

Personal income tax

Income from activities other than self employment

According to the amendments adopted, the calculation method of the consolidated tax base will change as of 1 January 2010 and the tax base will include amounts classified as tax base increasing items under the Act on PIT. Thus the consolidated tax base will include an amount determined according to the employer's social security contribution, calculated based on earnings (which, according to the Bill, would make up a total of 27% after 1 January 2010) or, if there is no social security liability, an amount calculated based on the health tax liability (which would also be 27% after 1 January 2010), while gross earnings will still be the basis for the social security contributions and the health tax.

Furthermore the terminology of "typical earning of an activity" and the concepts of entrepreneurial drawings and personal involvement fee will be introduced. Based on this, for private entrepreneurs and companies where the amount of withdrawals and personal contributions is less than the typical earning of the relevant activities determined based on the FEOR numbers, then such an amount qualifies as income that is part of the consolidated tax base of the private entrepreneur or company. The amount of typical earnings by FEOR numbers are unknown yet.

According to the tax table applicable to the consolidated tax base, the personal income tax rate of the lowest category will be reduced to 17% up to earnings of 5 million HUF. Earnings exceeding HUF 5 million, will be imposed by a personal income tax rate of 32%, with the solidarity tax being abolished and incorporated into the tax rate of the upper category of the personal income tax.

The monthly available limit of tax credit will be raised from HUF 11,340 to HUF 15,100 and to annual HUF 3,188,000, respectively. The tax implications of the above amendments are likely to favour those with monthly gross earnings between HUF 220 thousand and HUF 300 thousand. As of 2011, as a result of the amendments adopted, the limit of the lowest category will increase from HUF 5 million to HUF 15 million, with the tax rates will remaining unchanged.

As far as tax benefits are concerned, almost all tax benefits will be annulated, with the exception of family allowances and benefits related to payments made to voluntary mutual insurance funds and pension savings accounts.

Other incomes

In case of other incomes, from 2010, under the Act on CIT the portion of the after-tax profit of controlled foreign entities which is not distributed, but which is attributable to the individual as the owner, will be qualified as other income for the individual, provided that the individual's direct or indirect share or share of the votes (together with those of his/her close relatives) is at least 25%. The time of receipt of the income is the day when the entity's after-tax profit is approved. Other income will also include interest and dividends paid by controlled foreign companies, provided they are not taxed as non-distributed profit, along with any exchange rate gains on the sale of the shares of the controlled foreign company.

The total amount of interest, royalty and management fees paid to non-resident private individuals will be regarded as income subject to 30% withholding tax, provided that Hungary does not have an effective DTA with the private individual's country of residence. The tax shall be withdrawn and paid by the payer (or paid in the case of non-cash benefits), however, this liability does not apply to interest paid and credited by credit institutions.

The place of gainful activity in the case of income derived by a non-resident private individual from the transfer or lending of his share in a company that owns real estate in Hungary, will be in Hungary. Furthermore, in the case of such income the designation will be changed to "income from the transfer of real estate or rights in immovable's", however, it is not possible to apply the rules otherwise modifying income associated with real estate (such as percentage reduction).

Benefits in kind and other taxable benefits

Benefits in kind will be imposed by a more significant, higher and more rigorous tax rate than before, which will have significant impact on companies' so called cafeteria systems.

According to the new provisions:

- preferential computer and Internet use will continue to be tax exempt;
- liabilities forgiven by credit institutions will be also qualified as tax exempt benefits in kind, provided that the liabilities are forgiven in order to prevent the debtor and his/her family from going bankrupt, on the basis of the principle of equal treatment for those in identical circumstances;
- income associated with business entertainment and business gifts will qualify as tax exempt benefits in kind from 2010 provided that they are regarded as items increasing the corporate income tax base of the payer.
- Benefits taxed "at a preferential rate"; i.e. 25% tax payable by the provider (but exempt from any social security contributions) will include:
 - holiday vouchers (up to the amount of the minimum wage on 1st of January of the relevant year; and the administrative reporting obligation will be annulled),
 - school training (up to two and a half times the minimum wage),
 - local travel passes,
 - hot meal vouchers (up to 18.000 HUF / month),
 - school enrolment support (up to 30% of the minimum wage),
 - voluntary mutual pension funds and health care funds (up to 50% and 30% of the minimum wage, respectively),
 - contributions to employer sponsored pension institutions (up to 50% of the minimum wage) and
 - employer's supplements to mandatory private pension funds.
- In addition to the foregoing, having regard to the 54% general tax rate, from 2010 taxable benefits in kind will include, among others:
 - cold meal vouchers;
 - gifts of small value
 - fuel savings (which, however, will remain tax exempt up to 100.000 HUF/month).
- Employer support for housing purposes will become a non-taxable element. However, the possibility of treating products or services, provided to private individuals who have not entered into an insurance relationship, as benefits in kind is extended considerably.

