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GLOBAL TRANSFER PRICING SERVICES

Global Transfer Pricing Review

Hungary

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TAX



Hungary



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The tax authorities are paying special attention to transfer pricing issues. Previously, the mere availability of transfer pricing documentation was sufficient, but recent experience is showing that tax audits are moving towards more in-depth analysis of transactions (questioning qualitative screening, testing comparables, challenging benchmarking studies, examining or excluding loss making comparables in the benchmarking set and functional analysis). In addition, tax authorities are focusing on a comprehensive review of documentation (including contracts, calculations that support the arm's length pricing of transactions and deductibility of costs).

Basic information

Tax authority name

Nemzeti Adó- és Vámhivatal (NAV) – National Tax and Customs Administration of Hungary.

Citation for transfer pricing rules

Act LXXXI of 1996 on Corporate Income Tax and Dividend Tax (CIT):

- Section 4 (23) a–e determines the concept of related parties
- Section 18 (1)-(4) regulates the determination of the arm's length price and the applicable methods
- Section 18 (5) determines transfer pricing documentation requirements for taxpayers. Decree 22/2009 of the Ministry of Finance effective from 1 January 2010 determines the formal requirements for transfer pricing documentation
- Section 18 (6)-(8) special cases (e.g. dividend payment in-kind, capital decrease/increase in-kind etc.) are listed which have to be supported by transfer pricing documentation.

Act XCII of 2003 on Rules of Taxation:

- Section 23 (4) (b) notification of related parties (both the start and the cessation of relationship)

- Section 172 (16) default penalty
- Section 132/B-C Advance Pricing Agreement (APA)
- Section 178.17 definition of the related parties.

Act CXXVII of 2007 on VAT:

- Section 67 determination of VAT base provided the consideration is not considered as arm's length
- Section 255 determination of arm's length principle regarding VAT
- MF Decree 18/2003 detailed regulation of transfer pricing documentation (replaced by MF Decree 22/2009 effective from 1 January 2010)
- MF Decree 22/2009 detailed regulation of transfer pricing documentation
- MF Decree 38/2008 detailed regulation on APA procedures.

Effective date of transfer pricing rules

The new Decree (MF Decree 22/2009) on detailed regulation of transfer pricing documentation was effective from 1 January 2010 and is generally applicable for the 2010 financial year. However, if a company wished, the new regulations

could be also applied for the fulfillment of the obligations in connection with financial year 2009. From 1 January 2011, Section 18 of the CIT incorporated profit split and transactional net margin method (TNMM) as equivalent approaches with traditional transactional methods. However, note that this modification is only applied on business years starting in 2011 and onwards.

As of 1 January 2012 certain sections of 22/2009 MF Decree changed. These modifications aimed to decrease the administrative burden on taxpayers. However, note that the understanding of the new regulation is still uncertain due to possible differences in the interpretation of the wording of the new sections. Further clarification was published in 2013.

As of 21 June 2013 a new modification of the MF Decree 22/2009 was released. The purpose of the Decree was to decrease the administrative burden on taxpayers – which was the aim of the previous change as well – and also to clarify some vague provisions of the former regulation.

For 2009 and prior financial years, transfer pricing obligations were regulated by the 18/2003 MF Decree.

What is the relationship threshold for transfer pricing rules to apply between parties?

Direct or indirect ownership with greater than 50 percent voting power, or the existence of majority control. Majority control means when any party has the right to appoint or dismiss the majority of executive officers and supervisory board members.

What is the statute of limitations on assessment of transfer pricing adjustments?

Five years after the last day of the calendar year in which taxes should have been declared or reported, or paid in the absence of a tax return or declaration.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes.

What types of transfer pricing information must be disclosed?

A company should declare in the tax return that the transfer pricing documentation has been prepared in line with the European documentation standards.

What are the consequences of failure to prepare or submit disclosures?

If the taxpayer does not prepare its transfer pricing documentation before the statutory deadline, a default penalty can be imposed.

Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

Yes. For certain intra-group transactions. However, there are different transfer pricing documentation requirements (e.g. simplified, standalone, consolidated, European transfer pricing documentation).

