1. General presentation of CIT in Hungary

The Act IX of 1988 on entrepreneur’s profit tax introduced company taxation in Hungary. This Act was followed by the Act LXXXVI of 1991 on company taxation which was followed by the current law in force, the Act LXXXI of 1996 on company tax and dividend tax.

From the aspect of tax law there is no distinction between corporations and partnerships. According to statistics from September 2012 the total number of companies with legal entity was 417,526, the most common form of business with legal entity was the limited liability company (Ltd.) with 401,786 units, stock companies (or GB public company, Plc., US incorporated company, Inc.) were less in number (5,713) and there were cooperatives also (2,906). The same statistics mentioned 182,620 companies without legal entity, 174,830 deposit companies or limited partnerships and 5,217 general partnerships.

According to the Act CLXXXVIII of 2011 about the central budget of Hungary in 2012 the earmarked sum of company tax is 356,200 million HUF and of personal income tax is 1,574,300 million HUF. In comparison with the state revenues only the sums of VAT and excise exceed the sum of corporate income tax.

There are separate taxes in Hungary which are similar to corporate income tax. These are the “additional taxes” taxes of fiscal organizations and credit institutions, the allowance of credit institutions, the additional taxes of certain sectors and the special tax of energy providers. The introduction of the additional tax of fiscal organizations is effective from 27th September 2010, the same kind of tax on credit institutions was introduced on 1st January 2011; both of them was introduced by the modification of the Act LIX of 2006 on additional taxes and allowances in order to improve the balance of the budget.

There was no change in the system of corporate income tax but the scope of subjects changed. The reason of this change was the progress of the economic
change of regime and the privatization. In consequence of the privatization the transforming of state enterprises happened. Most of the state enterprises, trusts, business trusts became business companies, limited liability company and public company in the first place.

According to Sections 2 and 3 of the Act IX of 1988 CIT subjects are the state-controlled companies, trusts, business trusts, other state-controlled economic organizations, cooperatives, cooperative enterprises, - except water public-service corporation – water management company, association of water management companies, companies of certain legal entities, financial institution and affiliated company (subsidiaries), economic company, professional group of industrial and service cooperative, agricultural professional group, educational cooperative group functioning in higher educational institutions, partnership of individuals with legal entity, individual entrepreneur (self-employed person), if someone registers itself to the tax authority as a tax subject under this Act. This Act shall not cover the Hungarian National Bank (Magyar Nemzeti Bank), State Development Institution (Állami Fejlesztési Intézet) and the Central Office of Financial Institutions (Pénzintézeti Központ). The regulations on the obligations of these institutions towards the central budget are established by the Financial Minister. Housing cooperatives, social organizations, foundations, the cooperative with legal entity performing legal representation, water public-service corporations are obligated to pay tax after their business income. From 1990 the Act included government units, church and those individuals, who perform agricultural small producer activity and register itself to the tax authority as a tax subject.

According to Section 2 of the Act LXXXVI of 1991 the following are subject to taxation: business associations, cooperatives, state-controlled companies, other state-controlled economic organizations, trusts, business trusts, water management companies except water public-service corporation, water management associations, companies of certain legal entities, and subsidiaries, law offices, partnership of individuals with legal entity, artistic creative community, professional group of industrial and service cooperative and agricultural professional group until their abolition, individual entrepreneurs and agricultural small entrepreneurs who registered under the effect of the entrepreneur’s income tax until 31 December 1991 and registers itself under the effect of the Act on private individual income taxation, flat co-operative, social organizations, public bodies, churches, (also including the organizational units vested with legal corporate existence in the statutes, and/or deeds of foundation of social organization, public bodies, churches and foundations) foundations and public water management associations, if they realize revenues in the tax year from entrepreneurial activities. According to this Act the following are subject to taxation: legal entities, joint venture without legal entity, personal association,
other organizations which are owned by foreigners, perform business activity in Hungary, have their official address abroad if run a depot in Hungary (foreign entrepreneurs). Foreign based legal entities, unincorporated partnerships, associations of private persons and other organizations which have no premises in Hungary (foreign organizations) shall pay a defined rate of tax for the income received from domestic persons for entrepreneurial activities, provided the income was earned in the Republic of Hungary. This Act shall not cover the Hungarian National Bank, State Development Institution and the Central Office of Financial Institutions, budgetary organizations, the law enforcement enterprises under the supervision of the Ministry of Justice and the legal successors thereof performing the employment of prisoners.

