



Dear Readers,

Before I sat down to write this week's introduction to the Newsletter, I thumbed through our last edition and read that we urged you to relax until we got going again in January. I have no idea if you can still remember putting your feet up, but recharged batteries were definitely in demand to start this January. What new things has 2019 brought already?

If we start the list close to home, we must begin with a great piece of news: we are happy to welcome our colleague [Szabolcs Szeles as a new partner](#) from 1 January 2019. It is also good news that **our short image video** has been produced and released on our website as well as on our social media platforms. You can [watch the video here](#).

But steering away from self-praise, I strongly recommend this month's professional articles to you. Whether you read our piece on the accounting aspects of separating business divisions, or on the conditions of deducting mediated services from local business tax, or on the contribution-free framework for the employment of pensioners drawing a direct pension, I am sure you will find a lot of useful information.

All that remains is for me to say I hope you enjoy reading it. And don't forget, you can contact us any time if you need help with regard to tax, law or accounting.

Zoltán Lambert
managing partner

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Carve-out, or separation of a business division

Key cornerstones of a carve-out

- creating a carve-out strategy based on thorough and comprehensive preparations
- preparing financial plans, seeking potential buyers, conducting negotiations
- preparing for complete independence, concluding missing contracts, selecting service providers, preparing for launch of the new structure
- implementing the strategy, interim management until set-up of final structure, transition to final structure

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Above a certain company size – especially in the case of complex businesses operating more than one division – the need to **separate business divisions from the core activity** can often arise for various reasons. This process is called a **carve-out**. The reasons for a carve-out can include the declining prospects of a given business division, an ad-hoc opportunity for selling the division under favourable conditions, as well as just a simple portfolio restructuring. Whatever the case, separating a business division at growing companies is usually done in **preparation for the potential sale of the division**.

In a legal and business sense, a carve-out is a simple procedure that typically occurs through a separation, more often than not with a spin-off, but business division transfers are also popular solutions. Either way ensures that the business division, constituting an integral part of a company so far, henceforth functions as a separate legal entity, independent of the owners of the company. In the case of a spin-off, this is realised by establishing a new company, while the sale of a division leads to a merger with another legal entity.

From an operative point of view though, this can be somewhat more complicated depending on the **internal processes, resource needs and administrative tasks** of the division to be carved out. Another significant aspect is whether the separation happens as a prerequisite for a transaction already in progress or because of a prospective sale in the future.

Carve-out strategy

In many cases it is difficult to **define precisely which functions** need to be transferred to or shared with the newly-established business entity. It is much more straightforward with a decentralised structure than with a centralised one. Even if we assume the division operated relatively independently up until the point of separation, there are certain tasks where all rational arguments advocate centralisation, as long as the operation is incorporated in a legal entity or is within a group. These are typical **administrative areas** without which an independent unit is unable to conduct its activity in the long run, or even in the short run for that matter.

The carve-out strategy has to identify such areas and define the ways these tasks shall be carried out.

Separating a business division

Based on the provisions of the carve-out strategy, a solution for the **temporary lack of resources and infrastructure** at the carved-out division needs to be drawn up until a permanent solution is identified. If the separation is due to a sale that is not immediate, it is worth keeping certain functions temporarily at the "parent company", i.e. assigning such functions to the parent, since they have the required knowledge and resources to operate the separated division properly. In such cases the term, scope and form of settlement between the parties in relation to such services must be incorporated in a contract.

If a carve-out has to be conducted quickly, much depends on the **capacities** available at the party taking over the division. If necessary, it is recommended to entrust certain functions, such as accounting, tax or HR, to an external service provider, even if only temporarily.

You can listen to the radio interview about this topic by clicking here:



wtsklient.hu/2019/01/10/uzletag-levalasztasa/
Please note that the conversation is available only in Hungarian.

It is also important to **review all existing contracts**. Besides concluding new contracts for crucial services, it is also inevitable to identify the services for which no contractual relationship was transferred to the carved-out business division. It is important for the separated division to contract a service provider that is suitable given the structure, size and needs of the newly-established entity.

