



Lex Mundi European Union: Accession States Tax Guide

HUNGARY Nagy es Trocsanyi

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A. General information

The Republic of Hungary, a Central-European country with a population of over 10 million, is a member to the European Union since May 1, 2004. Pursuant to OECD statistics¹ the per capita gdp in Hungary was US\$15,946 in 2004 and the gdp growth rate between 2000-2006 averaged at 4.14% p.a. The consumer price index was 3.6% in 2005 and 3.9% in 2006.

Notwithstanding a robust economy, fiscal imbalance is however, somewhat alarming as it was around 10% of the gdp in 2006. As an immediate step to cut deficit, the newly elected socialist government raised taxes and social security contributions in 2006 which are hoped to be reversed as structural financial reforms permit.

Pursuant to data from the European Commission² the overall taxation level (including social security contribution) is 39.1% of the GDP compared to 39.3% for the EU weighted average. In terms of the tax mix, implicit tax rates on consumption and labor (including vat, excise tax and customs) are 3% and 5.2% respectively higher than the EU average. There is no tax on capital as opposed to the 29.9% average of the old member states and the 14% average of the new (which includes the Hungarian 0 rate) member states.

Otherwise the tax system is typical EU. Government income (including social security) in 2005, in proportion of the source, was as below³:

¹ <http://stats.oecd.org>

² TAXUD E4/2006/DOC/3201

³ act 2006: XCIX on financial closure of the 2005 budget

TAXES IN PROPORTION OF GOVERNMENT INCOME			
corporate tax	4,6%		
special tax of financial institutions	0,4%		
simplified entrepreneurship tax	1,0%		
energy tax	0,1%		
mining tax	0,3%		
game tax	0,7%		
other payments	0,1%		
other centralized payments	1,8%		
Taxes and payments from companies total		9,1%	
VAT	19,0%		
excise tax	7,2%		
car registration and consumption tax	0,7%		
Consumer type taxes total		26,9%	
personal income tax	10,6%		
inheritance and procedural dues	1,2%		

Direct taxes from individuals total		11,9%	
Diverse budget incomes		21,0%	
CENTRAL BUDGET TOTAL			68,7%
Health care contribution		11,7%	
Pension plan contribution		19,4%	
SOCIAL SECURITY TOTAL			31,1%
GRAND TOTAL			100,0%

As may well be seen from the distribution of the revenue sources, instead of corporate income and capital, the overall tax burden is on labor and consumption.

B. Corporate income taxation

1. Taxable entities

In general, practically any entity carrying out business activity within the territory of Hungary is subject to corporate tax, notwithstanding residency. This includes companies of any form, business partnerships, cooperatives and, in terms of their for profit activity, even not for profit entities, foundations, associations and churches.

It is worth noting that general and limited partnerships alike (including law firms, notaries' offices, patent attorney offices), lack of legal personality, notwithstanding, are treated as if they were companies

Foreign entities qualify as resident taxpayers if their place of management is in Hungary.

2. Taxable income

Resident taxpayers are taxed on their worldwide income, while non-resident entities only on income from their Hungarian branches.

It is worth mentioning however, that dividends received from a domestic source are exempt from the tax base, i.e. dividend received is not subject to corporate tax. Dividends from abroad are exempt also, except if there is no corporate tax at the place of business of the dividend payer or if its rate is below 2/3 of the Hungarian tax rate (i.e. 2/3 of 16%).

Tax base is the pre-tax result, i.e. income less the expenses directly related to the business and other deductibles such as dividend.

3. Tax rates

The general tax rate is 16%. For small businesses with a yearly income less than HUF 5 million (apr. €20,000) it is only 10%.

As part of an austerity package purported to lessen government deficit, since Sept. 1, 2006, there is a 4% surtax (with minor exceptions, it may be considered as an extra corporate tax) making the effective corporate tax burden 20%.

4. Capital gains taxation

Capital gains are included in general income and are taxed as such. Some exceptions apply in connection with mergers and stock exchange transactions.

5. Loss carries forward and backward

Except by financial institutions, loss incurred may be carried forward indefinitely. However, only from the 3rd year of operation and only upon the permission of the tax authority. Carry backward is available only for agricultural entities against the profits in the 2 preceding years.

6. Withholding tax

In general, taxes on payables to individuals including tax on interest (20%) and dividend (25% or 35%) are withheld at source. In cases where treaty rate applies and the recipient proves his foreign domicile through its home tax residence certificate, tax will be withheld at the reduced treaty rate. There is no tax on dividends and interests payable to entities, consequently, withholding is not an issue.