Since 1994 voluntary and mutual insurance funds, if they realize revenues from their supplementary entrepreneurial activities and the forest management associations.

The effective regulation today is the Act LXXXI of 1996 on Corporate Tax and Dividend Tax which differs between tax subjects according to their domicile.

Of domestic persons the following shall be deemed resident taxpayers:
- business associations (including nonprofit business association from 2011, also including the regulated real estate investment semi undertaking, the regulated real estate investment undertaking and the regulated real estate investment project undertaking),
- cooperatives (since 2004),
- professional associations,
- European public limited-liability companies (since 2006) (including European holding companies since 2011), and European cooperative societies (since 2007),
- state-controlled companies, trusts, other state-controlled economic organizations, companies of certain legal entities, and subsidiaries,
- law offices, executive office (since 2006), patent agencies, notary’s offices, forest management associations,
- Employee Stock Ownership Plan trusts (hereinafter referred to as 'ESOP'),
- water management associations,
- foundations, public foundations, civic organizations, public corporations, religious organizations, (including any organizational units of such organizations vested with legal personality in the statutes or deed of foundation),
- housing cooperatives, and voluntary mutual insurance funds,
- institutions of higher learning (including the institutions they have established), and student hostels (since 2006).
- European groupings of territorial cooperation (since 2009),
- individual entrepreneur (since 2010),
- European Research Infrastructure Consortium (ERIC since 2012).
Any foreign person whose place of management is located in Hungary shall be deemed a resident taxpayer.

Foreign nationals and non-resident persons shall be deemed non-resident taxpayers if they carry out business operations at their branches in Hungary, provided that they are not considered resident taxpayers due to the location of their place of management (hereinafter referred to as “non-resident entrepreneurs”).

2. Legislative technique

As we can see, taxable entities in Hungary are defined in high level legal instruments, typically through a section or paragraph which provides the complete list of the taxable entities.

3. Domestic entities

The list of entities which fall under CIT in Hungary is compatible with the annexes to the Parent-Subsidiary directive, the Interest-Royalty Directive and the Draft CCCTB Directive. One thing we have to add here: after the coming into force (1 July 2006) of the Act IV of 2006 on business associations the foundation of joint venture were no longer available. Those joint ventures which were registered or were under registration into the firm registry could continue their functioning according to the Act CXLIV of 1997 (form of 30 June 2006).

The organizations listed in Schedule No. 5 of the Act LXXXI of 1996 on Corporate Tax and Dividend Tax are not subject to corporate tax. These are:

1) the Hungarian National Bank,
2) economic organizations created for the statutory employment of prisoners under the supervision of the minister in charge of penal administration,
3) public-benefit organizations established exclusively for the sole purpose of the employment of prisoners, and public-benefit or priority public-benefit nonprofit business associations carrying on their operations,
4) the Reserve Management Public-Benefit Organization, and public-benefit or priority public-benefit nonprofit business associations carrying on their operations,
5) the Transportation, Communications and Water Reserve Management Public-Benefit Organization, and public-benefit or priority public-benefit nonprofit business associations carrying on their operations,
6) the Hungarian National Asset Management Zrt.,
7) public service broadcasters as specified by law,
8) parties subject to liquidation proceedings, as of the initial date of liquidation,
9) political parties,
10) the Hungarian News Agency Company,
11) joint-stock companies engaged exclusively in providing joint and several suretyship under the conditions specified in specific other act and in the legal regulation enacted under the authorization of such act,
12) legal persons and unincorporated business associations taxed under the simplified entrepreneurial taxation system during the tax year,
13) institutions of higher learning (including the institutions they have established) operating in the form of budgetary agencies, and student hostels.
14) National Device Manager Zrt.

The scope of tax exemptions are contained by the same Act.

