Recent Developments in International Taxation

Hungary

Janos Pasztor

Wolf Theiss, Budapest

janos.pasztor@wolftheiss.com
Corporate income tax

Termination of the Double Tax Convention between the US and Hungary

The US Treasury Department notified Hungary on 8 July 2022 that it was terminating the Double Tax Convention between the US and Hungary (‘DTC’). The provisions of the DTC will not be applicable after 31 December 2023.

From a Hungarian perspective, the treaty termination appears to be mostly detrimental to Hungarian resident private individuals who derive US-source income (certain preferential rules may prove inapplicable due to the mere absence of a DTC). However, it may also have an adverse impact on those Hungarian resident entities, inter alia, the Hungarian domestic rules may not provide complete relief from US source taxation.

From a US perspective, the absence of constraints previously imposed by the DTC on the taxing powers of the contracting parties could primarily affect US resident private individuals, but not entities as long as Hungary maintains its tax policy not to impose source taxation on payments made to legal entities. Nonetheless, the termination of the DTC may also compromise certain tax structures involving Hungary, which may be of concern to US resident entities.

Furthermore, absent the DTC, tax residents of the US or Hungary carrying out activities in any of these two countries in which they are not a resident party may face an increased risk of permanent establishment qualification in Hungary.

Implementation of rules combatting reverse hybrid mismatches

As of 1 January 2022, if a reverse hybrid entity is not deemed a tax resident in Hungary under the general rules but is incorporated or has its seat in Hungary, it will nonetheless qualify as a Hungarian tax resident on condition that either directly or indirectly at least 50 per cent of the voting rights, capital interests or rights to a share of profit in the hybrid entity are held by one or more associated entities resident in a state that considers the Hungarian hybrid entity as a taxpayer for corporate income tax purposes.

Such hybrid entity's income is taxable to the extent it is not otherwise subject to corporate income tax in Hungary or any other jurisdiction.

The above regime implements the provisions of the European Union Anti-Tax Avoidance Directive II (ATAD II).

Introduction of additional scenarios that give rise to a permanent establishment

As of 1 January 2021, new legal provisions dealing with service permanent establishments (PEs) have entered into force. Consequently, the provision of services through a natural person for a duration of at least 183 days in any 12-month period could create a permanent establishment in Hungary.
Also, as of 1 January 2021, a ‘back-up’ rule has been introduced. This provision stipulates that if the activities of a foreign entity are deemed to create a permanent establishment under the Double Tax Convention concluded between the state of its residence and Hungary, this will always result in a permanent establishment under the Hungarian domestic legislation as well.

**More stringent transfer pricing requirements**

A new disclosure requirement on intra-group transactions has to be complied with in corporate income tax returns submitted after 31 December 2022. The details of this novel disclosure requirement remain to be seen as the Minister of Finance is yet to issue the decree specifying them.

It will be obligatory to use the interquartile range starting from the tax year that commences in 2022 if the taxpayer takes into account data stored in a database or otherwise available for a comparable product, service or undertaking when determining the arm's length price.

If the consideration applied in a given intra-group transaction does not fall in the arm's length range, the transfer pricing adjustment should, as a general rule, be undertaken on the basis of the deemed value within the arm's length range. This should also be observed starting from the tax year that commences in 2022.

In addition to the foregoing, starting from the tax year that commences in 2022, it will no longer be possible to undertake either a downward or an upward transfer pricing adjustment where the consideration falls within the arm's length range.

**Amendments to the controlled foreign company regime**

Controlled foreign companies being tax residents of and permanent establishments located in the so-called uncooperative jurisdictions may not avoid being qualified as controlled foreign companies (if the pertaining definition is met). Therefore, they may no longer have recourse to the substance carve out or the exemption applicable to entities with low profits or a low profit margin. Uncooperative jurisdictions are specified in a ministerial decree on the basis of the EU list of non-cooperative jurisdictions, which is published as an annex to conclusions adopted by the Economic and Financial Affairs Council (Ecofin). This EU list considers jurisdictions based on criteria such as tax transparency, harmful tax practices and the status of the implementation of anti-base erosion profit shifting (BEPS) measures.