The exemptions are, briefly, as follows:

- to date, a taxpayer has been exempt from transfer pricing document preparation liability in the case of agreements concluded with private individuals and being a small or medium sized enterprise
- effective 1 January 2012, the exemption rules were extended. Accordingly, taxpayers are not liable to prepare transfer pricing documents:
 - for transactions covered by an APA
 - for cost recharges originally invoiced by third (independent) parties
 - for cash gifts
 - for transactions performed between the taxpayer's foreign branch office and related parties (where the exemption method might apply in order to avoid double taxation under the double taxation arrangement between the relevant country and Hungary)
 - for any transactions where the accumulated value does not exceed 50 million Hungarian forints (HUF) (175,000 Euros (EUR)), in the tax year (as of 21 June 2013).

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

The benefit of preparing a transfer pricing study is that the taxpayer shifts the burden of proof to the tax authorities.

Otherwise, the preparation of transfer pricing documentation is obligatory based on the relevant Hungarian regulations. If a company fails to prepare its documentation or the documentation prepared is incomplete, it will be subject to a default penalty of up to HUF2 million (approximately EUR7,000 per missing documentation per year.

Where a taxpayer repeatedly fails to comply with the transfer pricing documentation obligation, the upper cap of the default penalty can be doubled. In the case of repeated transgressions, four times the general penalty might be applicable. The upper cap of the default penalty can reach HUF8 million

(approximately EUR28,000) per missing or incomplete documentation per business year.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

The transfer pricing documentation should be prepared for every financial year. The deadline is the submission date of the corporate tax return. However, this date must not be later than the 150th day after the end of the financial year. If the tax authorities request the documentation during an audit of the company, it must be presented within 3 days of the request.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes. However, it should be noted that Chapter V is not directly applicable, rather only through the 22/2009 MF Decree on detailed regulation of transfer pricing, which is based on the OECD Guidelines, including Chapter V.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?

Yes.

Is there a priority among the acceptable methods?

Up to 31 December 2010, the traditional methods (comparable uncontrolled price (CUP) method, resale price method (RPM), cost plus method (CPLM)) were preferred. Basically, the traditional methods should have been applied, but if these methods were not applicable, then other methods could have been used.

While the traditional transaction methods are still preferred by the tax authorities, according to the modification of Section

(18) of CIT, effective from 1 January 2011, the TNMM and profit split method should be treated equally with the traditional transaction methods.

If there is no priority of methods, is there a “best method” rule?

In line with the above the OECD “most appropriate method” rule is generally applied, however, it is not laid down by the law.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer’s transfer pricing documentation, how long does the taxpayer have to submit its documentation?

Normal practice is to expect documentation within 3 days of request.

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

After unsuccessful exhaustion of administrative procedures, a company is entitled to bring the matter before the competent court.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

If the applied price is not in line with arm’s length prices, the adjustment will have an effect on the amount of tax payable. Accordingly, a default penalty of 50 percent and a late payment penalty interest might be levied on the basis of the tax arrears due to such adjustments.

To what extent are transfer pricing penalties enforced?

Unknown.

What defences are available with respect to penalties?

Default penalties can only be avoided by complying with transfer pricing requirements.

What trends are being observed currently?

More and more attention is being paid to the transfer pricing requirements during tax audits, and tax authority inspectors are being trained accordingly. Although special industry focus or transaction focus has not yet been observed, management fees and royalties are usually inspected thoroughly, as well as benchmarking studies (the screening steps, geographical selection, qualitative screening, and loss making comparables in the benchmarking set, etc.)

Special considerations

Are secret comparables used by tax authorities?

Generally no.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Yes. The tax authorities prefer local comparables. Where existing local comparables are left out of the benchmarking set, the tax authorities may challenge the benchmarking study prepared by the taxpayer and perform its own search.

Do tax authorities have requirements or preferences regarding databases for comparables?

Databases used by the taxpayer are obliged to be publicly available or verifiable by the tax authorities. The preferred database is Amadeus, published by BvD, but not required.

What level of interaction do tax authorities have with customs authorities?

Medium, but cooperation is increasing due to the merger of the National Tax and Customs Administrations in 2011.

Are management fees deductible?

In principle. Yes, but only if it can be supported that the management fees incurred are in the interest of the company.

Are management fees subject to withholding?

No.

Are year-end transfer pricing adjustments permitted?

Year-end adjustments are permitted, but they should be sufficiently justified by the taxpayer as to economic necessity (e.g. in order to achieve a targeted level of profitability in line with the functional profile of the taxpayer etc.) i.e. their business nature should be defensible. Where the tax authorities do not recognize such adjustments – true-ups – as costs that arose in the business interest of the taxpayer, its tax base might be increased with the amount of the true-ups and taxed accordingly.