According to the recent changes, the interest rate discount received by private individuals in respect of their dependent activities will also become taxable at flat rate pursuant to the rules applicable to income from interest rate discount. Furthermore, the tax rate applicable to income from interest rate discount will increase from 44% to 54% from 2010.

Social security contribution

As of 1 January 2010 the so called employer's and employee's contributions will be replaced by the labour market contribution.

The employer's social security contribution will be 27% of which the pension insurance contribution will be 24%, the health insurance contribution will be 2% and the labour market contribution will be 1%.

The insured person will still be subject to 9.5% pension insurance, 6% health insurance and 1.5% labour market contribution. Benefits in kind subject to 54% personal income tax will also attract 27% employer's contribution (or 27% health care contribution).

Similarly to the concept of "earnings typical of an activity" launched in Act on PIT, the concept of the "fair market value of the activity" will be introduced. After the introduction of the aforementioned concept, private entrepreneurs, business partnerships and employers will, as a general rule, be liable to pay social security contributions at least on the market value of the employee's activity. The employer may report any deviation from the foregoing by reporting the income constituting the actual contribution base in the monthly tax return.

The flat health care contribution will be cancelled from 2010. However, the 11% health tax rate will be raised to 27%. The provisions remain unchanged in respect of the 14% health care contribution.

As of 2010, without modification of the mandatory employment level (5%), the annual amount of rehabilitation contribution will be multiplied by five, i.e. it will be raised from the current HUF 192,900 to HUF 964,500 per person.

New type of tax: Tax on certain high value properties

This new tax type will be introduced in respect of the following types of properties:

- Residential real estate

According to the act the tax type is payable on residential real estate (i.e. homes or holiday homes including the land or portion of land belonging to them).

The taxable person is the private individual or organisation that is the owner of the real estate on the first day of the calendar year, or if the real estate is subject to a right in immovable, the beneficiary of such right. In case of multiple owners / beneficiaries they will be taxable in proportion to their respective ownership ratios / rights.

Under the act the tax liability will commence on the first day of the year following the year in which the occupancy or continuation permit issued for the residential real estate enters into force, while in the case of residential real estate constructed or occupied without a permit the tax

liability will commence on the first day of the year following the actual occupation of the residential real estate.

Any changes in the tax liability will take effect as of the first day of the next year. The tax liability on the real estate shall terminate on the last day of the year in which the residential real estate is destroyed, pulled down or reclassified as a non-residential real estate. However, suspension of the use of the residential real estate shall not have impact on the tax liability.

Elderly and helpless persons, underage taxpayers acquiring the residential real estate by inheritance and job seekers may request the tax authority to suspend the tax liability under certain conditions, and the former may even be eligible for tax exemption. The refurbishment of a listed building or a building under local protection may be eligible to a three year tax exemption. Parents raising three or more children may be eligible for a tax relief. The tax liability of the residential real estate may be reduced in the tax year, subject to certain other conditions, by the amount of value added tax charged on services or products purchased in relation to the refurbishment of the residential real estate, based on the relevant invoice.

The tax base is the market value of the residential real estate as of the first day of the tax year. The market value of the real estate below 30 million HUF is also part of the tax base.

According to the act the market value is the value expressed in money that could be generally achieved as the purchase price upon the sale of the property, irrespective of any debts encumbering the property.

The tax rate will be:

- 0.25% up to a tax base of 30 million HUF (from the first HUF),
- 0.35% on the portion of the tax base between 30 million HUF and 50 million HUF, and
- 0.5% of the part exceeding 50 million HUF, annually.

The taxpayer's place of residence - both according to the address register and in real life - shall be exempt from tax if its market value is below 30 million HUF as of the first day of the calendar year, along with another residential real estate of the taxpayer if its market value is below 15 million HUF as of the first day of the calendar year. Furthermore, according to the act, the taxpayer may deduct the amount of any building tax payable on the real estate in the tax year or the amount of any tourism tax payable on holiday homes from the amount of the residential real estate tax.

