General Information for Investors

TAXATION

HUNGARIAN INVESTMENT AND TRADE AGENCY

Updated in January 2011

TAXATION - SUMMARY

Central Taxes

1. Corporate income tax
2. VAT
3. Personal income tax

Local Taxes

1. Building tax
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2. R&Đ-related tax benefits

Central Taxes

1. CORPORATE INCOME TAX

- The corporate income tax rate is 10% on the first HUF 500 million of the positive tax base without any further preconditions, the tax rate above this limit is 19%.

From 1 January 2013 the corporate income tax rate will be 10% uniformly. (For more information: – Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §19)

- The corporate tax base is the income before tax. (For more information: Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §6)

- (Main) tax-deductible items:

o A monthly sum of 24% of the minimum wage may be deducted from the taxable base for each trainee employee. (For more information: Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §7 (1) i))

o R&D costs or depreciation of activated/accounted R&D may be fully deducted from the corporate tax base provided that R&D costs are not financed by government support. It should be noted however that only one of the above options can be chosen, thus either the full value of R&D costs or the activated value of the R&D investment may be deducted. In the latter case, depreciation rules apply. (For more information: Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §7 (1) t))

o A company operating on the premises of a higher education institute or the Hungarian Academy of Sciences may deduct 300% - up to a maximum of HUF 50 million – of direct expenses related to research and development activities from the taxable base. This rule applies only in conjunction with the rule above (§7 (1) t). (For more information: Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §7 (17).)

- Losses carried forward:

When a company records a loss in a given tax year, it can deduct the amount of this loss from pre-tax profit in the following years at its own discretion. Losses can be carried forward for an unlimited period of time.

For losses recorded in the fourth tax year and the years following the occurrence of tax liability (effectively in the fifth and subsequent years), companies must obtain a permit from the tax authority to carry forward these losses if the tax base for the current year is negative and if

a) sales revenues do not reach 50% of the combined value of costs and expenditures, or

b) the taxpayer recorded losses in the previous two tax years

(For more information: Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §17)

- Depreciation:

Depreciation should be proportioned if the asset in question has not been in the possession of the taxpayer for the full calendar year. Some key depreciation rates:

o Buildings:

☐ of long-life structure (concrete, iron-concrete, steel): 2%

☐ of medium-life structure (light steel and other metal structures): 3%

☐ of short-life structure (wood, temporary brick): 6%

o Industrial halls: 2%

o Machinery and equipment: the general rate is 14.5%, but a 33% rate applies to computer equipment and 20% for vehicles.

(For more information: Act LXXXI of 1996 on Corporate Tax and Dividend Tax, Annex 2)

- Tax-free development reserve:

50% of pre-tax profits (up to a maximum of HUF 500 million) can be reserved for future developments. This means that the company can put aside 50% of pre-tax profit for a maximum of 6 years, and if this money is used for development purposes within that timeframe, no tax is paid on that amount.

(For more information: Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §7 (1)f) – (15))

- No Withholding Tax

In Hungary, there is no withholding tax on dividend, royalties and interest payments made between corporate entities from a Hungarian source.

2. VALUE ADDED TAX (VAT)

- Rates of VAT: The general rate is 25% applied to most products and services (18% is applied to diary and bakery products, the supply of district heating to households is currently taxed at 25%, but from 1 August 2009, the applicable rate will be lowered to 18% unless the European Commission fails to approve this in the interim, 5% is applied to basic medicines and books) – Act LXXIV of 1992 on VAT, §28 (1)-(3), 70% of the VAT on telephone use is deductible only. As an offset measure, it is proposed that the private use of company phones should be treated as a benefit in kind. In addition, the rate of excise duty will increase by between 5% and 6% on average.

- Tax exempt: certain services, e.g. financial, postal, educational (with exceptions), rental of business property (or other property excluding residential properties and land) and utilization of such properties in other ways (with options to tax), assignment, etc.