Financial advisory

Separating business divisions due to market processes puts a substantial burden on the company's employees. It requires the design of new procedures and an approach vastly different from the everyday routine, all while carrying out day-to-day tasks. Under our **restructuring management** services, WTS Klient Hungary can advise you on the strategic considerations of separating a business division and the operational issues involved, i.e. on the entire carve-out procedure. And with our **interim management** services we provide active support to solve temporary problems related to a lack of resources.

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Languages

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- » [Likely negative tax implications of mergers](#)
- » [IFRS 16: integrating off-balance-sheet financing into the balance sheet](#)
- » [Financial diagnostics: are the finances of your company in order?](#)

Mediated services in connection with local business tax

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In Hungary, **local business tax** is levied based on net sales revenues which can be decreased by certain items, and thus by **mediated services**. You should be careful though because if the amount deducted on these grounds does not comply with the legal definition of mediated services, the tax authority of the local government may find a tax shortfall or set a tax penalty.

In respect of mediated services, among other things the following is definitely required:

- invoices clearly verifying the mediation
- contracts showing the possibility of mediation
- the inclusion of own and mediated services in separate rows on the invoice

Definition of the value of mediated services

Mediated services are defined by several laws in Hungary, so we find this term in the Act on VAT as well as in the Act on Accounting. Nevertheless, for **local business tax** Act C of 1990 on Local Taxes sets its own category. Accordingly, the value of mediated services means the value of a service purchased by the taxpayer in its own name, and resold (re invoiced) under the terms and conditions in a **written contract** with a third party (customer), in part or in whole as agreed in the contract, but in an unaltered state. With mediated services **the taxpayer is both the buyer and seller of the service**; the taxpayer mediates the purchased service, in part or in whole, with the **prospect of mediation clearly derived from the contract with the customer, and the actual mediation verified on the invoice**, i.e. showing that the taxpayer – in addition to its own services – also provides services it has purchased, in an unaltered state but not necessarily at the same price.

What else should you look out for?

Although the definition in Hungarian law represents a rather complicated and complex system of conditions, the issued legal interpretations and judicial practice include additional requirements on mediated services, which at first sight might not necessarily seem evident. For example, such requirements include that the incoming invoice issued to the taxpayer should not follow but rather precede the invoice issued (re-charged) by the taxpayer to its customer. The mediation is only evident from the invoice issued to the customer if **own and mediated services are indicated in separate rows on the invoice**.

As emphasised already, it is important for the taxpayer and its customer to conclude a written contract that clearly shows the possibility for mediation. The Hungarian **regulation does not prescribe any specific form for the contract** between the customer and the taxpayer, so theoretically even a **contract for services or any other atypical contract** can facilitate a tax base cut. Please note, however, that some argue **consignment contracts** comply with this legal condition the best (the consignee assumes an obligation to conclude a contract in its own name on behalf of the principal in connection with the service). Although the laws and regulations do not specify this either, it is also justified to set up an appropriate system of records for both outgoing and incoming invoices.

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Tax consulting

Should you have any questions regarding the inclusion of mediated services in your company's local business tax returns, we would be happy to assist you. Over the past twenty years we have prepared or reviewed the local business tax returns of hundreds of companies. **Our tax consulting team** looks forward to hearing from you by email, or just give us a phone.

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What can we do to mitigate the risk?

Recently we have seen that mediated services have often been a **focal point for the tax authorities of Hungarian local governments**. So it makes sense to review and inspect the [local business tax returns](#) of previous years and their underlying documentation, and to ascertain whether reducing the tax base on the grounds of mediated services was in line with Hungarian laws and regulations. If an inspection is just about to start with you, or

is already in progress, it is recommended that you contact an expert as soon as possible.

You can listen to the radio interview about this topic by clicking here:



wtsklient.hu/2019/01/17/kozvetített-szolgáltatások-erteke/
Please note that the conversation is available only in Hungarian.

