36.
Hungary

Introduction

Hungary became a member of the Organisation for Economic Co-operation and Development (OECD) in May 1996 and of the European Union on 1 May 2004.

Hungary introduced transfer pricing legislation in 1992, in Section 18 of the Corporate and Dividend Tax Act (CDTA). Section 18 of the Hungarian CDTA prescribes the use of the arm's-length principle (referred to as the customary market price) when setting the consideration associated with business contracts between affiliated companies.

Hungary as an OECD member state has acknowledged that the arm's-length principle as defined in Article 9 of the OECD Model Tax Convention is the international transfer pricing standard to be used.

The tools at the disposal of the tax authorities to monitor compliance include notification requirements, documentation and tax audits. In addition to the incremental tax that becomes payable, the costs of non-compliance with transfer pricing rules include tax penalties of 50% of the adjustment as well as interest on late payments of tax.

Statutory rules

On 1 January 2003, a new subsection introducing transfer pricing documentation requirements was added to Section 18 of the CDTA. This provision was followed by more detailed regulations contained in Decree No. 18/2003 of the Ministry of Finance.

On 16 October 2009, Decree No. 22/2009. (X.16) of the Ministry of Finance was published containing the changes of the documentation requirements pertaining to the determination of the arm's-length price (the Decree). The amended Decree came into effect as of 1 January 2010, and is first applicable to the transfer pricing documentations regarding the 2010 tax year.

These regulations require taxpayers to document each related party agreement with respect to the method in which the arm's-length price was determined, by the time the corporate income-tax return is filed. Such documentation needs to be updated for changes in the relevant circumstances that could cause unrelated third parties to renegotiate the pricing terms and conditions.

The penalty for non-compliance with the transfer pricing documentation requirements is detailed in Section 172 (16) Act XCII on the rules of taxation and is a default penalty of forint (HUF) 2 million per transaction per year, which significantly increased for repeated non-compliance to up to 4 million HUF for each register (combined register) in the case of repeated offenses. In the event of any repeat offense concerning the keeping of the same register, a default penalty of up to four times the penalty imposed for the first offense may be imposed upon the taxpayer. The tax authorities have explained that non-compliance includes lack of documentation, 'barely prepared' documentation, or documentation that does not meet the requirements determined in the law and documentations prepared late. The documentation must cover each agreement, and the agreements cannot be consolidated unless the terms of supply or performance are the same under the agreements or their subject matter is closely related.

The basis of imposition of the default penalty is the subject of a continuing controversy on the issue of whether the correct interpretation of the Decree would impose the default penalty in respect of each absence of documentation of each agreement rather than per default identified in a tax audit. The tax authorities have stated they interpret the imposition of a default fine based on the number of agreements for which documentation is not in place, counting each instance as a default.

Content requirements for the transfer pricing documentations regarding the 2010 tax year are regulated by Decree No. 22/2009. As opposed to the provisions of the previous decree, Decree No. 22/2009 allows the preparation of two different types of transfer pricing documentation: a country-specific, or a combined transfer pricing documentation. Taxpayers are required to declare the option they choose in their corporate tax return.

The requirements regarding the country-specific documentation mostly correspond to those set out in Section 4 of Decree No. 18/2003 of the Ministry of Finance (i.e. details of the related parties and inter-company transactions, industry analysis, company and functional analysis, economical and financial analysis). According to the new decree, taxpayers are allowed to prepare a combined transfer pricing documentation that shall consist of two main parts:

- The core documentation.
- The country-specific documentation(s).

The core documentation should contain the following common standard information with regard to each member company resident in any member state of the European Union:

- The general description of business structure.
- The general description of the group in terms of its organizational, legal and operational structure.
- The general denomination of the related parties conducting controlled transactions with EU group members.
- The general description of the controlled transactions, as well as the functions performed and risks assumed.
- Information on the ownership of intangible assets, and on royalties paid and received.
- The description of the transfer pricing policy or system within the group.
- The cost-contribution agreements, transfer pricing resolutions, and court decisions regarding the arm's-length price.
- The date on which the documentation was prepared or amended.

The elements of the country-specific documentation are generally similar in both cases. The country-specific documentation includes relevant data of the related parties involved in the controlled transaction; general description of the taxpayer's business enterprise and business strategy; description of agreements; benchmark analysis; and the description of comparable data.

