

# The regulation and problematic issues of Hungarian transfer pricing

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# Content

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1. Legal regulation generally
2. Definition of the associated person
3. Obligations and rights of tax-payers related to transfer pricing
4. Penalties
5. Problematic issues and audit experience of the tax authority

# 1.1. Transfer pricing rules in Hungary

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*As of January 1, 2018, a new three-level transfer pricing system was introduced in Hungary, in line with the international legal environment.*

*Affiliated corporate taxpayers concerned are required to apply transfer pricing rules based on stricter regulations with greater international visibility.*

*In terms of control, the tax authority can revise the taxpayer concerned with digitalised selection and control system and high efficiency.*

*Today, in Hungary, the value of the fines imposed on the transfer price is considerably higher than the value of the fines imposed on the VAT. The focus of the revision is the transfer price!*

# 1.2. Laws and regulations

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- Act XXXVII of 2013 on Certain Rules for International Administrative Cooperation in Tax and Other Public Duties (for CbCR)
- Guideline 32/2017 on the obligation to keep records of standard market prices. (X. 18.) NGM Decree, which replaces the former 22./2009. Ministry of Finance decree (for market price guideline)
- Act LXXXI of 1996 on Corporate Tax and Dividend Tax. Act (from now on: Corporate Tax Act)
- Double Taxation Conventions
- 2006 XXXVI Act concerning the elimination of double taxation in connection with the adjustment of profits of affiliated undertakings

***PROBLEM: TOO MANY SOURCES OF RELATED INFORMATION***

# 1.3. Legal regulation generally

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The Hungarian regulations are adapted to the OECD guidelines.

The regulation is applicable from the 2018 tax year provided for a new set of rules regarding the obligation to documentation

Three level liabilities for taxpayers:

- Declaration and reporting
- tax base correction
- documentation

The former two-level documentation obligation has become three-level or has remained two-level if a given condition is met

Three-level documentation

- CbCR
- Master File
- Local File

# 1.4. Current regulations

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- Previously, it was possible to create a joint documentation
- Since 2018 „Paradigm shift”
  - much more detailed data content and complex analysis is required (the transfer pricing rules are based on the principles laid down in the OECD Transfer Pricing Guidelines)
  - The Master File must be prepared for the level of the company group
  - **PROBLEM: HUNGARIAN MEMBERS DO NOT KNOW THE WHOLE NETWORK, LACK OF INFORMATION**
  - 1-year delay of creating Master File is acceptable for companies, where the ultimate parent company’s country do not require this obligation.
  - **PROBLEM: REFERRING TO THIS, THEY DO NOT PREPARE THE MASTER FILE**
- Deadline of preparation of documents: the day of corporate tax declaration submission or at least 31. May.

# 1.5. CbCR – Hungarian characteristics

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- Act XXXVII of 2013 on Certain Rules for International Administrative Cooperation in Tax and Other Public Duties.
- The superior parent company is the reporting agent and must submit the report.
- Hungarian characteristics
  - Due to the peculiarities of the Hungarian economic sphere (in most cases foreign affiliates are present) few companies are obliged to submit the report in Hungary (i.e. MOL Plc.)
- **PROBLEMS**
  - **HUNGARIAN SUBSIDIARIES COULD NOT FIND OUT WHAT IS THE SUPERIOR PARENT COMPANY. THEY DO NOT KNOW IF THE PARENT COMPANY HAS SUBMITTED THE CBCR OR NOT.**
  - **FAILURES OF REPORTING OBLIGATION DUE TO THE LACK OF INFORMATION**
  - **THEY DO NOT KNOW IF THEY ARE REPORTING CBCR DATA → PREVIOUS REPORTS (FOR OTHER OCCASION) HAVE COVERED THE INFORMATION NEED FOR CBCR**

# 1.6. Obligated taxpayers

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- The Corporate Tax Act (Section 18) (5) defines the **taxpayers who are required to register** if they have a related party:
  - business associations
    - general partnership,
    - limited partnership,
    - limited liability company,
    - joint venture,
    - joint-stock company,
  - merger, European company joint-stock company,
  - cooperative, European cooperative
  - foreign entrepreneur.

The details of the documentation and some exceptions are set out in section 32/2017. (X. 18.) NGM Decree.



# 1.7. Exempted taxpayers 1

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- companies qualifying as ***small companies*** on the last day of the tax year: in the two business years preceding the reference year, the number of employees did not exceed 50 and the net sales or balance sheet total was EUR 10 million (at group level)
- ***non-profit organisations*** of public interest
- companies where ***the State has a majority influence***
- ***undisbursed value-added service***: it must be confirmed that the cost has been billed without a profit margin. If it had been billed to more than one person, the distribution method must comply with the normal market price principle
- an **official price transaction** is exempted (but only by specific price)
- the cost burden (but the related party distribution is already supported by the register)
- transaction for which the **tax authority has determined the usual market price** (APA = Advance Pricing Arrangement).

