**TAXES IN HUNGARY**

**SHORT SUMMARY**

**(effective as of 2008)**

**A - TAXATION OF COMPANIES**

**CORPORATE INCOME TAX**

Corporate profits are subject to corporate income tax. Dividends paid to corporate shareholders are exempt from any further taxation.

***1. Taxable persons***

Resident taxpayers for corporate income tax purposes include:

        entities incorporated under Hungarian law, e.g. corporate entities created under the Company Law, i.e. joint-stock companies (Rt.), limited liability companies (Kft.), joint ventures (Kv.), general partnerships (Kkt.) and limited partnerships (Bt.);

        foreign entities that have their place of management in Hungary.

There is no group taxation under Hungarian law.

In general, the tax year is the calendar year. Under the accounting law, however, taxpayers may, in certain circumstances, elect a financial year which is different from the calendar year.

***2. Taxable income***

Resident companies are taxed on their worldwide income. The taxable base is computed from the accounting profits by adjusting them for prescribed items.

There is a general anti-avoidance rule which allows the tax authorities to ignore the legal form of an arrangement between entities and to look to the actual substance or genuine purpose of a contract or transaction. Under an additional general anti-avoidance provision, costs, expenditures and losses related to a transaction are not deductible for corporate income tax purposes if the purpose of the transaction was merely to achieve tax advantage.

As from 1 July 2007 the taxation on a minimum income/tax base is applicable: if the higher amount of the pre-tax result or the taxable base is lower than 2% of the total revenue [less e.g. the purchase cost of goods sold and the value of (intermediated) services sold], the taxpayers must

        pay tax on the basis of 2% of the total revenue (adjusted), or

        submit a special declaration to the tax authority.

*2.1. Exempt income*

The significant items of exempt income include domestic and foreign dividends, as well as 50% of royalties, subject to limitations.

*2.2. Deductions*

In general, all expenses directly related to the operation of a business are deductible.

The following expenses are, especially, not deductible for tax purposes: fines, penalties and interest for late payment of taxes; the book value of assets transferred for no consideration, or services provided for free, subject to exceptions.

*2.3. Valuation of inventory*

No special valuation rules for inventory apply for tax purposes.

*2.4. Depreciation and amortization*

For tax purposes, the depreciable base is generally the total acquisition or production cost.

*2.5. Reserves and provisions*

The amount allocated from retained earnings to reserves created for future development is considered as accelerated depreciation and is thus deductible in one sum. The taxpayer may only release such reserves consistently with the cost of the developments carried out in the 4 years following the tax year in which the reserve was created. This accelerated depreciation deduction may not exceed the lower of the 50% of the before-tax result or HUF 500 million per year.

No provision can be set up for doubtful debts. Devaluation expenses of debt claims, the value of which has decreased permanently and substantially, are not deductible for tax purposes. Actual bad debts are, however, deductible.

Different rules apply for banks.

*2.6. Capital gains*

Capital gains are generally included in the company's total ordinary income. However, 50% of capital gains on transactions on a regulated stock exchange by a company other than an insurance or financial institution are exempt, subject to limitations.

*2.7. Losses*

Losses incurred in tax year 2004 or later years may be carried forward at the taxpayer's election indefinitely (this rule does not apply to financial institutions). Losses incurred after the fourth year of the business activity may, however, be carried forward only with the express permission of the tax authorities if, in the year in question, the pre-tax result is negative and the taxpayer has not generated turnover equal to at least 50% of incurred expenses, or if it incurred losses in the preceding 2 years.

*2.8. Dividends*

In general, when determining the corporate income tax base of Hungarian companies, the dividend income is not taxable. However, dividends received from foreign controlled corporations are not deductible.

Distributions made by a resident company to another resident or non-resident company are exempt from withholding tax and corporate income tax in the hands of the shareholder, regardless of the size of the holding.