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Languages

Hungarian, German, English



From 2019, employees who are pensioners drawing a direct pension do not have to pay contributions in Hungary

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There is a very important change from 1 January 2019 regarding the contributions payable by employees who are pensioners drawing a direct pension. The essence of the change is that starting from this year, employees who are pensioners drawing a direct pension will not have to pay contributions, and their employers will not have to pay the social contribution tax. In this article we summarise the essence of the new regulation.

“The exemption from contributions is only permitted if the pensioners drawing a direct pension earn money under an employment framework in accordance with the Hungarian Labour Code.”

Who are deemed pensioners drawing a direct pension?

Firstly, in order to apply the new Hungarian regulation properly it has to be specified who can be considered a pensioner drawing a direct pension **from the perspective of social security**.

According to Section 4 f) of Act LXXX of 1997 on the Eligibility for Social Security Benefits and Private Pensions and the Funding for These Services (hereinafter: the “Social Security Benefits Act”) pensioners drawing a direct pension are people who:

- by applying the Act on Social Security Pension Benefits (Act LXXXI of 1997) and an international treaty, draw a direct pension as defined in Section 14 (3) a) (**old-age pension**), **disability pension aid** (in pension), a pension from an ecclesiastical entity or an increased old-age/disability allowance,
- by applying **EU regulations** on the coordination of social security systems and the implementation thereof, and the legal regulations of the EEA, receive an old-age pension,
- qualify as pensioners drawing a direct pension according to the previous two paragraphs, and according to the Hungarian Labour Code are **employed** even if payment of the pension is suspended.

Based on the above definition, pensioners drawing a direct pension are essentially **people who have reached retirement age** and **people drawing the preferential pension for women**.

The following people do **not qualify as pensioners drawing a direct pension**:

- those whose pension was not disbursed as a pension from 1 January 2012 but as a pre-retirement benefit or service allowance;
- those for whom a pre-retirement benefit or service allowance was determined after 31 December 2011,
- those whose disability or accident-related disability pension is disbursed from 1 January 2012 as a rehabilitation or invalidity benefit, or their benefit for a reduced capacity to work was determined from this date.

When are pensioners drawing a direct pension exempt from paying contributions?

Based on Section 25 of the Social Security Benefits Act "pensioners drawing a direct pension who are employed (excluding those employed according to the Hungarian Labour Code and qualifying as pensioners drawing a direct pension) shall **pay an in-kind health insurance contribution and a pension contribution** on their income underlying the contribution base. If disbursement of the pension is suspended, employed pensioners drawing a direct pension shall pay a **health insurance contribution** in cash."

So based on the above Hungarian law, pensioners drawing a direct pension who are **employed according to the Hungarian Labour Code** and qualify as employees will not have to pay **the 10% pension contribution and the 4% in-kind health insurance contribution** on their income in 2019. It also means that pensioners drawing a direct pension who work based on an employment contract only have to pay the personal income tax (15%).

So in 2019, pensioners drawing a direct pension, who are employed according to the Hungarian Labour Code, will not be entitled to healthcare services as employees, but will be entitled based on Section 16 (1) b) of the Social Security Benefits Act as **domestic pensioners** covered by the **central budget**.

It is very important that the exemption from contributions and the lack of insurance will only be permitted if the pensioners drawing a direct pension earn money **under an employment framework**. Pensioners drawing a direct pension who work in a public service type job, or work under an engagement contract for example, will continue to be insured based on their legal status, and on the basis of this activity they will have to pay a health insurance contribution and a pension insurance contribution.

One important consequence of this change is that due to the lack of contribution payment **the 0.5% pension increase shall not be applicable** to pensioners drawing a direct pension.

Task for employers in connection with change in rules

According to Section 3.2 of Schedule 1 to Act CL of 2017 on Rules of Taxation, **employers have to report** the end of the insured status of the people affected to the National Tax and Customs Administration **within eight days** on form no. T1041.

Payroll

Our article does not fully cover the regulation on the contribution payments of employees who are pensioners drawing a direct pension, it only tries to outline the most significant changes. Feel free to contact our [payroll staff](#) if you have any specific questions regarding the amended act.

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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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