# 1.7. Exempted taxpayers 2

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- the exemption by **transaction-level of less than 50 million HUF** (~156 thousand EUR) transaction values.
  - However, it is important to emphasise that the transaction must be valued at market price, below the market value of 50 million per year in order not to be included in the register.
  - However, companies often include these transactions as the tax base adjustment obligation also covers these transactions, and it may also be useful to document the market price shown to meet the threshold.

## 2. Definition of the associated person

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The concept of an associated person is not uniform for each regulation

- Act C. of 2000 on Accounting
- IAS 24
- Corporate Tax Act (according to the Civil Code)
- Other taxes: VAT, personal income tax
- According to corporate tax act:
  - Local business tax
  - Small company tax
  - Innovation contribution
  - Other duties and fees

**The provisions of the Corporate Tax Act must be applied for the transfer price!!**

## 2.1. Associated person under the Accounting Act 1

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- According to the law, the *parent company* is the entrepreneur who directly or indirectly exercises a dominant influence over another entrepreneur (subsidiary) because he has at least one of the following conditions:
  - based on its ownership percentage in the share capital, it solely controls the majority (over 50 per cent) of the votes of the owners (shareholders),
  - it solely controls the majority of votes based on an agreement with the other owners (shareholders),
  - in its capacity as an owner (shareholder) of the company, it is entitled to elect or dismiss the majority of executive employees or members of the supervisory board
  - based on a contract concluded with the owners (shareholders), or a provision of the instrument of the constitution, it exercises dominant supervision and control, irrespective of its percentage in the share capital, voting ratio and the right to elect and dismiss executive employees.

## 2.1. Associated person under the Accounting Act 2

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The parent company and the subsidiary, as well as the jointly controlled entity, are considered to be related entities under **Act C. of 2000 on Accounting**.

A *subsidiary* is the business entity to which the parent company can exercise a dominant influence.

A *jointly controlled entity* shall mean a business association in which, on the one hand, the parent company (or the consolidated subsidiary of the parent company), and on the other hand, one (or several) another enterprise (s), have the at least 33 per cent voting rights.

*Associated company* shall mean a business association that is not fully consolidated, in which the parent company or a consolidated subsidiary thereof has a substantial share and exercises considerable influence over the business and financial policy of the business association.

A company that controls, directly or indirectly, a minimum of 20 per cent of the votes in another business association shall be construed as having *considerable influence*.

## 2.2. Associated person under IAS 24

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- Under **IAS 24**, an entity is classified as a *related party* as follows:
  - Controls, is controlled by or is under common control with the entity (this includes parents, subsidiaries and fellow subsidiaries).
  - Has an interest in the entity that gives it significant influence over the entity or has joint control over the entity
  - The party is an associate of the entity, or the party is a joint venture in which the entity is a venturer.
  - The party in a key position is under the control or significant influence of the entity or its subsidiary, or close relatives of that individual, or their relatives.
- A *related party transaction* is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.
- *Close members of the family of an individual* are those family members who may be expected to influence or be influenced by, that individual in their dealings with the entity. They may include:
  - the individual's domestic partner and children;
  - children of the individual's domestic partner; and
  - dependants of the individual or the individual's domestic partner.

## 2.3. Associated person under the Corporate Tax Act 1

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- The definition of an *associated person* under the corporate tax law is if the taxpayer has a direct or indirect majority influence and if a third party establishes a related relationship by having a majority influence in both parties
- The corporate tax act also names **an individual**, as the IAS 24
  - the votes of direct relatives are added up (spouse and relatives and siblings).
  - From 2015, the relationship will be realised even in case of the identity of the executive. However, in this case, the law does not examine the close relatives; for example, if two siblings in a different company are not affiliated

## 2.3. Associated person under the Corporate Tax Act 2

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- The concept of majority influence is defined by the Civil Code (Act V of 2013)
  - more than 50% of the voting power and the dominant influence are the majority.
  - We can consider a decisive influence when it comes to the majority of the votes based on the agreement between the members and holds the right of manager selection and recall

### ***PROBLEMS:***

- ***DEFINITIONS ARE NOT UNIFORM***
- ***CORPORATE TAX BASE CORRECTION → TAXPAYERS ARE CONFUSED WHICH DEFINITION SHOULD BE APPLIED***



# 3. Obligations and rights of tax-payers related to transfer pricing

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- 1. Declaration and Reporting
- 2. Tax base correction
- 3. Documentation
  
- +: CbCR
  - Reporting data for the superior parent company

# 3.1. Declaration and reporting

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- Companies with affiliated companies must report their related parties to the tax authority.
- The notification must be made within 15 days of the first conclusion of the contract between the related parties. It is very important that the notification should be made even if the contract has not been performed.
- It is important to know that after the termination of the affiliated relationship the taxpayer must sign off within 15 days after the termination of the relationship