- High performance passenger cars

In case of passenger cars with an engine whose output is equal to or above 125 kW (with the exception of "old-timers", indicated with an OT number plate) a property tax will be payable over and above the otherwise applicable vehicle tax.

The taxable person will be the individual or organisation that is the owner of the passenger car indicated in the register kept by the competent authority as of the first day of the calendar year, and in the case of more than one owners they will be taxable in proportion to their respective ownership ratios. If the passenger car is not included in the register kept by the Hungarian authority, the taxable person will be the owner of the car.

Tax rate:

- passenger cars with an output equal to or above 125 kW but below 175 kW double the tax amount under the Motor Vehicle Act,
- passenger cars with an output equal to or above 175 kW but below 200 kW 2.5 times the tax amount under the Motor Vehicle Act,
- passenger cars with an output of at least 200 kW three times the tax amount under the Motor Vehicle Act will be payable as property tax,
- passenger cars with purely electric or hybrid engines will be entitled to a 50% tax relief, and
- parents raising three or more children are also eligible for a 50% tax relief on one car.

In order to avoid double taxation, any vehicle tax already paid may be deducted from this tax liability.

- **Watercraft**

The tax will be levied on watercraft included in the registry kept by the National Transport Authority as well as on the watercraft of resident private individuals under the Act on Personal Income Tax and of organisations registered in Hungary that meet the technical conditions for registration in the aforementioned registry, but are not included therein or have been registered abroad.

The definition of watercraft shall include large seafaring vessels, inland waterway crafts and engine-driven watersports crafts, provided that the nominal sail surface of (sailed) vessels exceeds 25 m² or in the case of engine-driven craft the combined output of the main engines exceeds 50 kilowatts. However, boats and non-engine-driven watersports crafts are not subject to this tax type.

The taxable person is the person that is the owner of the watercraft on the first day of the calendar year. In the case of more than one owners, they shall be taxable in proportion to their respective ownership ratios.

The tax base varies depending on whether the watercraft is sailed or engine driven.

Tax base:

- sailed watercraft: nominal sail surface of the watercraft expressed in square meters.
- engine-driven watercraft: aggregate output of the main engines of the watercraft expressed in kilowatts.

The tax rate varies depending on the sail surface of the watercraft / the output of the main engines in kilowatts as well as on the age of the watercraft. The regulations also provide for exemptions. Exempt watercraft include, among others, watercraft owned or operated by sports clubs and sports associations (subject to certain conditions), watercraft registered for the purpose of water rescue activities, original historic vessels and the individual copies thereof.

- **Aircraft**

The tax will be levied on aircraft included in the registry kept by the competent authority as well as on the aircraft of resident private individuals under the Act on Personal Income Tax and of organisations registered in Hungary that meet the technical conditions for registration in the aforementioned registry, but are not included therein or have been registered abroad.

The definition of aircraft shall only extend to civil aircraft and shall include helicopters, hot-air balloons, zeppelins, hang-gliders, gliders and airplanes whose maximum take-off weight exceeds 100 kilograms.

The taxpayer will be the person that is the owner of the aircraft under the Civil Code as of the first day of the calendar year, and in the case of more than one owners they will be taxable in proportion to their respective ownership ratios. The tax base will be the maximum take-off weight indicated in the operating licence of the aircraft issued by the competent authority and the tax rate will be dependent on the same figure and the age of the aircraft.

Exempt aircraft include, among others, aircraft owned or operated by sports clubs and sports associations (subject to certain conditions) as well as aircraft owned or operated by an organisation holding an air operator's certificate.

In the case of high-performance passenger cars, watercraft and aircraft the tax liability is incurred on the first day of the year following the year in which ownership of the vehicle is acquired. Any changes in the tax liability (e.g. sale of the vehicle) will take effect as of the first day of the year following the year of the change. The tax liability will cease on the last day of the year in which the vehicle is sold or destroyed.

Corporate income tax

Among changes adopted for 2010, the most remarkable is the temporary increase of the corporate income tax rate to 19%. At the same time, the act on solidarity tax payable by companies has been repealed, except for the provisions on credit institutions' contribution.

Besides the increase of the CIT rate, the legal amendments are aimed at a significant restructuring of the effective corporate income tax system. The modifications belong to the following three large categories:

- New provisions aiming the prevention of tax evasion in line with the changed personal income tax system include the following:
 - taxation of undistributed income of controlled foreign companies
 - introduction of withholding tax on payments to countries without a DTA
 - Regulation of the taxable status of a non-resident member of a company that owns real estate
- Crisis management and business incentive measures
- Restriction of modifying items and technical changes

The majority of modifications will take effect as of 1 January 2010, but provisions aiming crisis management applicable as early as the tax year 2009.