From 1 May 2004, non-resident EU taxpayers or taxpayers from countries that have concluded bilateral agreements on reclaiming VAT (Liechtenstein and Switzerland) may obtain a VAT refund in certain circumstances. Based on the new VAT rules, certain domestic transactions (especially in connection with real estate) are taxed according to the reverse charge mechanism, i.e. the buyer pays the VAT.

3. PERSONAL INCOME TAX

16% flat tax rate - on all types of income (also income in the consolidated tax base income, e.g. employment income, and personal income, e.g. interest income, dividend income, etc.)

Non-taxable emolument concept would be abolished

New rule for rental income

- also part of consolidated tax base
- 16% flat rate is applicable
- revenue could be decreased for tax purposes by 10 % flat cost or with the real cost (if documented properly)

Consolidated tax base – “super gross”

The tax base increasing item (27%) added to the gross income to form the consolidated tax base would remain in effect in 2011.

- To be reduced to 13.5% in 2012

• To be abolished as of 1 January 2013

Family tax allowance

Tax base reducing item

The tax base to be reduced is the income increased with the tax base increasing item (27%).

Amount of the allowance:

- Families with one or two children: HUF 62,500 per child monthly
- Families with three or more children: HUF 206,250 per child monthly

Tax credit

Calculated tax reducing item

- maximum HUF 12 100 per month if the annual income does not exceed HUF 2 750 000
- If the annual income exceeds HUF 2 750 000 but not is higher than HUF 3 960 000 the tax credit will be reduced proportionally
- Calculated based on the increased tax base before reducing with the applicable family allowance

Non cash payments

As of 2011 non-cash payments have been re-classified. From 2011 there will be three categories of them, which are as follows:

Fringe benefit – Cafeteria (Béren kívüli juttatás)

- tax base is 119 %, 16% personal income tax is payable by the provider company

Benefit in kind (Béren kívülinek nem minősülő egyes meghatározott juttatások)

• tax base is 119 %, 16% personal income tax and 27% health care contribution is payable by the provider company

Other non cash payments

• taxed according to the legal relationship between the provider and the private individual

• tax base is 127 % (as part of the consolidated tax base)

• the individual is paying 16% personal income tax and the applicable social security

• the provider will pay 27% social security or health care contribution and depending on the legal relationship

Fringe benefit – Cafeteria

maximum

Vacation voucher 78 000 HUF/year/person

hot meal voucher HUF 18 000 / per month

Cold meal voucher

Training costs Official trainings, up to double and

half of the minimum wage

Schooling assistance 30% of the minimum wage

Local public transport passes Payable fee

Internet cost HUF 5 000 / per month

Széchenyi Recreation Card HUF 300 000 / per year

Contribution to a private pension fund -

Contribution to a voluntary pension

fund 50% of the minimum wage per

month

Contribution to a health fund and self -help fund   30% of the minimum wage per

month

Benefit in kind

- Travel, accommodation, food, drink, other services provided during a program free or for discounted rate (except travel and accommodation cost of business travel, food, drink, services treated as representation or business gift)
- Group insurance
- Private use of phone
- Business gift (25% of the minimum wage)
- Small value gift (10% of the minimum wage) three times a year
- Representation or business gift if the provider is not subject to corporate income tax
- If the fringe benefit value is higher than the applicable limit described above

Social Security Contributions

The employer’s contribution payable on each employee is 27% in total (24% pension insurance and 3% social security insurance). A 1.5% training contribution is also payable by the employer.

For new entrants to the labour market, unemployed persons over 50 and job-seekers returning to work after caring for children, the social security contribution rate is 10% of the employee's gross salary for the first year of employment and 20% for the second year.

Employee's contribution: 17,5% (7,5% healthcare and 10% pension found contribution).

The private pension fund contribution is cancelled as of November 2010. Members of private pension funds are obliged to pay 10% state pension contribution as well until 31 December 2011. Within this period of time the membership fee of the private pension fund will be 0%.