*2.9. Transfer pricing*

Transfer pricing rules are generally based on OECD guidelines. The transfer pricing provisions state that transactions between related parties must be at arm's length. If the price used between related parties is lower or higher than the arm's length price, the taxpayer is required to:

        decrease its taxable income with the difference, provided that:

     its taxable income is higher than it would have been when using the arm's length price;

     the relevant related party is a Hungarian resident or a non-resident (except CFC) which is subject to corporate income tax in its country of residence; and

     the taxpayer is in the possession of a document signed by the other party stating the amount of difference; or

        increase its taxable income with the difference, provided that its taxable income is lower than it would have been when using an arm's length price.

The above transfer pricing rules do not apply to long-term contracts that are concluded by small and medium-sized enterprises with a related party established for the purpose of joint acquisition or sale, provided that the total voting rights of the small and medium-sized enterprises in the related party exceed 50%.

*2.10. Controlled foreign company*

Dividends received from a controlled foreign company (CFC) are included in the taxable base of a resident corporate taxpayer (dividends are normally excluded). In addition, items booked as expenses relating to the devaluation of the participation in a CFC or as losses incurred from the withdrawal of such participation, are added back to the taxable income of the resident company to the extent to which they exceed the income from the participation. Payments to CFCs are generally not deductible, unless the taxpayer proves that they are directly related to the operation of its business.

A controlled foreign company is defined as a foreign person or its permanent establishment abroad, in which the taxpayer or the taxpayer's associated company has a participation and whose legal seat or permanent establishment is located in or which is registered as a resident in a country that does not impose corporate income tax on its income or in which the effective corporate income tax burden is less than 10.67% (two thirds of the Hungarian corporate income tax rate of 16%). This provision does not apply if the foreign person’s legal seat or permanent establishment is located in or the foreign person is registered as a resident in any member state of the European Union or the OECD or in a state having double taxation treaty with Hungary.

***3. Rates***

The corporate income tax rate is 16%. If certain conditions are fulfilled, a rate of 10% is applicable to the part of the tax base which does not exceed HUF 50 million, while any excess profits are taxable at the 16% rate. For this progressive scale to be applied, the taxpayer cannot make use of any tax incentives, it must employ at least one employee in the tax year, it has to pay social security contributions with respect to each of its employees in an amount which equals at least 2 times the contributions payable on the minimum wage, it has to pay corporate income tax at least on the basis of minimum income/tax base and it must fulfil legal requirements related to the employment. The tax benefit from the use of preferential 10% rate must be used for investments or employment.

***4. Tax incentives***

*4.1. Tax credit for the promotion of development*

The taxpayers may avail themselves of tax credit incentives for qualifying investments that will be realized in the framework of a development programme. Qualifying investments include, e.g.:

(1)   investments with a present value of at least HUF 3 billion;

(2)   investments in a priority municipality with a present value of at least HUF 1 billion;

(3)   investments in broadband internet services with a present value of at least HUF 100 million;

(4)   investments serving the production of films or videos with a present value of at least HUF 100 million; and

(5)   investments for the creation of work places.

The investments in (1) and (2) must also satisfy further requirements.

*4.2. Employment incentives*

For every apprentice, a company may deduct (i) 24% of the effective minimum wage if the apprentice is contracted for vocational training under specific conditions determined by law, and (ii) 12% of the effective minimum wage if the apprentice's vocational training is based on a cooperation agreement with his school.

Companies with less than 20 employees may deduct 100% of the wages paid to employees who are at least 50% disabled, up to the effective minimum wage.

***5. Double taxation relief***

Double taxation relief may be obtained either unilaterally or under a tax treaty. Unilateral relief is granted for taxes paid or payable abroad by way of an ordinary tax credit. The amount of credit is calculated separately for each item of foreign-source income. It is limited to 90% of the foreign tax and may not exceed the Hungarian tax on the same income.

If a treaty is applicable, double taxation relief is granted in accordance with the treaty. The relief is normally granted as an ordinary tax credit.

***6. Treatment of non-residents***

Non-residents carrying on a business through a permanent establishment (known as “foreign entrepreneurs” in Hungary) are taxed on income derived through the permanent establishment.

Two forms of permanent establishment are distinguished for tax purposes, i.e. the branch and the “standard” permanent establishment. The branch is an organizational unit of a non-resident entity that has economic independence but no separate legal personality and is registered in the commercial register. The definition of the “standard” permanent establishment (i.e. a permanent establishment other than a branch) broadly follows the definition contained in the OECD Model Convention. However, a building site or construction project constitutes a permanent establishment after 3 months.