Section 20:
The following parties shall be exempt from paying tax:
a) foundations, public foundations, civic organizations - with the exception of national interest representation organizations - and public corporations not qualifying as nonprofit companies or priority nonprofit companies, as well as housing cooperatives, if the revenues realized from their business operations, recorded pursuant to the regulations of specific other legislation applicable to their activity and the provisions of Schedule No. 6, are not more than HUF 10 million, and do not exceed 10 per cent of total revenues realized in the tax year;
b) voluntary mutual insurance funds, provided that the revenues of such funds generated from auxiliary business operations do not exceed 20 per cent of total revenues;
c) water management associations for the portion of the tax base defined in Subsection (5) - in Subsection (6) as of 1 July 2009 - that, as a part of all revenue, represents revenue realized from activities conducted as public duties;
d) public-benefit or priority public-benefit nonprofit business associations, and social cooperatives for the portion of the tax base defined in Subsection (6) that, as a part of all revenue, represents revenue realized from preferential activities as established pursuant to Chapter E) of Schedule No. 6.

These organizations are not subjects of the CIT because these are not founded to perform business activity in principle. The Act CV of 2008 on the functioning, controlling and supervising of budgetary organizations defines the concept of business activity. Business activity means those activities which diverge from the basic activity and are performed for gaining regular profit, from sources different from (state) aids, for other legal entities or natural person, not binding, productive, service providing, marketing activity.
3.2. More details
As a conclusion we can state that the definition of legal entities falling under the CIT is dependent from the definition of business associations or company law because the companies falling under the effect of the Act on Business Associations will always be the subjects of the Act on Corporate Tax as joint undertaking. Article 2 of the Act IV of 2006 states:

“(1) Business associations may only be founded in the forms regulated in this Act.

(2) Associations lacking the legal status of a legal person are general partnerships (kkt.) and limited partnerships (bt.). Business associations with legal personality are private limited liability companies (kft.) and public and private limited companies (rt.).”

The answer to that question, is there a link between limited liability of shareholders (or partners) and the personal scope of CIT, the answer is that the Act on Company tax and Dividend tax is no longer containing the regulation of dividend taxation since 1 January 2006. The CIT Act contains the word “dividend tax” only in its title so the Act LXXXI of 1996 on Company tax and Dividend tax has no effect on shareholders, so there is no such link or connection. If the shareholder is a private individual, the regulations of the personal income taxation are effective to the case of him or her; the tax rate of capital income is 16%.

One-manned or single manned companies fall under the scope of CIT, if they function as business association or individual company.

A tax subject to fall under the scope of CIT does not have to possess legal entity, likewise general partnerships (kkt.) and limited partnerships (bt.) also lack the legal status of a legal person still fall under the scope of CIT. If associations lacking the legal status of a legal person have revenues realized from preferential activities, they also obligated to pay the sum of corporate income tax.

However, it is also possible that certain public and private limited companies (rt.) and companies as listed earlier (organizations listed in Schedule No. 5 of the Act LXXXI of 1996 on Corporate Tax and Dividend Tax, see above: page 4) are business associations but do not have the obligation to contribute to the CIT revenues.

Charitable organizations and associations

According to (Sections 18, 28 and 29 of) the Act CLXXV of 2011 on the rights of association, nonprofit legal status and the functioning and supporting of civil
organizations civil associations shall perform nonprofit activities (according to its basic objectives) and economic-business activities.

In that case if the civil association performs economic-business activities, it will fall under the scope CIT Act. The only criterion is the performance of economic-business activity.

The civil associations have to isolate the record of their revenues, expenses and expenditures from nonprofit activities and economic-business activities.

The form of the account depends on the type of activity, the measure of the total revenues (both from nonprofit activities and economic-business activities) in the tax year, and the manner of accounting.

The accounting of the civil association should be in the system of single-entry or twofold/double-entry bookkeeping, in Hungarian and in forint (HUF).

In case of double bookkeeping civil associations shall attach other enclosures than just the nonprofit enclosure.

The VAT criteria is very similar in that case, if the nonprofit civil association does not perform economic-business activities, it will enjoy tax payer exemption but if it performs such activities it will be VAT subject above a certain (5,000,000 HUF) level of revenue. Under 5,000,000 HUF revenues after economic-business activities depending on the civil association’ type of activity the civil association may still choose tax payer exemption.

