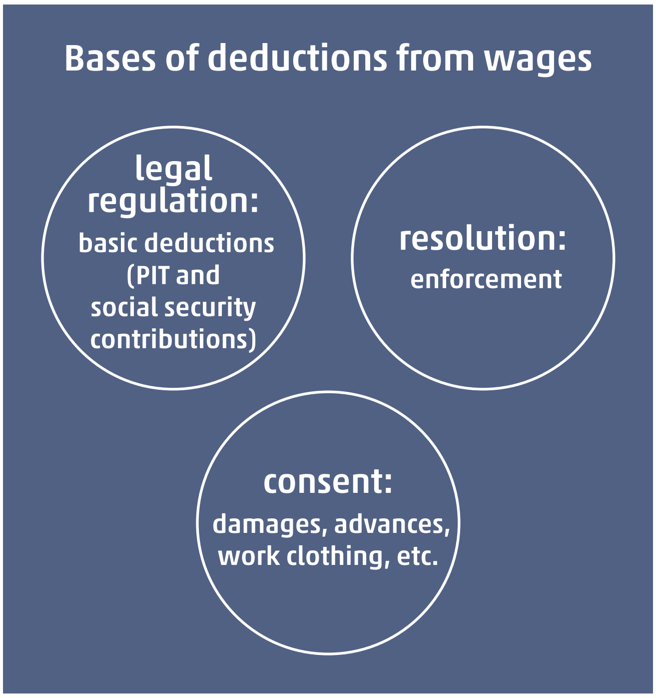
- In the case of a preferential transformation and valuation at market value, the revaluation difference will not be taxable during the transformation but the tax depreciation of the tangible asset will be completely different from the accounting depreciation in terms of both the gross value and the remaining useful life of the asset, because we committed to defining the tax base after the transformation as if the transformation had not taken place. We calculate **accounting depreciation based on the changed gross value**, and calculate it with the full re-started useful life of the asset, **while in the case of tax depreciation, the useful life applied at the legal predecessor must be continued**.

- If the transforming party does not opt for a market valuation but fulfils the commitment, **the carrying value** as of the transformation **will be the new accounting gross value, while the tax depreciation has to be continued based on the legal predecessor's records**. The accounting depreciation clearly changes here too since the net value as of the transformation will be the asset's new gross value.

- In this last case, when the transforming party chooses a preferential transformation at carrying value without a commitment, it can only claim duty exemption. Here, we have to follow the first point, which means the **depreciation of the asset received will restart** at the legal successor **under both accounting and tax law**.

Based on the above, the adjustment items for the future corporate tax base of the legal successor can vary widely depending on the choices made.

## Rules for deductions from wages

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Deductions from wages are subject to **strict legal regulations**. In our article we summarise the rules that affect this action by employers. This is because an employer can only make deductions from wages in the cases provided for by law.

Deductions from wages may only be carried out:

- based on a legal regulation,
- based on the decision of an authority or court up to the wage portion exempt from deductions,
- based on an employee's consent and to settle receivables derived from advances provided.

### Amount of deductions from wages

In Hungary, basic deductions are based on legal regulations. In this case, employers deduct personal income tax and social security contributions from employees' gross wages. If an employer receives an **enforcement resolution**, the deduction will be based on the net wage. As a general rule, only 33% can be deducted from a net wage, but there can be exceptions when the deduction even reaches 50%.

Higher percentage deductions may occur in the case of the following receivables:

- child support,
- employee wage receivable due from the debtor,
- employee wage and social security benefit received without legal grounds.

Except for fringe benefits, all monetary benefits paid in light of the employee's employment or the termination thereof and subject to personal income tax qualify as wages in Hungary.

Based on legal regulations, the portion of a monthly paid wage equalling the lowest old-age pension, which is **HUF 28,500 (approx. EUR 90)** in Hungary in 2017, is **exempt from enforcement proceedings**. This exemption shall not apply when enforcing child support and costs related to child birth.

### Order of receivables

The Hungarian law on enforcement defines the **order of deductions** too. Consequently, the order is as follows:

- child support,
- other statutory maintenance,
- employee wages and remuneration qualifying as wages,
- any amount payable to the state from the debtor in a criminal, penal or offence procedure, or receivables derived from the confiscation of property (except for demands under civil law),
- outstanding taxes, social security and other public debts,
- other claims,
- disciplinary fine imposed in enforcement proceedings.

After full payment of the preceding receivable in the order, the claim that is next in line can be paid. If there are several receivables under the same point, the order can be established based on which claim was received earlier by the employer.

**Very important!** From the perspective of employers in Hungary it is very important that **if the obligation regarding wage-related enforcement is violated**, the employer **shall have joint and several liability** towards the party requesting the enforcement, up to the amount that is not deducted.

### Deductions from wages based on consent

Based on an **employee's consent**, employers in Hungary may deduct their own receivables up to the wage portion that is exempt from deductions. These include damages, receivables from advances, or the deduction of the consideration for working clothes or occupational safety equipment.

The regulation on deductions from wages is a key provision of the Hungarian Labour Code in respect of wage protection, thus employers always have to comply with the strict rules defined in the laws.

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.

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