The taxable income of a permanent establishment is calculated according to the rules applicable to resident companies as if the permanent establishment were an independent business entity. Additionally, the taxable base of the permanent establishment must be adjusted so that the proportional part of the aggregate management and administrative expenses of the non-resident company are deducted, instead of those accounted for by the permanent establishment as an expense in calculating the pre-tax results, and that 5% of the profits derived through the permanent establishment but not accounted for by the permanent establishment are included.

Permanent establishments are taxed at the general corporate income tax rate. They are also entitled to tax incentives.

Non-resident companies without a permanent establishment in Hungary are not subject to tax on any item of their Hungarian-source income.

***7. Administration (tax returns and assessment, payment of tax)***

Annual corporate income tax returns for a tax year must be filed by 31 May of the following year. Taxpayers who apply a financial year other than a calendar year must file an income tax return by the 150th day from the last day of their tax year.

Corporate income tax is assessed in the form of self-assessment by the taxpayer.

**OTHER TAXES ON INCOME**

Corporations are obliged to pay surtax on the basis of (adjusted) pre-tax profit. This tax is levied at a rate of 4%.

**TAXES ON CAPITAL**

There is no net worth tax.

Dwellings (residential and holiday houses) the value of which exceeds HUF 100 million are subject to a luxury tax. The municipalities are entitled to the revenue from this tax and they are responsible for its collection. The luxury tax is imposed on dwellings which are owned by corporations or on which a corporation has property rights. The tax base is the value of the dwelling calculated pursuant to the detailed rules set out in the law. The tax is levied at an annual rate of 0.5% on the part of the calculated value which exceeds HUF 100 million. Other local taxes paid with respect to the dwelling may be deducted from the luxury tax.

Immovable property situated in Hungary may be subject to two annual municipal real estate taxes: (1) building tax and (2) land tax. The owner is the taxable person. The building tax is either a maximum of HUF 1083.2 per year per square metre or a maximum of 3% per year of the market value of the building. The land tax is either a maximum of HUF 240.7 per year per square metre or a maximum of 3% per year of the market value of the land. These taxes are deductible for corporate income tax purposes.

**B - TAXATION OF INDIVIDUALS**

**PERSONAL INCOME TAX**

***1. Taxable persons***

Resident individuals are taxed on their worldwide income.

The tax year is the calendar year.

***2. Taxable income***

Individuals are subject to income tax on all items of income, unless expressly exempt. The individual income tax law distinguishes the following categories of income:

        aggregate income, including income from dependent personal services, income from independent personal services and other aggregate income;

        entrepreneurial income;

        capital gains on movable and immovable property;

        income from capital, including dividends, interest and capital gains on securities;

        benefits in kind;

        income from the receipt of securities, options and similar rights; and

        miscellaneous income (e.g. small receipts and rental income from immovable property).

Aggregate income is taxed at progressive rates. Income from other categories is taxed separately at flat rates.

*2.1. Exempt income*

The following are the most significant types of exempt income:

        certain child allowances paid by the state;

        scholarships granted by non-residents to (resident) students and researchers studying or working abroad;

        certain subsidies for the acquisition of dwellings; and

        insurance payments and damages, subject to conditions.

*2.2. Income from dependent personal services*

Income from dependent personal services includes, in particular, payments in respect of employment, the personal services of a member of a company (provided the payment was accounted for as an expense by the company), activities carried out by members of Parliament and representatives of local governments.

Income from dependent personal services includes all items of income received by an individual with regard to his dependent personal services or the underlying legal relationship, especially salary, bonuses, reimbursement of costs and taxable premiums for an insurance policy concluded for the employee's benefit. Expenses are, in general, not deductible.

*2.3. Benefits in kind*

Benefits in kind are determined by an exhaustive list that includes promotional business gifts and services, products and services provided to all employees (or to a group of employees as provided by the-employer's regulations) under the same conditions for free or against a low price, dining and other services provided in connection with a business trip, the free or beneficial use of sport facilities or personal transportation services, the private use of public transport tickets provided for free or at a beneficial rate by the employer, premiums of an insurance policy concluded by an employer for a specific group of employees and the private use of company cars.