There are some differences in the criteria of for-profit entities for domestic and foreign entities for example in the CIT Act at tax base decrement and increment factors (see later, page 10)

**3.3.3. Miscellaneous on CIT subjects**

*Water management associations* and *forest management associations* are typical Hungarian business associations because of the unique geographical and hydrographical conditions of Hungary. In order to exploit these opportunities:

“The following parties shall be exempt from paying tax: *water management associations* for the portion of the tax base defined in Subsection (5) - in Subsection (6) as of 1 July 2009 - that, as a part of all revenue, represents revenue realized from activities conducted as public duties;”¹

“social cooperatives, public-benefit or priority public-benefit nonprofit business associations, and *water management associations* may claim tax allowances in the proportion of the corporate tax reduced by tax exemptions.”²

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¹ Act LXXXI of 1996 Section 20. (1) d)
² Act LXXXI of 1996 Section 20. (2)
The latter mentioned forest management associations has a special act, the Act XLIX of 1994 on the forest management association.

State owned CIT subjects do not raise special questions or issues: if they do not perform any business activities, they do not have to pay any corporate income tax.

3.3.4. Partial implementation of CIT

In Hungary limited partnerships (bt.) are CIT subject except they live with the opportunity to choose simplified tax of entrepreneurs (egyszerűsített vállalkozói adó - EVA).

If the earlier mentioned budgetary organizations perform business activity beyond their basic activity, their revenues from the business activity will fall under tax obligation. However, if they only perform their basic activities and do not perform business activities, they are not obligated to pay corporate income tax so they will fall under the scope of CIT just to a certain extent.

In Hungary a individual entrepreneur (self-employed person) will fall under the scope of CIT, if he/she registers itself to the Companies Registry as an individual company.

3.3.5. Tax planning

Tax rules have significant relevance in setting up a corporation rather than a partnership (or the opposite) in Hungary. Companies with smaller income can choose from several tax forms. If somebody is willing to start an individual company, he/she can choose between CIT, personal income taxation of entrepreneurs or tax of entrepreneurs (EVA), if the criteria of these tax forms are met. Since 2011 it is better to fall under the scope of CIT because the tax rate is only 10% which is smaller than other tax forms (personal income taxation, tax of entrepreneurs (EVA)). After 1 January 2013 a new tax form will appear, the small entrepreneur’s tax).

3.3.6 Others

On the basis of the Act on Corporate Tax and Dividend Tax there is no possibility for the taxable income to be assessed on a lump-sum basis, but the Act on Personal Income Taxation gives the opportunity to entrepreneurs to choose the possibility for the taxable income to be assessed on a lump-sum basis.
4. Cross-border situations

Foreign persons defined here, according to the Act on Corporate Tax and Dividend Tax, shall be subject to corporate tax in Hungary: a ‘foreign person’ means an artificial person, a partnership without legal personality, an association of persons and any other organization established under foreign law;”

There are two types of foreign persons from 1 January 2011:

1. **Non-resident entrepreneurs**: “foreign nationals and non-resident persons shall be deemed non-resident taxpayers if they carry out business operations at their branches in Hungary, provided that they are not considered resident taxpayers due to the location of their place of management.”

2. **Member of a company with real estate holdings**: if they obtain any income through the transfer or withdrawal of participating interest in a company with real estate holdings.

Corporate tax liability for foreign entrepreneurs:

- The corporate tax liability of a foreign entrepreneur shall commence on the day his branch office is registered in the Register of Companies and terminate on the day the branch office is removed from the Register of Companies. The tax liability of a foreign entrepreneur shall terminate on the day preceding the day on which a liquidation proceeding (including any equivalent proceeding) is initiated against such foreign entrepreneur in Hungary or, if it involves his Hungarian branch office, abroad.
- If a foreign entrepreneur is engaged in business operations in Hungary through a business establishment that has not been registered by the court of registry, his tax liability shall commence on the day on which the first legal statement that brings the place of business into existence is issued, and it shall terminate on the day on which the foreign entrepreneur is dissolved or the legal statement resulting in the dissolution of the business establishment is issued (even if the activities are continued in in a branch office or in the form of a European public limited-liability company or a European cooperative society).
- In those cases in which a construction project has been undertaken in Hungary by a foreign entrepreneur, the foreign entrepreneur’s tax liability shall commence on the first day of construction if the duration of the project exceeds the period of time specified in the agreement or, if there is

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3 Act LXXXI of 1996 Section 4. (27)
4 Act LXXXI of 1996 Section 2. (4)
no agreement, three months. The continuity of construction shall not be affected by the fact that it is performed by a foreign entrepreneur at his branch office or other fixed establishment.”

