

# Transfer Pricing Country Summary Hungary

February 2018

## Legislation

### Existence of Transfer Pricing Laws/Guidelines

The application of the arm's length principle between related parties is prescribed by Section 18 of the Act LXXXI of 1996 on Corporate Income Taxation (CIT Act).

In late 2017, the Hungarian Ministry for National Economy issued Decree 32/2017 - on the basis of Article 18 (5) of CIT Act -, based on which related companies shall document the arm's length price, the method used for establishing the arm's length price, and all evidence or circumstances supporting them, for the intra-group transactions. When applying the arm's length principle, the CIT Act refers to the OECD Transfer Pricing Guidelines as the basis of the legislation.

Act XXXVII of 2013 incorporates the Country-by-Country Reporting ("CbCR") requirements in the Hungarian legislation. CbCR requirements have been implemented in line with the BEPS Action Plan and Council Directive (EU) 2016/881. The first year to be covered starts from January 1, 2016 for Hungarian parent companies and surrogate parents, whereas other group entities are affected from January 1, 2017 onwards.

### Definition of Related Party

Related parties are defined as enterprises that would meet any of these:

- Connected by direct or indirect majority (more than 50%) shareholding (voting rights);
- Have a common direct or indirect majority shareholder;
- One is able to appoint or dismiss the majority of the key management or the supervisory board of the other enterprise;
- Foreign entrepreneur with domestic branch;
- Domestic entrepreneur with foreign branch; or
- Have the same managing directors or have the same management.

### Transfer Pricing Audits

Transfer pricing has been in the focus of the Tax Authority since 2004. Transfer pricing may be audited during a general examination or audits only with transfer pricing focus can be ran.

Those taxpayers may expect tax audits with a higher probability that generate losses on a continuous basis, or that pay a high volume management or royalty fee. Entities paying or receiving a loan interest are also in the focus.

### Transfer Pricing Related Penalties

Lack of documentation:

If a tax payer fails to comply with the transfer pricing documentation requirements, it would be subject to a default penalty. In line with the legislation, the lack of either of the master file and the local file would entail a default fine. A penalty up to 2 million HUF (~6,500 EUR) may be levied per missing documentation. For subsequent violation of documentation obligation, the Tax Authority may impose a default penalty of up to 4 million HUF (~13,000 EUR) per documentation. For repeated omissions in connection with the same documentation, the fine may be up to four times the amount first imposed (8 million HUF, that is ~26,000 EUR).

In the case of a missing, delayed, incorrect or incomplete fulfilment of CbC reports or CbC notification, the Hungarian Tax Authority may impose a fine up to HUF 20 million (~EUR 65,000) upon the taxpayer, or the reporting entity.

Tax underpayment:

A 50% tax penalty can be charged on the assessed tax underpayment, if any. Additionally, a late payment penalty equal to twice the base rate of the Hungarian National Bank (currently 0.9%) may also be charged.

## Advance Pricing Agreement (APA)

APAs are available as from January 1, 2007. Applications can be made for future transactions on a unilateral, bilateral or multilateral basis for a period of minimum 3 and maximum 5 years (with a possible extension for further three years).

An application fee of 2 million HUF (~6,500 EUR) will be charged per each agreement. The fee of preliminary consultation is 500 thousand HUF (~1,625 EUR) per consultation. The maximum timeframe for making a decision on the application is 120 days, which may be prolonged by 60 days twice.

## Documentation and Disclosure Requirements

### Tax Return Disclosures

Taxpayers must notify within 15 days if they enter into an agreement with a related party or if that related party becomes independent. The notification should include the name, the seat and the tax ID of the other party.

Taxpayers subject to CbCR obligations on their own should file the CbC Report by the end of the 12<sup>th</sup> month following the business year. Taxpayers that are part of an MNE subject to CbCR must also notify the tax authority whether they are obliged to file CbC Report on their own or if not, they should name the reporting entity in the notification form. The deadline for filing the relevant notification form is the last day of each business year.

### Level of Documentation

A transfer pricing documentation should be prepared if the taxpayer performs a controlled transaction with any of its related parties. Taxpayers are exempted from documentation obligation in any of the following cases:

- The taxpayer qualifies as a small-sized entrepreneur;
- Transactions performed with private persons in a status other than private entrepreneurs (such as transactions with the owners);
- The arm's length price of the given transaction had been assessed and agreed with the tax authority in the frame of an APA;
- Cost recharges;
- Money transfers made free of charge;
- Transactions performed on the stock exchange;
- The price of the transaction is fixed by legislation or authority assessment;
- The arm's length value of the intra-group transaction does not exceed 50 million HUF

(approximately 165,000 EUR) per fiscal year.

The Hungarian legislation follows the **BEPS recommendations**. In line with Decree 32/2017, the documentation consists of the master file and the local file, therefore the subsidiaries themselves are ultimately liable for the preparation even for the master file. The masterfile-local file approach is mandatory from 2018 onwards, however, taxpayers may satisfy their documentation obligations upon the formerly effective legislation and prepare a standalone study in respect of 2017 for the last time.