The benefits included in the list are taxed separately at a fiat rate of 54%. The tax is payable by the provider of the benefits, e.g. the employer. The taxable value of benefits in kind is the usual market price less any amount paid by the recipient.

2.3.1. Low-interest loans

The benefit of an interest-free or low-interest loan provided by an employer is taxable as employment income. If, however, the provision of such loan is not related to an employment, the benefit so derived is subject to tax at a fiat rate of 44%. The taxable value of a benefit from an interest-free or low-interest loan is computed as the difference between the prime rate of the Hungarian National Bank increased by 5 percentage points and the rate actually charged.

2.3.2. Stocks and options

If a company grants stocks to its employees, no taxable benefit is included in the employee's income, if e.g. the stocks were granted under a recognized employees' stock programme registered with the Ministry of Finance.

*2.4. Pension income*

Pension is fully exempt from income tax as long as no extra income earning activity is performed besides, however, as soon as this happens, the income thus generated will be taxable together with the pension and the tax calculated on the pension is deductible. The term “pension” generally encompasses:

        pensions provided on the basis of statutory provisions;

        pensions provided by a private pension fund;

        items of income characterized as pension under the provisions of a tax treaty and, unless a treaty applies, similar payments from a foreign organization.

*2.5. Business and professional income*

2.5.1. Business income

In general, business income is included in the aggregate income as income from independent personal services, unless it falls under the entrepreneurial income category, which is taxed separately. Individuals carrying on independent personal services include original agricultural producers, lessors, elected auditors and members of companies providing supplementary services to the company under a separate contract (provided that the company does not deduct the payments as expenses).

Entrepreneurs are subject to a special entrepreneurial income tax and entrepreneurial dividend tax. Under certain conditions, an entrepreneur may opt for lump-sum taxation. Capital that is withdrawn in order to pay an entrepreneur for his personal services performed for the business is regarded as income from independent personal services and is included in aggregate income.

Taxable entrepreneurial income is calculated as the difference between gross income and related expenses. Expenses also include payments made to compensate the entrepreneur for his personal work. Income may be further reduced by several items. As from 1 July 2007 the taxation on a minimum income/tax base (similar to that effective in the corporate income tax) is applicable to self-entrepreneurs.

The depreciation rules are similar to those applicable to companies.

From 1 January 2004, entrepreneurs may carry losses forward indefinitely. Losses incurred after the fourth year of business activity may, however, be carried forward only with the express permission of the tax authorities if, in the year in question, the taxpayer has not generated turnover equal to at least 50% of incurred expenses, or if he has incurred losses in the preceding 2 years.

The entrepreneurial income tax is levied at a rate of 16% on entrepreneurial income. Under certain conditions, the income up to HUF 50 million is taxed at a rate of 10%, while any excess is taxed at 16%.

The entrepreneurial dividend tax is levied on entrepreneurial income after accounting for entrepreneurial income tax and adjusted for entrepreneurial dividend tax purposes. The tax is levied at a rate of 25% on 30% of the amount withdrawn from capital for personal work, the remaining part of the entrepreneurial dividend tax base is taxed at a rate of 35%.

An entrepreneur who opts for lump-sum taxation is taxed on gross income less a notional deduction for expenses, which varies between 40% and 93% depending on the type of activity. The tax is levied at the progressive rates.

2.5.2. Professional income

In general, professional income qualifies as income from independent personal services. The scope of this concept is, however, narrow because professionals such as lawyers, notaries, private legal executors and individuals providing social and pharmacological services are treated as entrepreneurs.

As a rule, income from independent personal services is calculated as the difference between gross income and deductible expenses. The taxpayer may, however, elect to deduct a lump sum equal to 10% of gross income instead of actual expenses.