Other regulations

Simplified documentation

According to Section 6 of Decree No. 22/2009, taxpayers may fulfil their documentation obligation with the preparation of a so called simplified documentation for low value adding services. The simplified documentation should contain the details of the related parties, the subject matter, date, terms and conditions of the underlying agreement, the arm's-length price (i.e. the mark-up between 3% and 7%), and the date when the documentation was prepared.

Low value adding services are defined as low-risk routine services between related parties that are incidental to the taxpayer's main activity (main services), and are not directly related to the recipient's main business activity; and the service represents economic or business value for the recipient. In addition, the following conditions have to be taken into account:

- The value of the transaction included in the contract at an arm's-length price (exclusive of VAT) does not exceed HUF 150 million in the tax year under review, 5% of the service provider's annual net sales revenue or 10% of the recipient's annual operating costs and expenses in the tax year.
- The taxpayer undertakes to determine the arm's-length price using the Cost Plus Method.
- A mark-up between 3% and 7% is applied for the services.
- The low value adding services are not provided to a non-related party, or received from a non-related party, under comparable circumstances in the given tax year or in the preceding two tax years, which would establish that the use of a mark-up between 3% and 7% would result in a non-arm's-length price.

The Decree specifies in Schedule No. 1 what kind of services qualify in particular as low value adding intra-group services: information technology services; real estate activities; professional, scientific, research and technical activities (e.g. accounting services); education services; administrative services; transport, transport agency, cargo handling, warehousing and storage services and some other services.

Exceptions

Taxpayers are not subject to the transfer pricing documentation requirement under the Decree among others:

- To transactions made by a resident taxpayer with its foreign branch or affiliate, if the resident taxpayer makes adjustments in its corporate tax base pursuant to international agreement so that it contains no income that is subject to taxation abroad.
- In connection with related-party transactions if the state tax authority has issued an APA resolution establishing the arm's-length price, for the period of validity of the resolution.

- If the consideration due for goods or services supplied as part of an activity that is incidental to the taxpayer's main activity is recharged in full to a related party.
- In the case of liquid assets transferred without consideration.
- If the value of the transaction included in the contract at an arm's-length price (exclusive of VAT) does not exceed HUF 50 million during the period between the date of the contract and the last day of the tax year. When determining the threshold (irrespective of the fact of consolidation), the aggregate value of the transactions included in the contracts that may be consolidated under this Decree must be taken into consideration.

The requirement for documentation does not apply to individuals, small or micro enterprises (as defined in Section 3, Act XCV of 1999), individuals and transactions conducted on the stock exchange or at an officially set price (however, cases of insider trading, fraudulent attempts to influence exchange rates or applying prices in breach of legal regulations are not exempt).

Legal cases
There has been little in the way of legal cases dealing with transfer pricing in Hungary.

Burden of proof
Since the introduction of transfer pricing documentation requirements, the burden of proof has passed on to the taxpayer. Taxpayers are required to support their related party transactions with specific documentation that has to be in place on the date a corporate income-tax return is filed.

As the documentation rules are clear as to the level of detail and approach required, taxpayers are faced with carrying out a detailed analysis of their related party transactions.

In the event that adequate documentation is in place, it is up to the tax authorities to demonstrate that the method selected, the search criteria and the uncontrolled comparables identified are not applicable. This assumes that the functions are correctly determined and the financial analysis and implementation of related party agreements are correctly disclosed.

Tax audit procedures
The number of transfer pricing audits has increased significantly in the previous years, and this trend is expected to continue in the future. During these audits, the tax authority reviews the formal elements and also the supporting analysis of the inter-company transactions from an arm's-length point of view. Standard tax audits have raised queries regarding the degree of compliance with the related party documentation regulations, with increasing numbers of questions regarding the transfer pricing methodology selection.

Facing budgetary pressures, the government has been under pressure to step up enforcement activities. At the same time, in recent submissions on creating a sustainable investment climate, the government has emphasised that it will also seek to address taxpayers' concerns of transparency in the enforcement of legislation. Regarding penalties, Hungarian tax authorities have been active in publicising that:

- penalties should not be considered to be a one-time payment as an alternative to compliance; and
- taxpayers will now be held to due dates, which previously have not been strictly enforced.