7. Preferential tax

Pre-EU tax incentives formerly granted, if not already unavailable, are yet in force until expiration not later than 2011. The off-shore regime has been revoked prior to EU accession and companies formerly qualified may have applied these incentives until 2005.

Small and medium size entities are entitled to a tax credit of up to HUF 6 million per year in the amount of 40% of the interests paid on loans financing purchase of assets.

By resolution of the Ministry of Finance decree, development tax incentives are available in the total amount of the tax otherwise payable after;

- Investments of at least HUF 3 billion (apr. €12 million) resulting in at least 150 new jobs;
- Investments of at least HUF 1 billion (apr. €4 million) in the territories of privileged municipalities resulting in at least 75 new jobs;
- Investments into food production hygiene of production facilities of value of at least HUF 100 million;
- Investments of at least HUF 100 million (apr. €400,000) into environment protection, broadband internet service, basic or applied research or development by scientific institutions, film or video production,
- Investments resulting in certain number of new jobs, provided 20% will be taken by school graduates.

Entrepreneurs, partnerships and limited liability companies may qualify under the simplified entrepreneurship tax regime if, besides certain other conditions, their annual income does not exceed HUF 25 million (apr. €100,000). The tax is 25% of income (inclusive vat) with deductions permitted.

8. Anti-avoidance rules

In general, the tax authority has the power to re-qualify contracts and transactions according to their underlying real substance and if their sole purpose was to avoid tax obligations.

Transfer pricing rules apply on transactions between affiliates in case where one has a majority control of any form over the other. The transfer pricing rules follow the oecd guidelines and, pursuant to a court ruling, the oecd guidelines and principles serve even as primary source of interpretation of laws. Transfer price ruling may be applied for and granted. Said transfer price ruling will then be binding.

Dividend received (which is otherwise exempt from corporate tax) from an affiliate resident in a jurisdiction where corporate type tax is less than 2/3 of the Hungarian rate (16%) will add to the general tax base, except if it is substantiated that the dividend payer company carries out real business activity.

Debt – equity ratio, in general, is 3:1, i.e. interest on debt (except to banks) in excess of three times the equity will add to tax base. Special rules apply between affiliates, i.e. the 50% of the negative balance of interest paid and received adds to tax base.

9. Main administrative requirements

Quarterly (in cases where the annual tax is apparently over HUF 5 million monthly) tax advance returns are to be filed and tax advance be paid until the 20th on the month following the tax advance return period. The interim tax advances are to be filled up to the pre-calculated level of

tax until December 20th of the tax year. Final tax return is to be filed and unpaid balance of tax shall be paid until May 31st of the year following tax year.

10. For tax treaties see appendix

11. Tax incentives for special entities

Foundations, public foundations, social organizations, public bodies, churches, condominiums, mutual insurance savings, universities, schools and other not-for-profit cooperatives and companies enjoy special privileges which vary from reduced rates to tax holidays for purpose bound incomes.

C. Individuals

1. Taxable persons

Hungarian citizens and individuals resident in the territory of the Republic of Hungary are subject to taxation on their worldwide income. Foreign nationals are treated as Hungarian residents if present in Hungary for an aggregate period of 183 days or longer during a calendar year. Otherwise, foreign nationals are subject to Hungarian income tax if they derive certain types of income from Hungarian sources.

2. Taxable income specified

In general, any income except for pension is taxable notwithstanding its source, unless specifically exempted. There exists a mushrooming and overcomplicated system of exemptions, e.g. governmental social, child and educational supports, housing aids, certain donations, diplomatic and other international related incomes.

The personal income tax law distinguishes between income from dependent and independent services.

The income of entrepreneurs, from selling properties, interest and dividend are taxed differently from regular income.

Family members are taxed separately and file separate tax returns.

Income from certain artistic and other cultural professions is taxed at 11% together with a 4% social security contribution (making it altogether 15%).

3. Tax rates

Tax rate is set as percentage of the taxable income. The general scheme is 18% up to HUF 1,700,000 (apr. €6,800) of annual income and 36% above.

Dividend received is taxed at a 25% rate, except dividend paid in excess of 30% of the equity of the Hungarian dividend payer, in which case the rate is 35%. Dividend paid on securities listed or traded on an established European stock exchange is taxed at 10%.

4. Capital gains

Income from selling securities is taxed at 25%, from other stock exchange transaction at 20%.

5. Loss carry forward

Entrepreneurs may carry forward their losses, however from the third year of operation only upon the permission of the tax authority.

D. Capital

Tax on income from selling movable property is 25%, on interest 20%.

Tax on income from selling real property is 25%, however, according to a time scale, it is reduced up to technically 0% after having the property owned for over 15 years.