<u>Wage cost summary</u>

Employee's liabilities

PIT rate 16%

base tax base correction item 27%

healthcare contribution 7,5%

pension found contribution 10%

caped – applicable cap 7 665 000

Employer's liabilities

healthcare 3%

pension found contribution 24%

training contribution 1.5%

CRISIS TAX – extraordinary tax for selected sectors

Temporary taxes introduced for the companies acting within retail, telecommunications and energy sector. The tax base is the net sales revenue of the company within the financial year. According to the Government's communication such tax obligation is payable by the companies affected for the years 2010, 2011 and 2012.

The tax base of the crisis tax is the net revenue of the taxpayers, the related parties should totalize their tax base and the tax proportionally.

tax rate related to the tax base

retail HUF 0-500 million

0% HUF 500 million

–30 billion

0,1% HUF 30 –

100 billion

0,4% above

HUF 100 billion

2,5%

telecom HUF 0-100 million

0% HUF 100

– 500 million

2,5% HUF 500 million

– 5 billion

4,5% above

HUF 5 billion

6,5%

energy 1,5%

Local Taxes

(Statutory base: Act C of 1990, levied by local municipalities, modified by Act C of 2004)

Please note that not all of the taxes below are applicable in each settlement. The taxes actually levied are at the local municipality's discretion.

In some cases, e.g. in case of the local business tax, the rate of the tax actually levied is also decided by the local municipality. The maximum rate of tax is set by legislation in effect throughout Hungary.

1. BUILDING TAX

- To be paid based on the floor space of buildings
- Maximum HUF 900 (EUR 3.2)/m2/year or a maximum of 3% of the adjusted market value of the building (as determined by the local government)

2. LAND TAX

- To be paid on undeveloped land
- Maximum of HUF 200 (approx. EUR 0.7)/m2/year or a maximum of 3% of the adjusted market value of the land

3. LOCAL BUSINESS TAX

- Business activity of a permanent or temporary nature performed in the area of jurisdiction of the local government (hereinafter: business activity) is subject to taxation. The subject of the tax is the entrepreneur.
- The tax base is net sales revenue on products sold or services provided.

- The following can be deducted from the tax base:
  - purchase value of products sold
  - value of services sold (intermediated)
  - material costs
  - the direct costs of basic research, applied research and experimental development accounted for in the tax year
- Revenue included in the local business tax base that is derived from an activity pursued outside Hungary is exempt from local business tax in Hungary.
- The tax rate is decided by the local municipality up to a maximum of 2%.
- If the average number of staff is increased, the base of local business tax may be reduced by HUF 1 million (EUR 3,498) per new employee. Please note that companies receiving state subsidies are not eligible for this exemption.

Tax-Related Incentives

1. DEVELOPMENT TAX ALLOWANCE

(Statutory bases: Government Decree No. 275/2003 and 85/2004, Act LXXXI of 1996 on Corporate Tax and Dividend Tax, Communication from the Commission C (2002) 315 2002/C 70/04)

- Utilisation of tax benefit: up to 80% of payable tax can be deducted each year.

- Length of tax benefit: maximum 10 years (from the first year after the activation of the investment plus the subsequent nine years, or – upon request of the taxpayer – from the year of activation of the investment plus the subsequent nine years). The taxpayer can take advantage of this tax relief in the 14th year following the tax year in which the notification or the application was submitted at the latest. – Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §22/B (7).

- Rate of tax benefit: up to the intensity ratio defined in EU regulations less all other direct subsidies. Maximum intensity ratios are defined by regions:

o 10% in Budapest

o 30% in Pest County

o 40% in Western Transdanubia

o 50% in all other regions of Hungary

10% is added to the above rates for mid-sized enterprises and 20% for small enterprises.

Defined by size of investment:

o Up to EUR 50 million worth of investment – no further restrictions are applicable other than regional differences.

o Between EUR 50 million and EUR 100 million worth of investment (i.e. for the second EUR 50 million) – 50% of the regionally permitted intensity ratio is applicable.

o Over EUR 100 million worth of investment – 34% of the regionally allowed intensity ratio is applicable.

Example: Maximum intensity ratio for a EUR 135 million investment in Budapest is 25%: 50 million * 25% + (100-50 million) * 25% * 50% + (135-100 million) * 25% * 34%

Defined by sectors: Sensitive sectors are listed in accordance with EU-regulations, for which further decreased state subsidies or no subsidies at all are granted.