Dividends or capital gains connected to controlled foreign companies resulting from genuine arrangements will not be subject to corporate income tax. As a result, only the income derived from non-genuine arrangements will be caught by the reattribution rules applicable to controlled foreign companies.
VAT

Implementation of the e-commerce package

Businesses operating electronic interfaces (eg, marketplaces or platforms) facilitating the sale of goods may, under certain circumstances, be deemed to be the suppliers for VAT purposes of sales facilitated by them. This could occur in connection with intra-EU distance sales by businesses not established in the EU or in case of distance sale of low-value goods imported into the EU.

The non-European Union scheme known from the mini one-stop shop for supplies of telecommunications, broadcasting and electronics has been extended to all types of cross-border services to final consumers in the EU. In a similar vein, the EU regime has been extended to all types of cross-border services to final consumers, as well as to intra-EU distance sales of goods and certain domestic supplies facilitated by electronic interfaces.

The VAT exemption for the importation of goods in small consignments with a value of up to EUR 22 has been abolished. However, an import scheme may be applied pursuant to which the distance sales of goods imported into the EU up to a value of EUR 150 may be VAT exempt upon importation. This is conditional upon the seller charging and collecting VAT in line with the destination principle and subsequently declaring as well as paying the VAT to the Member State of identification in a one-stop shop solution.

When the abovementioned import scheme is not applied, it is possible for the customs declarant to collect the VAT from the customers and remit it to the tax authority.

The above amendments were implemented as of 1 July 2021.

Windfall taxes on certain sectors and the re-introduction of the advertisement tax

Windfall taxes

The Hungarian Government introduced windfall taxes and hikes in the tax liability affecting certain sectors where such liabilities concern 2022 and 2023. A common element of these measures is that they target the gross revenue of the taxpayers. Concentrating on international aspects, the highlights are outlined below.

The Hungary-bound cross-border provision of investment services may, under certain circumstances, result in the service provider concerned incurring financial transactions tax. The tax base is the value (purchase price) of the financial instrument credited to the customer's account (securities account). The tax rate is 0.3 per cent but shall not exceed HUF 10,000 (approx. EUR 25) per purchase.

Insurance companies are obliged to pay an extra insurance premium tax for insurance premiums received between 1 July 2022 and 31 December 2023. For insurance premiums received on comprehensive (ie, ‘casco’) property, casualty and liability insurance for cars that are already subject to a regular insurance premium
tax, an additional progressive tax is now payable at variable rates from four per cent to 14 per cent in 2022 and two per cent to seven per cent in 2023.

Insurance premium received on life insurance, capitalisation transactions (insurance savings), management of group pension funds, transactions relating to the length of human life that were not subject to the regular insurance premium tax will be taxed at a progressive rate of two per cent to six per cent in 2022 and one per cent to three per cent in 2023.

A one-off 80 per cent surcharge is payable to be assessed on the basis of the retail tax due for the last tax year that commenced in 2021, or, in absence thereof, for the last tax year that has commenced in 2022. Moreover, the rates of the retail tax have been increased for the tax year commencing in 2023.

**Advertisement tax**

Due to the dispute with the European Commission as regards the advertisement tax having been closed, Hungary will once again start collecting advertisement tax on the basis of the advertisement turnover from 1 January 2023. The tax is currently expected to be imposed at a flat rate of 7.5 per cent.

It has to be highlighted that advertisement tax liability can arise irrespective of the tax residence by undertaking the activities subjected to this tax and under certain circumstances even by commissioning such services (this a sort of secondary, back-up liability resulting from the service provider's non-compliance).

**Innovation contribution**

The branch office or permanent establishment (other than a branch office) for local business tax purposes of a foreign entity is subject to innovation contribution from 26 August 2022. The base of the innovation contribution corresponds to that of the local business tax (ie, the adjusted turnover), while the tax rate is 0.3 per cent.

Tax advance has to be assessed, declared, and paid for 2022 and the first two quarters of 2023 by 20 October 2022.

The innovation contribution is not covered by the double tax conventions concluded by Hungary.