*2.6. Investment income, capital gains*

Dividends are taxed separately by way of withholding at different rates. In the case of dividends distributed by resident companies, tax is levied at a rate of 25% on the amount of dividends that does not exceed 30% of the value of the equity's portion that is attributable to the individual's shareholding/participation, and at a rate of 35% on the amount of dividends that exceeds that amount. Income characterized as a dividend under foreign law is considered a foreign dividend and is subject to tax in Hungary at a rate of 25%. If a company registered at the exchange market is paying dividends, those incomes are taxable at a rate of 10%. Any withholding tax paid abroad is credited against the Hungarian tax liability, but the remaining tax liability so calculated may not be less than 5% of the gross dividends, unless a treaty provides otherwise.

Interest income is subject to tax at a rate of 20%. The definition of interest income includes e.g. interest from savings deposits, interest on publicly issued and traded securities representing debt claims, interest on publicly issued investment fund certificates.

Royalties are generally taxed as income from independent personal services. Rental income derived from immovable property is subject to tax at a 25% rate.

In general, capital gains on immovable property and rights thereon are taxed separately at a 25% rate. After the property other than dwelling has been owned for 6 years, the taxable base is reduced by an initial 10%, followed by a further 10% reduction for every additional year, resulting in an exemption after the property has been owned for 15 years. As regards dwellings, the taxable base can be reduced more progressively, resulting in an exemption after the dwelling has been owned for 5 years.

Gains on securities are taxed separately at a 25% rate, unless they qualify as interest or other specific type of income. The taxable gain is the sales proceeds, less documented expenses, including the acquisition cost and transaction costs. Gains from any transaction concluded in the exchange market are generally taxed separately at a 20% rate.

In general, capital gains on private movable property are taxed separately at a 25% rate. Capital gains on the withdrawal of business property (e.g. liquidation surplus) from a company are also taxed separately at a 25% rate.

Dividends, interest and capital gains derived from a company or other institution the seat of which is located in a state having a low tax rate, constitute aggregate income. Low-rate-state is defined as a country, other than a country with which Hungary has concluded a tax treaty that does not impose corporate tax or where the applicable tax rate is not higher than 12%.

***3. Rates***

From 1 January 2007, the aggregate annual taxable income is subject to income tax at a rate of 18% on the first HUF 1.7 million and at a rate of 36% on any excess.

***4. Double taxation relief***

Relief from double taxation of foreign income may be obtained either unilaterally (in the absence of a tax treaty) or under a tax treaty.

Unilateral relief takes the form of a tax credit and is available for income and withholding taxes levied abroad on foreign-source income that is included in the aggregate income or in the entrepreneurial income. In both cases, the tax credit is limited to 90% of the foreign tax and may not exceed the Hungarian tax on the aggregate income/entrepreneurial income that pertains to the foreign income. Similarly, a foreign tax credit is also available to entrepreneurs applying the entrepreneurial lump-sum taxation system.

The provisions of a tax treaty prevail over domestic law. For income derived from treaty countries, double taxation relief is granted according to the treaty provisions.

***5. Administration (tax returns and assessment, payment of tax)***

Income tax is generally collected by way of self-assessment. Individual taxpayers other than entrepreneurs may, however, request the tax authorities to assess their annual taxable income and tax due.

Employers are required to withhold tax from salaries and other payments to employees on the basis of the progressive rates on aggregate income. In general, advance income tax payments must be made by an individual if he derives income falling under the aggregate income category, unless the paying agent is required to withhold the tax. With respect to income falling under other categories, the tax must generally be withheld at the applicable flat rate.

Income tax returns for a tax year must generally be filed by 20 May of the following year.

**OTHER TAXES ON INCOME**

Private entrepreneurs are obliged to pay surtax on the basis of business income (the positive difference of business revenues and related costs). This tax is levied at a rate of 4%.

In addition, private persons with an annual aggregate income of more than HUF 7 137 000 must pay surtax. The tax base is the portion of the income over HUF 7 137 000. The tax rate is 4%.

**TAXES ON CAPITAL**

There is no net wealth tax.

As for the real estate taxes and the luxury tax, the same rules apply as for companies.

Immovable property located abroad is not subject to real estate taxes in Hungary. Non-residents are subject to real estate taxes and the luxury tax in respect of property located in Hungary.