- (Major) eligibility criteria:

o Investment sum is HUF 3 billion (EUR 10 million) anywhere in Hungary OR HUF 1 billion (EUR 3.5 million) in priority regions of the country; HUF 100 million (EUR 349,821) for carrying out R&D projects for basic research, applied research or experimental development – Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §22/B (1) a) b) f).

Investment costs: See separate material on Eligible Investment Costs. In case of R&D projects eligible costs can be tangible assets of the R&D project.

AND

- Employment of 150 persons anywhere in Hungary or 75 persons in priority regions of the country for at least five years. For R&D investments, job creation is not an eligibility criterion – Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §22/B (9) a)

OR

- Annual wage costs are 600 times the official minimum wage (HUF 71,500 or EUR 250) anywhere in Hungary OR 300 times the official minimum wage in priority regions of the country for at least five years. For R&D investments, increasing wage cost is not an eligibility criterion – Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §22/B (9) b)

OR

- Procure a minimum of 30% of supplies from firms qualifying as small and mid-sized enterprises for at least five years – Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §22/B (9) c); Definition of SMEs - Act XXXIV of 2004 on Small and Mid-sized Enterprises

3. § (1) Small and mid-sized enterprises are defined having

a) a total number of employees of less than 250 persons, and

b) yearly net turnover not exceeding the forint equivalent of EUR 50 million, and/or an annual balance sheet total not exceeding the forint equivalent of EUR 43 million. §3 (4) A company is a small- and medium-sized enterprise, if the shares of the State, Local Government or any Third Party – based on capital share or voting right – do not exceed 25%, neither individually, nor altogether.

o Realising job creation investments, if the investment involves creation of new facilities or expanding existing capacities and is operated for five years from the original investment. – Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §22/B (1) h)

AND

- At least 20% of employees are entrants (entrant is a natural person who establishes labour relations with a company for the first time within one calendar year of graduating from a full-time secondary school or higher education institution) in the third year following the first utilisation of the tax benefit and in the subsequent four years. – Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §22/B (12)a)

AND

- The number of employees has increased by 300 persons anywhere in Hungary OR by 150 people in the priority regions of the country in the third year following the first utilisation of the tax benefit and in the subsequent four years, as compared to the tax year preceding the start of investment. (For mid-sized enterprises, the thresholds for application are 150 and 75 people, whereas for small enterprises the thresholds are 30 or 15 people respectively.) – Act LXXXI of 1996 on Corporate Tax and Dividend Tax, §22/B (12) b)

• Application for tax benefit: Investment above the value of EUR 100 million should be submitted to the Ministry of Finance, which will approve and authorize the tax benefit if the applicant meets all the requirements of the relevant laws described above. A decision will be made within 60 days upon receipt of application, or – if completion of documents is asked for – within 60 days upon receipt of the completed application. This deadline can be extended once by a further 60 days. If the Ministry of Finance does not reject the application within the deadline, it should be assumed that the application has been approved.

2. FURTHER R&D TAX-RELATED BENEFITS

Tax benefits in addition to the regional intensity rate

- R&D costs or depreciation of activated/accounted R&D can be 100% deducted from the corporate tax base

- 10% of R&D direct costs and wage costs (for small and mid-sized enterprises, 15%) for software developer in employment can be deducted for a period of 4 years

- Tax-free employment of PhD, MSc or MBA students (up to the official minimum wage) in the field of education and research activities

- Tax allowance for corporate donations to non-profit organisations supporting R&D activities exclusively for public benefit

- Tax-free development reserve for four years – 50% of pre-tax profit (max. HUF 500 million, approx. EUR 2 million)

Tax benefits within the regional intensity rate

- Tax benefits on credit agreements are the only type of incentive other than cash and development tax allowances that are set by the regional intensity ratio.

- 300% R&D direct expenses – up to HUF 50 million (approx. EUR 200 thousand) - can be deducted from the corporate tax base if operations of the company R&D unit are located at university or public research institute (e.g. the Hungarian Academy of Sciences)

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