- The tax liability of any member of a company with real estate holdings shall apply as of the day of transfer of his share in the said company with real estate holdings, or when the subscribed capital is decreased through disinvestment.

CIT tax base decrement and increment factors: there are no differences between foreign and domestic CIT subjects due to the EU harmonization.

The following shall be deducted from the pre-tax profit:
- for taxpayers, income received or due from dividends and shares:
  1. during the tax year (or other taxable income of the like for enterprises keeping single-entry books), with the exception of the income received or due as dividends and shares from a controlled foreign company, in due consideration of what is contained in Point 2,
  2. during the tax year, up to the amount claimed as an increment to the pre-tax profit according to Paragraph f) of Subsection (1) of Section 8 - as verified by the taxpayer’s related tax return and the underlying records and documents - and that was not yet deducted from the pre-tax profit;

- the income of members (shareholders, partners):
  1. shown for the tax year that is in excess of the value - determined according to Subsection (10) - of shares that are derecognized (whether in full or in part), including the liabilities shown under shareholder contributions for pre-companies, but not including shares in a controlled foreign company, if the investment in an enterprise is eliminated or reduced due to the enterprise being wound up without succession, if its subscribed capital is decreased through disinvestment, or if the enterprise is terminated by way of preferential transformation, in due consideration of what is contained in Point 2,
  2. where shares in a controlled foreign company are eliminated according to Point 1, the resulting income claimed for the tax year in excess of the value of the derecognized shares under Subsection (10), up to the amount claimed as an increment to the pre-tax profit according to Paragraph f) of Subsection (1) of Section 8 - as verified by the taxpayer’s related tax return and the underlying records and documents - and that was not yet deducted from the pre-tax profit;

The following shall increase pretax profit:
- the amount of profit after tax shown for the last day of the tax year (financial year) of the controlled foreign company – as commensurate according the

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5 Act LXXXI of 1996 Section 5. (3), (9)
6 Act LXXXI of 1996 Section 7. (1) g), gy)
taxpayer’s direct holding in the controlled foreign company on the last day of the tax year – less any dividend paid out, provided that the taxpayer controls at least twenty-five per cent of the voting rights or the capital of the controlled foreign company, or has a dominant influence by definition of the Civil Code, and provided that private individuals regarded as resident in accordance with the Act on Personal Income Tax have no holding in the taxpayer;

- for the taxpayer:
  a) the loss in value or capital loss shown under expenses for the tax year in connection with the shares in a controlled foreign company, and the part of expenses resulting from the retirement of such shares for any reason, that is in excess of the income accounted;  

There is no such “resemblance test” applied in Hungary which would compare foreign and domestic CIT subjects and would legally bind certain features to be met in order to admit a foreign CIT subject as CIT subject in Hungary.

The application of the so-called „tax paradise” (off-shore) rules had been a legal way for tax evasion and tax optimisation until Hungary joined the European Union in 2004. The Act on Corporation Tax regulated the preferential taxation of 'taxable persons operating abroad' (off-shore firm) until 1 January 2004. Off-shore companies in Hungary had to pay only 3% corporation tax instead of 18%. The elimination and abrogation of this rule, that is the complete eradication of „tax paradise” (off-shore) from the body of law on corporate taxation, can be evaluated as a special provision. 8 Off-shore firms could be created in Hungary until 31 December 2002 and could claim for paying 3% corporation tax until 31 December 2005 so the off-shore firms and their tax reliefs were completely gone from the Hungarian legal material after January of 2006, since then these firms pay taxes like any other domestic firm does and no special provisions or denominations or other related preferences can be used by them. So the rule of tax haven ceased to exist in Hungary from 2006.
Legislators have brought tax haven regulation to an end and according to this there is no regulation like this, Legislators gave tax amnesty9 to the owners of money invested into foreign off-shore firms which regulation may be considered as a tax refuge. The point was