The penalties were introduced to encourage taxpayer compliance with the legislation in the belief that the penalty would never have to be imposed. Non-compliance with the legislation in practice has resulted in the recent public campaign of the tax authorities to educate taxpayers about what is to come.

Revised assessments and the appeals procedure

Almost all Hungarian taxes are levied by self-assessment. In other words, the taxpayer must file the return and make any payment by the due date, without waiting for a formal assessment or payment demand from the tax authorities.

In Hungary, a tax authority audit can be started at any time during the five years following the end of the year in which the return was originally due. The statutory period of limitations for starting a tax audit is, therefore, six calendar years from the year-end date. The tax auditors generally make field visits to the taxpayer's premises lasting several weeks and covering a span of two to five years. Their findings are discussed with the taxpayer and its representatives.

The tax authority will issue minutes on its findings, and the taxpayer has 15 days to file their response to the minutes. The tax authority then issues its first-level resolution. Appeals against the first-level resolution have to be filed within 30 days to a higher authority within the tax administration. A second-level resolution may be issued by the tax authority following the appeal against the first-level resolution. The taxpayer can then submit appeals against the second-level resolution to the relevant court.

Additional tax and penalties

Failure to comply with the Hungarian transfer pricing documentation regulations is subject to a penalty of up to HUF 14 million (approx. USD 63,000) as detailed above.

Adequate and timely documentation should not be underestimated as an indicator of the taxpayer's good faith if transfer prices are queried. Good faith clearly will have a bearing on the resolution of a transfer pricing dispute.

Transfer pricing adjustments (assuming they are in favour of the tax authority) could not only increase the tax liability of the taxpayer but also result in a tax penalty of 50% on any additional tax payable plus interest on late payment of tax at twice the base rate of the National Bank of Hungary. As of 29 August 2012, the base rate of the National Bank of Hungary was 6.75%.

In addition to the above, there is also the risk of double taxation when a 'corresponding adjustment' is not accepted in the other tax jurisdiction involved.

These risks exist for qualifying agreements in any of the years open to scrutiny by the tax authority under the Hungarian statute of limitations, which is five years.

Resources available to the tax authorities

The tax authority set up a central transfer pricing unit in 2006 to carry out transfer pricing-specific audits and assist in local general tax audits when a transfer pricing issue is identified. This unit also works closely with the department of large taxpayers, which looks after the largest taxpayers in Hungary. As of 1 January 2007, the tax authority's directorate of high-importance taxpayers has sole jurisdiction in cases defined by law, as well as in cases involving taxpayers regarded as 'high importance' under separate legislation. It is also responsible for conducting centralised inspections.

According to the Decree No. 4/2012 (II.14.) of the Ministry of National Economics, high-importance taxpayers include credit institutions and insurance companies organised as joint-stock companies and (except for state entities, sole proprietors and private persons defined by the Personal Income Tax Act), taxpayers with tax obligations (i.e. all tax obligations of a company including those collected and payable by the company) of HUF 3,250 million or more, provided that they are not subject to bankruptcy, liquidation, or winding-up proceedings on the last day of the year preceding the tax year.

Use and availability of comparable information

The tax authority has introduced a number of external databases, which it uses to assist in its tax audits. The two major publicly available Hungarian databases are KJK-Kerszőv DVD Céghírek and IM Online, where public financial information can be downloaded on Hungarian companies. The tax authority also uses Bureau van Dijk's AMADEUS database and Bloomberg databases and has developed its own internal database on the basis of the financial information received during tax audits.

Risk transactions or industries

The tax authority has publicly stated that it considers entities that are either loss-making or show an accounting profit of less than 2% of gross revenue as the subject of particular attention in transfer pricing audits.

Advance pricing agreements (APAs)

Hungary adopted legislation regarding advance pricing agreements on 1 January 2007. The Decree No. 38/2006 of the Ministry of Finance details the procedure for making applications for advance pricing agreements. An application form is available at the Hungarian Tax Authority website (http://www.nav.gov.hu).