In certain cases, such adjustments might also entail VAT or local business tax issues (e.g. if the adjustments are directly related to transactions subject to VAT, the costs of goods sold or services intermediated are adjusted etc.).

Year-end adjustments are generally recordable in the financial statements, pursuant to Hungarian generally accepted accounting principles (GAAP), i.e. no special treatments are required.

Other unique attributes?

Effective from 1 January 2012, in the case of certain low value-added services (as defined by the 22/2009 MF Decree e.g. IT services, translation, interpreting, accounting and legal activities, language education, administrative services, storage, canteen service, etc.) special rules were introduced in order to ease the associated burden to prepare transfer pricing documentation. This rule was further modified as of 21 June 2013.

According to the new rules on simplified documentation applicable for these services, if the service provider applies a margin between 3 and 10 percent, the price applied is qualified as an arm’s length price without any further analysis or benchmark study. Accordingly, the transfer pricing documentation can be prepared with limited content. However,

the condition for applying the new rule is that the arm's length price of the service needs to be assessed by means of the cost-plus method.

Please note that, pursuant to the MF Decree, there are a limited number of conditions that if not met, can result in the simplified documentation being rejected. First, if the margin applied falls outside the previously mentioned range of 3 and 10 percent or the pricing method of cost-plus 3 and 10 percent does not reflect the arm's length price, the taxpayer is not entitled to apply the simplified documentation. Furthermore, the net value of the services, taking into consideration all transactions which can be consolidated in one document, cannot exceed HUF150 million (EUR526,000), 5 percent of the seller's net sales revenue and 10 percent of the operation costs of the purchaser in the tax year.

However, note that the understanding of the new regulation is currently uncertain due to possible differences in the interpretation of the wording of the new sections.

Other recent developments

None.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Extensive.

If extensive, is the competent authority effective in obtaining double tax relief?

In the case of transfer pricing issues, it is not usually effective.

When may a taxpayer submit an adjustment to competent authority?

The taxpayers are entitled to submit an adjustment to the tax authorities, as competent authority, at any time. However, we would note that such claims made directly to the tax authorities are very rare in the Hungarian market.

May a taxpayer go to competent authority before paying tax?

Yes. The possibility to file an APA exists.

Advance pricing agreements

What APA options are available, if any?

Advance rulings and APAs have been available since 1 January 2007 (unilateral, bilateral and multilateral). Completion of an APA can help mitigate transfer pricing-related risks arising from price setting. Note, effective from 1 January 2012, the taxpayer is not obligated to prepare transfer pricing documentation covering a transaction supported by an APA. This rule was further amended effective from 21 June 2013 clarifying that the exception applies from the year in which the application is submitted up to the last day of the tax year in which the decision ceases to be valid.

Is there a filing fee for APAs?

Yes. The filing fee depends on the type of APA (unilateral, bilateral, or multilateral procedure) and on the type of applicable approach (transfer pricing methods).

- for unilateral procedures with traditional methods (i.e. CUP method, RPM and CPLM), the fee payable is from HUF500,000 (approximately EUR1,700) to HUF5 million (approximately EUR17,500)
- for unilateral procedures with other methods, the fee payable is from HUF2 million (EUR7,000) to HUF7 million (approximately EUR24,500)
- for bilateral procedures the fee payable is from HUF3 million (approximately EUR10,500) to HUF8 million (approximately EUR28,000)
- for multilateral procedures the fee payable is HUF5 million (approximately EUR17,500) to HUF10million (approximately EUR35,000).

If the exact arm's length price could not be established or the subject of the agreement is only the methodology, the filing fee is the minimum amount of the fee ranges shown above.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

No.

Please provide some information on how successful the APA program is and whether there are any known difficulties?

Unilateral APAs are quite common now due to the 2009 decrease in procedure fees. Contemporaneously bilateral APAs, nontraditional approaches or more complex cases may cause difficulties for the tax authorities. Based on general experience, an APA procedure might be time consuming (depending on the type of the APA, the complexity of the intra- group transaction as well as the capacity of the tax authorities).

Language

In which language or languages can documentation be filed?

The documentation needs to be prepared in Hungarian for financial years 2008 and before. Effective 1 January 2010 (applicable retroactively for financial year 2009 as well) the documentation may be prepared in a language other than Hungarian. However, it should be made available in Hungarian within a defined period of time upon request of the tax authority.

In the case of tax investigations carried out by the tax authorities after 1 January 2012, where documentation is prepared in English, German or French (besides Hungarian), translation cannot be requested by the tax authorities.

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