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7 Act LXXXI of 1996 Section 8.
8 The 2002 évi XLVII. tv. 303.§.(10) abrogated the favourable corporation tax regulations on „taxable person operating abroad (off -shore firms). Valid establishment until 31 December 2002, taxation validity (3%) until 31 December 2005.
9 see: 2008.évi LXXXI. tv. 276.§ and 277.§ modifications of tax laws about tax amnesty provisions (applicated until 30 June 2009) ; and 2009.évi LXXVII. tv. 175.§, 231.§. and 233.§
in tax amnesty that if one part of the income brought home from the off-shore firms (approximately the half of it) was invested in Hungarian State Papers until - at least - two years the incomes of off-shore firms - rescued into abroad - could be brought to home with a preferential taxation (10%) in 2009. This condition does not fit to the European Union regulation of the free movement of capital since the purchase of statepapers are not motivated by market devices. According to this the parliament altered the amnesty provision on the government’s proposal so that now it will not clash into the norms of the European Union any more. However, tax amnesty was not applicable if it may have derived from crime only if the source of the incomes had a fully legal source.

In order to suppress tax avoidance they introduced the extension of taxable value over the incomes and properties rescued into tax paradise by 1 January 2010.

The legal correction\(^\text{10}\) of the concept of controlled foreign companies\(^\text{11}\) founded in tax paradise and the extension of tax obligation over rescued and even produced incomes in the context of joint relationship ensured the avoidance of double taxation. This rule is authoritative even in cases where the incomes were produced, but not brought home before 2010.

In order to suppress tax haven and tax evasion they extended the rules concerning joint undertakings over transactions between taxpayers and their subsidiaries abroad in order to prevent the withdrawal of allocated devices from taxation.

The introduction of source taxes on a 30% rate, with those countries which Hungary does not signed a convention to avoid double taxation, to pay the interest, royalty and service fees.”

In 2010 the Act CLIII of 2010 introduced tax amnesty in two fields: about the extention of the deadline and the alteration of the public burdens policy. According to them the tax amnesty provisions could be used until the end of 2009 (31 December).

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10 see the Act on Corporation Tax
11 Act LXXXI of 1996 Section 4. (11):
'controlled foreign company' means a person or his place of business in another state, in which the taxpayer or his affiliated company holds a participating interest and that is established or has a branch in, or is a resident of a state where no tax liability that is equivalent to corporate tax is prescribed by law in respect of the income of such foreign persons, or the quotient of the liability equivalent to corporate tax prescribed for the tax year and the pre-tax profit is less than two-thirds of the percentage rate defined in Subsection (1) of Section 19. This provision shall not apply if the person is established or has a branch in, or is a resident of a Member State of the European Union or a Member State of the Organization for Economic Cooperation and Development (OECD), or a state with which the Republic of Hungary has an agreement on double taxation concerning the income and wealth tax system;
- if money from foreign bank accounts or offshore firms were brought home to Hungary until 31 October 2010 and the 10% tax were paid (bringing home ‘black money’), or
- if foreign corporate shares in Hungarian offshore firms were bought (back) and this was registered at the Registry Court until 31 December 2011 (repatriation of firms).

In 2011 the Act CXVI of 2011 postponed and extended tax amnesty to a third field besides the already existing two:
- bringing home ‘black money’,
- repatriation of firms, and
- acquisition of domestic real estate or motor vehicle owned by an offshore firm by a domestic tax subject, if the contract was put in writing and the purchase price was transferred through the selected financial institution until 30 June 2012 (concretization of property).

The Hungarian Act on Corporate Tax and Dividend Tax is fully compatible with the mentioned Directives. 

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12 Act LXXXI of 1996 Section 31. (1) This Act serves the purpose of compliance with the following legislation of the Communities:

a) Council Directive 90/434/EEC on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States;
b) Council Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States;
c) Council Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States;