Procedure

The applications for advance pricing arrangements are lodged with the Tax Authority's Directorate of High Importance Taxpayers and are required to be co-signed by a tax advisor, a tax expert (a registered professional tax specialist in Hungary), a chartered tax consultant or a lawyer.

Fees

The fees are 1% of the arm's-length price determined by the authority with the following limits:

- HUF 500,000 but no more than HUF 5 million for a unilateral APA where traditional methods (CUP), resale price method (RPM), (CPM)) are applied.
- HUF 2 million but no more than HUF 7 million for unilateral APA where profit-based methods (TNMM, profit split method) are applied.

- HUF 3 million for a bilateral APA but no more than HUF 8 million.
- HUF 5 million for a multilateral APA but no more than HUF 10 million.

The application should be accompanied by a copy of the receipt certifying payment of the application fee in full, duly signed by the issuing bank.

If an application for an advance pricing arrangement is dismissed, the tax authority will refund 75% of the application fee to the taxpayer within 15 days of the resolution on the dismissal of the application (usually 30 days after the issue of a resolution).

The application may be requested for three to five years and may be extended (once) or amended for an additional fee of 50% of the fee paid for the original proceeding.

The administrative time limit for these proceedings is 120 days, which may be extended on two occasions by 60 days.

Note: There is an Annex to Decree No. 38/2006 of the Minister of Finance that sets out the details to be included in the advance pricing agreement application.

Notification to the local tax office
All applications for an advance pricing arrangement are automatically notified to the local tax office dealing with the day-to-day tax affairs of the taxpayer.

Appeals
Appeals against the first instance resolution (ruling) must be addressed to the Chairman of the Tax Authority and filed with the Tax Authority's Central Office. If, following an unsuccessful appeal, the resolution (ruling) is not cancelled, amended, corrected, replaced or complemented as requested in the appeal, the decision on the appeal must be prepared and presented to the Chairman by a tax authority unit organisationally independent and separate from the unit that prepared the first instance resolution. This provides some comfort that there will at least be a peer review of unsuccessful appeals.

Bilateral and multilateral procedures
In bilateral and multilateral procedures, the taxpayer will not be involved in the exchange of information or multilateral procedure between the Hungarian Tax Authority and the foreign tax authority or authorities. The Hungarian Tax Authority does, however, have the right to request the applicant to supply, within eight days, any additional information at the applicant's disposal that is considered material for the purposes of assessing the APA application, or for clarifying new facts, data or circumstances, if any, that may emerge in the course of such procedures.

Advance pricing arrangement in practice
The Tax Authority requires information requested in the Decree to be supplied in advance of the submission of the application for advance pricing agreements and it is usual for a preliminary meeting to be held with the Tax Authorities to explain the background of the application and clarify any initial queries that the Tax Authority may have in respect of the information provided. The Hungarian Tax Authorities are in practice generally helpful in ensuring a smooth APA procedure for the taxpayer.

Anticipated developments in law and practice

The Hungarian transfer pricing legislation continues to develop as part of the general harmonisation with the EU legislation and directives and therefore taxpayers can anticipate significant developments in the future both in terms of the quality of the tax audits and legislative background. The last year has already seen an increase in the quality of tax audits and imposition of default penalties where documentation is either incomplete or not available. This is expected to be a continuing trend.

OECD issues

The Decree No 22/2009 of the Minister of Finance on Documentation states that it is based on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and related protocols, which include the OECD Transfer Pricing Documentation Guidelines. Therefore the OECD transfer pricing developments should be seen to play a major part in the development of transfer pricing legislation and practice in Hungary.

Thin capitalisation

Under Paragraph j) in Section 8 (1) of the Hungarian Corporate Tax Act, interest on liabilities in an amount pro-rated to the portion of such liabilities that exceed three times the equity capital results in an increase to the corporate tax base.

For purposes of thin capitalisation, liability means the average daily balance of outstanding loans (with the exception of liabilities due from financial institutions) and outstanding debt securities, while equity capital means the average daily balance of subscribed capital, capital reserve, profit reserve and tied-up reserves.

Note: From 2012 interest free loans received from related parties also have to be taken into account, if the tax base was decreased with the arm's-length interest according to Section 18 of the Act LXXXI of 1996 on Corporate Tax and Dividend Tax.