## ***PROBLEMS***

- ***TAXPAYERS OFTEN FAIL THE NOTIFICATION OR SIGN OFF AFTER THE TERMINATION OF RELATIONSHIP***

## 3.2. Tax base correction obligation

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- If there was a performance, then it is necessary to determine its standard market price and, if there is a difference, the tax effect of the difference in the corporate tax base.
  - If the tax base has been reduced due to the applied price, it is possible for the taxpayer to set the difference as a deduction item for the corporate tax base, but only if it has a statement from its affiliated company that it increases its tax base with the same value as a Hungarian company.
- In order to determine the standard market price, the Corporate Tax Act provides a briefing listing of the five methods
- Also, it is essential to pay attention to invoiced transactions, non-invoiced, occasionally free transactions.
- ***The tax base correction is a part of the corporate tax declaration. So the deadline of the transfer pricing is the day of submission of the corporate tax declaration or at least 31. May.***

# 3.3. Documentation

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The first task of the group is to **determine the transfer price documentation obligation** in order to decide whether two-level or three-level is required. Groups with a revenue of over 750 million euros are subject to three-level registers, and groups with smaller total revenues are subject to two-level registration.

Three level documentation (over 750 million euros)

- CbCR
- Master File
- Local File

Two level documentation (under 750 million euros)

- Master File
- Local File

# 3.3.1. Master File 1.

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- The Master File must be created at the group level
- But, at the same time as creating a local document, all group members need to localize it after the same definitions do not exist in each country.
- Overall, it is crucial to have information about the company that can produce the Master File.
- At the same time, it is very important for the Hungarian taxpayer to have an appropriate weight in the analysis. For a business that produces the Master File itself, it should, if necessary, develop significant collaboration with other members of the group to provide them with the information they need.

## **PROBLEMS**

- **THE COMPANY GROUP DO NOT PREPARE THE MASTER FILE → THE HUNGARIAN HAS TO**
- **LACK OF INFORMATION**
- **APPLICATION FIRST TIME OF NEW 2018 REGULATION**

# 3.3.1. Master File 2.

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- The **Master File** contains three main topics.
  - *The first topic* is for the primary management processes, the value and decision chain, and the functional analysis, which illustrates the contribution of the actors within the group to value creation
  - *The second topic* analyses the intangible rights and research and development processes of the group
  - *The third topic* analyses the financial situation, processes, revenues, expenditures, results and, in this context, the tax consequences of the group. The subject of the analysis is whether tax consequences follow the value creation process

## 3.3.2. Local File

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### **1. part:** presentation of the enterprise

- Organisation diagram, decision-making chain
- Companies obligated for reporting
- Description of main business processes
- strategy
- List of main competitors

### **2. part: transfer pricing by transactions**

- The values of the transactions must be given per associated party,
- The nature of the transaction, the identity of the affiliated party involved in the transaction, the most appropriate market pricing method, compliance with normal market price or non-compliance shall be listed per transaction.
- Novelty: earnings analysis per transaction

# 4.1. Penalties 1

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Hungarian rules in transfer pricing are **strict and consistent** and require documentation for each tax year.

Serious sanctions are imposed on the taxpayer due to faulty preparation or non-production.

In terms of control, a **high-level auditing system** filters out the risky business to be controlled based on anomalies and internal contradictions.



## 4.2. Penalties 2

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- **CbCR**

- The CbCR obligation is very important, with a fine of 20 million HUF (62,5 thousand EUR) for those who fail to do so.
- A company that does not fulfil its reporting obligation i.e. does not enter the Country by Country Report of the Group as obligated, is also liable to a fine of 20 million HUF.

- **Transfer price register**

- Lack or failure to complete the transfer price register may result in a fine of 2 million HUF (~6,25 thousand EUR) per transaction.
- If the taxpayer does not prepare the record on demand, it is 4 per transaction and then 8 million HUF (25 thousand EUR) for each transaction.

# 5. Problematic issues and audit experience of the tax authority 1

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- **The tax base correction is incompatible** with the transfer price register and the corporate tax return. The taxpayer did not set up a tax base adjustment in his tax declaration, although according to the register there was less tax base due to the difference between the applied price and the market price. Therefore the corporate tax base should be increased by a certain amount - this is reflected in the transfer price register.
- The taxpayer accounted for the 50 million HUF transaction value limit in invoiced value and **did not examine the value of the transaction at market price**. On this basis, it was wrong to conclude that the transaction was less than 50 million HUF, and it was not necessary to register the transaction.

# 5. Problematic issues and audit experience of the tax authority 2

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- **Free transactions were not taken into account** by taxpayers. The taxpayer has given a guarantee for the credit of his affiliated company. Unfortunately, the affiliated company did not pay the loan, which resulted that the taxpayer should have been paid, but its transfer price register did not include the transaction.
- **Database problems with market price**
  - Calculating Net Profitability – Differences
  - Incorrect database, errors
  - Different projection base
  - Content different from international data
  - Wrong calculations (outliers, interquartile)

# Summary

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- Paradigm shift → more detailed data are required at the group level (the authority would like to see the whole group network and its income redistribution)
- Common problems:
  - Applying new regulations for the first time → challenges
  - Lack of information about the company group
  - There is no summarising source of law according to transfer prices, taxpayers have to collect information from multiple sources.
  - Failures in documentation and reporting

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Thank you for your kind  
attention!