Depending on value and grade of relation, gift and inheritance tax, in general, varies between 11-40%, except in case of dwelling property, in which case the gift tax rate is between 5-30%, that of inheritance is between 2,5-21%.

Prizes from the lottery and other similar games are taxed at 25%.

E. Indirect taxes

The implicit tax burden on consumption 10-15 years ago used to be about 150% of the EU average. Since then, however, the implicit tax rates have been gradually lowered to around the EU average.

As 19% of overall budget revenues come from value added taxation (vat), so like in other EU countries, vat is the centrepiece of the tax system. The Hungarian vat system is based on and strictly follows the EU Sixth Directive. The general vat rate has been reduced from 25% to 20% in 2006, however, applicability of preferential rates of 0 and 5% have been simultaneously reduced. Export is free of vat.

Excise tax is levied on petroleum products, alcoholic beverages and tobacco products. On petroleum products the tax is between HUF 90,000 – 111,800 per 1000 litres, on alcohols diverse amounts on spirit, beer and wine measured in alcohol content. Cigarettes are taxed at HUF 7,240 per 1,000 pieces (apr. 60 €cent a pack), other tobacco products between 32,5 – 52%.

F. Other taxes

Transfer tax on purchase of real properties (and certain immovables) is in general 10%, except in case of dwelling properties 2-6%, for real property businesses when buying for re-sale only 2%.

First registration of passenger cars fall under registration tax of between HUF 190,000 – 9,622,000 (apr. €760 – 35,500), that of for motorcycles and trailers is lower.

G. Enforcement

The Hungarian tax authority, APEH, is evidently tough. From the resolution of the first instance tax administration one may apply to the second instance, the resolution of which is already enforceable. The second instance tax resolution may be sued again before county courts and rulings at that level -- which may be expected within a year -- is final with no remedy other than supervision by the Supreme Court, the availability of which is, however, limited. Courts show minimal sympathy to evaders.

Late payment interest is the double of the prime interest rate applied by the National Bank of Hungary. Tax administration fine is 50% of unpaid taxes.

INCOME TAX RATES

Corporations and Partnerships		Individuals	
less than €20,000 income	10%	up to €6,800	18%
general rate	16%	above that	36%
surtax on top of 10/16%	4%		

LIST OF DTC AGREEMENTS

Country	withholding tax rates (%)			
	Interest	Royalties	Dividends	
			individuals, companies	Qualified companies
Albania	0	5	10	5
Australia	10	10	15	15
Austria	0	0	10	10
Belarus	5	5	15	5
Belgium	15	0	10	10
Bosnia-Herzegovina	0	10	10	10
Brazil	10/15	15/25	15	15
Bulgaria	10	10	10	10
Canada	10	0/10	15	5
China (People's Rep.)	10	10	10	10
Croatia	0	0	10	5
Cyprus	10	0	15	5
Czech Republic	0	10	15	5
Denmark	0	0	15	5
Egypt	15	15	20	15
Estonia	10	5/10	15	5
Finland	0	0/5	15	5
France	0	0	15	5
Germany	0	0	15	5
Greece	10	0/10	10	10
India	10	10	10	10
Indonesia	15	15	15	15
Ireland	0	0	15	5
Israel	0	0	15	5
Italy	0	0	10	10

Country	withholding tax rates (%)			
	Interest	Royalties	Dividends	
			individuals, companies	Qualified companies
Japan	10	0/10	10	10
Kazakhstan	10	10	15	5
Korea (Rep.)	0	0	10	5
Kuwait	0	10	0	0
Latvia	10	5/10	10	5
Lithuania	10	5/10	15	5
Luxembourg	0	0	15	5
Macedonia	0	0	15	5
Malaysia	15	15	10	10
Malta	10	10	15	5
Moldova	10	0	15	5
Mongolia	10	5	15	5
Morocco	10	10	12	12
Netherlands	0	0	15	5
Norway	0	0	10	10
Pakistan	15	15	20	15
Philippines	15	10	20	15
Poland	10	10	10	10
Portugal	10	10	15	10
Romania	15	10	15	5
Russia	0	0	10	10
Serbia and Montenegro	10	10	15	5
Singapore	5	5	10	5
Slovak Republic	0	10	15	5
Slovenia	5	5	15	5
South Africa	0	0	15	5
Spain	0	0	15	5
Sweden	0	0	15	5
Switzerland	10	0	10	10
Thailand	10/25	15	20	15
Tunisia	12	12	12	10
Turkey	10	10	15	10
Ukraine	10	5	15	5
United Kingdom	0	0	15	5
United States	0	0	15	5

	withholding tax rates (%)			
Country	Interest	Royalties	Dividends	
			individuals, companies	Qualified companies
Uruguay	15	15	15	15
Vietnam	10	10	10	10