The content and formal requirements of the local file are as follows:

- Administrative information
  - Date of preparing the documentation;
  - Registered seats and tax ID numbers of the parties;
  - Copy of such effective unilateral, bilateral and multilateral APAs and other taxation agreements should be attached, that were issued by an authority other than the Hungarian Tax Authority;
  - General administrative information on any closed authority and court cases related to the assessment of the arm's length price of the transactions covered by the documentation.
- General information on the local entities and its operations
  - Detailed information regarding the local entity's management and reporting flow, the business strategy and the list of the competitors;
  - Information on business restructurings and transfer of intangible assets;
- Information specific for the local entities' intra-group transactions
  - General presentation and the general administrative information of the concerned intra-group transactions;
  - The copy of the intercompany agreements, or a detailed presentation of the contract if the parties entered into a verbal agreement;
  - Detailed functional analysis in respect of all parties engaged in the intercompany transaction, mentioning any changes having taken place compared to the previous years;
  - Identification of the most appropriate transfer pricing method with respect of the nature and type of the intra-group transaction and the availability of the comparable data;
  - Methodology for the comparability analysis;
  - Source of data to be used in the course of the comparability analysis;
  - Presentation of the selected internal and external comparable transactions, including the financial data of the independent comparable entities used in the comparability analysis for identifying the arm's length remuneration.
  - Selection of the tested party (when using a one-sided transfer pricing method),
  - Providing an explanation for using a multi-year comparability analysis.
  - A conclusion determining whether the applied transfer prices were at arm's length.

## Language for Documentation

Hungarian, English, German and French documents must be accepted by the Tax Authority. However, it is

recommended having a Hungarian summary as the Tax Officers may not speak all of these languages.

### Deadline to Prepare Documentation

The local file should be prepared by the date of filing the annual corporate income tax return (the deadline of which is the last day of the 5<sup>th</sup> month following the business year, i.e. May 31 in the case of taxpayers with a calendar year). The documentation does not need to be filed with the tax authorities.

If allowed by the legislation of the group's ultimate parent company, the deadline of preparing the master file may be prolonged, but only up to the last day of the 12<sup>th</sup> month following the business year.

### Deadline to Present the Documentation

Upon request, taxpayers have 3 days to submit their TP documentation to the tax authority.

### Small and Medium Sized Enterprises (SMEs)

SMEs are also obliged to apply the arm's length principle. However, entities qualifying as small-sized enterprises are exempted from documentation obligations.

### Statute of Limitation

The statute of limitation in Hungary is 5 years, which may practically be even 7 years.

### Safe Harbor Rules

#### Low Value-Adding Services

A simplified documentation may be prepared in case of low value-adding services (the legislation lists these services) performed within a multinational group.

All the below conditions should be met to be entitled for the preparation of simplified documentation:

- The service is not the core activity of the service provider; and
- The arm's length value of the transaction does not exceed HUF 150 million (~ 500,000 EUR) in a tax year; and
- The revenue from the transaction does not exceed 5% of the sales revenue of the service provider; and
- The cost of the transaction does not exceed 10% of the operational costs and expenses of the service receiver; and
- The arm's length price is established based on the cost plus method; and
- The applied mark-up is in the range of 3-7% (constituting arm's length mark-up).

The simplified documentation must include:

- Name, registered seat and tax registration number of the related party;

- The subject of the contract;
- Date of signature and term of the contract;
- The arm's length price (i.e. no comparability analysis is necessary); and
- The date of preparation (and date of amendment, if any) of the document.

## Transfer Pricing Methods

The Hungarian legislation follows the recommendations laid down in the OECD Transfer Pricing Guidelines. The following methods are accepted in the CIT Act:

- Comparable Uncontrolled Price Method
- Resale Price Method
- Cost Plus Method
- Transactional Net Margin Method
- Profit Split Method

If none of these methods is applicable, the tax payer may use another approach.

## Arm's Length Range

When identifying the arm's length remuneration, the taxpayers should consider the interquartile range, if the following conditions are met:

- The comparable data are sourced from publicly available databases; and
- The analysis takes data into account at least 10 comparable entities with at least 3 years of financial data/the number of observations is more than 30, or the extent of the full arm's length range (minimum-maximum) exceeds 15 percentage points.

## Comparables

Local comparables are primarily preferred. However, if the reliability of these comparables is not sufficient enough, comparable data from different geographical region with similar economic conditions should be acceptable as well.

A database search should be prepared at least every three years, while the financial data of comparable companies selected during the database search should be updated on an annual basis.

## Mutual agreement procedure ("MAP")

MAP is adopted in the local legislation; it is, however, not used on a regular basis. No MAP can be initiated in Hungary if the subject period of time is elapsed.

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