Income of foreign controlled companies

The definition of a "controlled foreign company" is to be modified to be stricter than before, i.e. rules on controlled foreign companies will only be applicable if there is a Hungarian resident who is an actual shareholder in the foreign entity.

A private individual qualifies as the actual owner if

- he/she holds 25% of the voting rights or has 25% ownership,
- he/she has controlling interest (i.e. is entitled to appoint and recall the majority of the senior executives and members of the supervisory board, or directly or indirectly holds at least 50% of the voting rights under an agreement with other members or shareholders).

This means that the foreign related parties of multinational companies present in Hungary where the ultimate owners are typically non-resident entities will, by definition, not qualify as controlled foreign companies in the future, irrespective of the geography of their operations and their tax residence.

A foreign entity qualifies as a controlled foreign company if the ratio of its tax paid (or payable) to its tax base is below two thirds of the Hungarian corporate income tax rate (i.e. 12.66% considering the suggested 19% rate), or if the foreign company pays no form of tax equivalent to corporate income tax as a result of having a zero or negative tax base, even though it makes a profit. If both the company's profit and tax base are zero or negative then it is the foreign statutory tax rate that must reach two thirds of the Hungarian corporate income tax rate. Companies in EU or OECD member states, or in countries without DTA with Hungary need not fulfil this criterion, but in this case the act requires real economic presence in these countries as a conjunctive criterion.

Production, processing, agricultural, service, trade and investment activities jointly performed with own assets and human resources by the foreign company and its related parties in the given state qualify as real economic presence if the related income is at least 50% of their total income (to be evidenced by the taxpayer).

Furthermore, foreign companies in which a reputable listed entity or one of its related parties has a share will not qualify as controlled foreign companies.

The new regulation introduces taxes on the undistributed income of the controlled foreign company as well. However, with a view to the DTAs, dividend received from a controlled foreign company will decrease the pre-tax profit up to the previous tax base increase. Similarly, the exchange rate gain realised on the derecognition of the share held in the controlled foreign company will also decrease the pre-tax profit up to the amount of the former tax base increase (due to the undistributed income).

Withholding tax on payments to companies in countries without a DTA

The amendment act will re-introduce withholding tax for foreign entities in some cases. The tax is payable by a foreign person or non-resident person who is paid royalty, interest or service fee by a resident taxpayer other than private individuals, provided that there is no effective DTA between the country of the foreign person's residence and Hungary.

The tax base of the foreign entity is the interest, royalty or service fee received. Service fees include fees for management, management consulting, advertising, public opinion polling and business agency activities, as set forth in Regulation (EC) No. 1893/2006.

The withholding tax rate payable on the income of the foreign entity will be 30%, to be deducted and paid by the payer.

Taxation of members of companies that own real estate

The legal amendment introduces the concept of a company that owns real estate referring to taxpayers and related parties owning real estate in Hungary where the value of Hungarian real estate exceeds 75% of the aggregate market value of assets shown in the financial statements, and a member (shareholder) is a foreign resident in a country with which Hungary has not concluded a DTA, or the effective treaty allows the taxation of the exchange rate gain in Hungary. Consequently, if - with the related party data also taken into account - the company group qualifies as an entity that owns real estate, then each member of the group qualifies as such independently.

The tax is payable by non-resident persons who gain income from the alienation or divestment of a share in a company that owns real estate ("member of a company that owns real estate"). Tax liability is incurred as of the day of alienating the share or the decrease of registered capital by means of divestment.

The amendment provides specific rules for the assessment of the tax base in case of members of companies that own real estate, under which the tax base is the positive amount of the consideration at the time of alienation or decrease of the company's registered capital, less the purchase price of the share and justified expenses associated with the acquisition or holding of the share, while the tax rate is the general rate stipulated by law.

The changes also provides for the exchange rates to be applied for converting the foreign currency amounts into HUF for the assessment of the tax base, and also defines alienation (sale, contribution in kind, and transfer without consideration) and stipulates what to be regarded as consideration (consideration set forth in a contract, arm's length price in case of related parties).

The foreign member (shareholder) is not liable to declare and pay a tax advance, but the tax shall be declared and paid by 20 November of the year following the tax year.

