

Tax Newsletter

Transfer pricing in Hungary

Our Newsletter intends to inform you on the changes of the Hungarian transfer pricing legislation. If you have transactions with your related parties the new changes prescribe how to support these transactions by documents.

Who are the persons subject to the new Order?

In which cases shall the documentation be prepared?

What sort of documentation shall be prepared?

The changes of the corporate tax legislation which have come into effect from 1 January 2003 indicated that taxpayers shall support their transactions with related parties by documents. The Law states that a separate order will govern these rules. (§18 (5) of the Law on Corporate Income and Dividend Taxation). However, the Order of the Minister of Finance No. 18/2003 defining the preparation and the content of such documentation was only published on 16 July 2003 and it came into force from 1 September 2003.

These requirements fixed by the new Order indicate that the Tax Authority may pay more attention to the issues of transfer pricing in the future in the course of its tax investigations. The reason for this is that related parties are interested in allocation profits within the group through transfer prices in order to optimize the tax liabilities at group level. The goal of these new rules is to limit the possibility of such profit reallocation and to provide means for the Tax Authority to have a more effective control on these transfer prices.

The Order relates to all the business organisations which are not deemed as micro or small enterprises at the end of the tax year. Companies are qualified as related parties if, inter alia, have a majority directly or indirectly in the control of another company.

The obligation to have proper record-keeping relates to contracts concluded between related parties if supply of products or services provided in the relevant tax year on the basis of these contacts provided that this was concluded after 1 September 2003 (when the Order came into force).

If the parties become related parties later than the date when they make the contact, this obligation shall be applied only if the parties make significant changes in the contract, or if such changes occur which will be considered by independent parties.

Companies shall consider all significant facts and circumstances when preparing their record-keeping and documentation on the transfer pricing policy. The Order states that taxpayers are not obliged to set up such documentation which can cause disproportionately big costs for them. However, this does not mean that companies can neglect to prepare any documentation referring to this rule. The documentation shall be prepared separately to each contract.

Companies shall set up full or simplified documentation depending upon the value of transactions. If the value of the transaction computing at the fair market price excluding VAT does not exceed the threshold of HUF 50 million, companies may prepare simplified documentation relating to that

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The content of the documentation

transaction. In this respect the contracts belonging to each other shall be calculated together.

The aim of the documentation is to provide information to the Tax Authority on what is the transfer price in the transactions of the taxpayers made between related parties. Therefore the following information shall be indicated in the documentation:

1. The name, the seat and the tax number of the related parties (or instead of the tax number, the registration number of the company given by the relevant Court of Registration, and the name and the seat of the relevant Court of Registration)
2. The content of the documentation:
 - a) The content of the contracts
 - b) The subject of the contract, date of the contract, date when modified the contract, the duration of the contract
 - c) The characterization of the products/services supplied (e.g. physical characteristics like quantity, quality, measurement), the way of the performance, terms and conditions
 - d) The main features of the activity performed, the resources used, the business risks undertaken (FX risks, guaranties, financial risks)
 - e) Determination of the market from the point of view of the potential targeted markets, the characterisation of the market (size of the market, degree of the liberalisation of the market, the competition, the competitors, the availability of replaceable goods and services); the geographical region
 - where the goods/services are not available/saleable (or the availability/marketability of them is very difficult) or
 - where the goods/services cannot be sold, cannot be considered for transfer pricing purposes.
3. The method of determining the fair market value of the goods/services (if the company uses special methods, the description of the method shall be attached to the documentation as well). The documentation shall contain the explanation why that method was selected and applied, the definition (description) of the comparable data, the way how the data were selected, the explanation to this way and all the facts and circumstances relating to the comparable goods or services.
4. The determination of the fair market price
 - a) on the basis of comparable goods or services, the computation of the fair market price, margin, profit, or other figures or the relevant ranges (depending on the method selected)
 - b) the difference in the aspects influencing the fair market price; the adjustments computed on the basis of such differences
 - c) the fair market price
5. Pending issues relating to the contract (court cases, procedures of authorities)
6. The date of preparation and the modification of that documentation

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The simplified documentation

Modification of the documentation

How can MAZARS help you when preparing the documentation?

The simplified documentation is very limited compared to the full documentation. The simplified documentation shall contain the following information:

1. The name, the seat and the tax number of the related parties (or instead of the tax number, the registration number of the company given by the relevant Court of Registration, and the name and the seat of the relevant Court of Registration)
2. The content of the contracts; the subject of the contract, date of the contract, date when modified the contract, the duration of the contract
3. The fair market value
4. The date of the preparation and the modification of the simplified documentation

If there was a significant change in the facts and circumstances which would be considered by independent parties when determining their prices, the taxpayer shall modify its documentation accordingly.

The most of the information you have to be included in the documentation is available at you company. The big question is how the transfer price shall be determined in order to meet the requirements of the Hungarian transfer pricing legislation and the transfer pricing guidelines of the OECD. Mazars can help you effectively in this respect.

Please note, although the Order discussed in our Newsletter is applicable to the contract entering into force from 1 September 2003 but the Hungarian transfer pricing legislation is applicable to all contract, since that legislation was introduced in 1992. Therefore all the taxpayers shall be prepared to prove that they apply proper transfer prices in their business transactions with related parties in the course of a tax investigation of the Tax Authority. If you need to know the tax risks at your company, please contact us.

If you have any further questions in relation with the themes of this newsletter, we are at your disposal with our help.

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Disclaimer: The above information is intended to provide general guidance only. It should not be used as a substitute for professional advices or as the basis for decisions or actions without prior consultation with your advisor.