Transfer pricing regulations

The changed law extends transfer pricing regulations to foundation through contribution in kind, and also to transactions between a foreign entity and his domestic sites or the taxpayer and his foreign sites.

Crisis management and business incentive measures

Expired receivables

According to the new regulation 20% of expired receivables - but no more than the amount of impairment recorded - will be deducted from the tax base, thanks to the new definition of uncollectible receivables.

Furthermore, financial institutions will be exempted by the legal amendment from the obligation to increase the tax base due to impairment (from 2009 onwards).

As a transitional rule, the amendment allows financial institutions to reduce their tax bases by the amount of impairment increasing the tax base recorded before 31 December 2008, in five equal instalments, one each year.

Development reserve

The period available for the tax-exempt release of development reserves made prior to 31 December 2008 will be prolonged by two years, meaning that such reserves could be released within 6 years.

Development tax allowance

Pursuant to the amendment, small and medium-sized enterprises would be entitled to a development tax allowance if they carry out a construction project with a present value of at least 500 million HUF in any region. A prerequisite is that companies must increase headcount by 20 or staff costs by 50 times the annual minimum wage for small enterprises and increase headcount by 20 or staff costs by 50 times the annual minimum wage for medium enterprises.

Deferral of losses

The new regulation extends the scope of the rules pertaining to the deferral of losses to credit institutions and financial institutions who will be able to use this option for the first time in 2009.

Restriction of tax base modifying items and technical changes

All tax base benefits will be abolished, with the exception of benefits related to construction projects, employment, royalties, research and development and reported shares.

The items abolished are as follows:

- tax base decrease based on the income from transactions made on a regulated market,
- tax base decrease based on the proceeds received in compensation for the transfer of any emission allowance unit,
- benefits applicable to small and medium-sized enterprises which are based on a patent, consumer or industrial design and a consumer or industrial design protection right,
- deductibility of exchange rate gain realised on investments in small and medium sized enterprises,
- incentive based on the purchase of a work of fine art,
- use of local business tax as an item decreasing the tax base,
- subsidies granted and received,
- modifying items pertaining to 50% of the interest paid/received by related parties
- option to apply local business tax as a reduction item.

Adjustment items related to transactions without consideration (subsidies granted and received, forgiven liabilities, assumed debt) will be abolished.

Companies may apply the currently effective rules up until 2012 for income recognised in the tax year (as a result of deferrals) in relation to liabilities forgiven and debt assumed before 31 December 2009, and for income recognised in the tax year in relation to aid and subsidies received.

The current adjustment (increasing and decreasing) item related to donations will also be abolished, but this will not lead to any changes in the taxation of donations eventually since subsidies granted and received do not modify the tax base in the first place.

A portion of aid granted to special public service organisations or based on longterm donation agreements would still be eligible for tax benefits identical to those allowed by the current regulations (appropriate verification documents will still be required).

The amendment clarifies the rules of tax base benefits related to research and development activities by allowing only the direct costs of research and development performed by the company to be deducted from the pre-tax profit.

Under the legal amendment, business entertainment and business gifts will be subject to corporate income tax as they represent costs that are not incurred in the interest of the company (however, the same benefits will be exempt from tax for personal income tax purposes as detailed before). At the same time, the amendment provides that discounts, rebates, products, in-kind benefits and product samples (provided that such samples are not purchased for long-term use and their volume is less than the minimum threshold for distribution) provided publicly, under the same circumstances and for promotional purposes, do qualify as costs incurred in the interest of the company.

Changes in fees payable for advance pricing agreements

The fees payable for advance pricing agreements (APA) will be reduced as follows:

- in case of a unilateral procedure the fee range will be between HUF 500 thousand and HUF 5 million, provided that the arm's length price may be determined with the comparable prices method, the resale prices method or the cost plus method.
- in case of a unilateral procedure the fee range will be between HUF 2 million and HUF 7 million, provided that the arm's length price may be determined with an other method,
- in case of a bilateral procedure the fee range will be between HUF 3 million and HUF 8 million,
- in case of a multilateral procedure the fee range will be between HUF 5 million and HUF 10 million.

Foreign permanent establishment

From 2010 the part of the tax base derived from activities pursued at foreign permanent establishments will be exempt from business tax, irrespective of whether the taxpayer is subject to a tax liability in the territory of the foreign state that corresponds to the Hungarian business tax.

Should you have any questions or need further information please don't hesitate to contact me.

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