

Overview

LeitnerLeitner Tax | Audit | Advisory, Taxand (Hungary)

Our tax consulting company located in Budapest, Hungary, provides our clients with complex, personalized, high quality transfer pricing professional support and security. The transfer pricing expertise, combined with the full-service coverage in all tax areas, accounting and legal topics is a guarantee for our clients to achieve tailor-made best assistance. Our full services in the field of transfer pricing covers the following:

- ❖ transfer pricing consultancy services
- ❖ transfer pricing expert activity: planning of intercompany transfer pricing structures, preparation and introduction of policies
- ❖ preparing, reviewing, updating transfer pricing documentation (Local Files and Master Files)
- ❖ preparing, reviewing database search, benchmark analysis
- ❖ preparation of the requests, representation in advanced pricing arrangement (APA) procedures
- ❖ representation in mutual agreement procedures (MAP)
- ❖ country by country reporting (CbCR) advisory services
- ❖ representation in transfer pricing audits and remedy procedures

General: Transfer Pricing Framework

The Hungarian legislation applies the Arm's Length Principle as an essence of transfer pricing; and the Hungarian Corporate Income Tax Act refers to the OECD Transfer Pricing Guidelines (TP Guidelines). Though the TP Guidelines are not legally binding in Hungary, the Hungarian transfer pricing regulations are based on the TP Guidelines. The main rules of the Hungarian transfer pricing are provided in the Corporate Income Tax Act, in the Decree of the Ministry of Finance on the transfer pricing documentation and in the Act on the International Administrative Cooperation in the field of taxes and other duties. In general, the transfer pricing requirements also apply not only to cross-border relations but equally to domestic transactions. In Hungary, the transfer pricing documentation is mandatory.

Accepted Transfer Pricing Methodologies

In accordance with the TP Guidelines, the domestic law defines the methods that can be used when determining the arm's length price (CUP, RSP, CPM, TNMM, PSM - methods designated by law). Based on the domestic legislation, the arm's length price shall be determined applying one of the methods listed by the law, or by an "other method" -this latter however requires specific and explicit explanation and reasoning for the elimination of the traditional methods. The Hungarian legislation; otherwise, does not determine the hierarchy of the methods, only the "other method" may be used only if the arm's length price cannot be determined by none of methods designated by law.

Transfer Pricing Documentation Requirements

In Hungary, the transfer pricing documentation includes the Master file for the corporate level (based on Annex I to Chapter V of the TP Guidelines) and the Local files to be prepared on a transactional basis (based on Annex II to Chapter V of the TP Guidelines). If there is only one transaction for the MNE that requires the preparation of the Local file, in this case the Master file must also be prepared. There are a number of exceptions. e.g., small companies, non-profit associations, state-controlled enterprises; taxpayers having an APA coverage are exempt from the transfer pricing documentation obligation. As of 2022, the materiality threshold is HUF 100 million, approx. EUR 250,000, meaning that transaction below this yearly threshold need not be documented – although even in this case the application of the arm's length principle is obligatory with a preference of a benchmark support. The CbCR, as a third level of transfer pricing documentation, is also relevant for Hungary; however, MNEs are not required to prepare CbCR if their consolidated revenue is under EUR 750 million in the financial year preceding the financial year reported.

The preparation deadline of the Local file(s) is the effective filing date of the yearly corporate income tax return. The transfer pricing documentation does not need to be submitted to the tax authority together with the corporate income tax return; however, it should be available and disclosed upon request of a tax audit theoretically within 3 working days. Since FY 2022, the yearly CIT return also contains a reporting of the related party transactions in a very detailed transactional base format.

The Master file should be available by the end of the following financial year at the latest (i.e. until the deadline for preparing the MF for the ultimate parent company of the group, but not later than the end of the year following the tax year). As the MF is also frequently asked in the course of tax audit, it is highly advisable to ensure the availability and the conformity of such document with the Hungarian legislation.

The CbCR (if applicable) shall be submitted within 12 months following the end the reporting period. In addition, Hungarian entities that belongs to a group over the threshold have a notification obligation, the deadline for which is the last day of the financial year of the multinational company group.

Local Jurisdiction Benchmarks

The Hungarian rules follow the guidance in Chapter III of the OECD Transfer Pricing Guidelines regarding benchmark studies.

Internal CUPs are acceptable in Hungary. Moreover, if there is internal comparable data available, it precedes data from an external source, as internal comparable data provides the highest level of comparison. In the absence of internal comparable data, a benchmark study is required in order to determine the arm's length price of the controlled transaction.

The arm's length price is usually determined using the TNMM and with the use of a business database

containing company-level data, but - if the available data allows - the CUP (with the application of internal comparables or with the use of a database containing comparables, mainly for financial transactions and license fees) and the CPM are used.

Database regarding comparable products or services, furthermore database regarding comparable enterprises can be applied.

Companies are required to use databases that are publicly available or accessible or can be verified by the Hungarian Tax Authority. Strict documentary requirements apply to the database search support (e.g. saving search information, webpage screen-shots).

A database search of companies selected as comparable should be prepared every 3rd year. The result of the benchmark study must be updated annually i.e. the 2 years in between.

Local companies are preferred for purposes of the comparability analyses. The geographic selection criteria are as follows: Hungary, Visegrád countries and if necessary, the scope can be extended further.

The latest available version of the database should be applied. The basis of calculations shall be the data of the latest financial years that are available, typically of the latest three years (multiannual analysis), pooled method is preferred.

In case of the company group-level benchmark, we suggest supporting and supplementing it with a local database search to be accepted by the Hungarian Tax Authority as this is safer for the Hungarian entity and is more personalized from its point of view.

Advance Pricing Agreement "APA"/Bilateral Advance Pricing Agreement "BAPA" Overview

In Hungary, unilateral and bilateral / multilateral APAs are also available. The Ministry of Finance approves the procedure for establishing the arm's length price (practical application of the transfer pricing method), the facts and circumstances based on which it is determined, and, if possible, the arm's length price or price range.

The request shall be submitted before the conclusion of the contract (or other transaction). Or a request for an APA may be submitted after the date of conclusion of the contract if the contract is performed in a continuous manner. This means that the contract is concluded for a minimum term of six months, and a) under which at least one performance takes place every other month, or b) under which one of the parties maintain specific credit facilities in favour of the other party during the contract, or c) that contains the requirement of continuous availability for either of the parties.

The application for establishing the arm's length price shall be submitted by way of electronic means using the electronic form designed for this purpose.

The binding power of the resolution establishing the arm's length price shall be determined for a fixed period of at least three, but no longer than five years. The starting date of the effect of the resolution shall be established based on applications, but it shall not be earlier than the first day of the tax year when the application was submitted, nor later than the first day of the tax year following the date when the resolution becomes final. If requested by the taxpayer, in bilateral or multilateral proceedings, in case the competent authorities so agree, the binding force of the resolution may cover the tax years before the submission year provided that these tax years a) are not closed by a tax authority audit, b) have not been expired; and c) are not affected by an audit in progress, which results in a period closed by an audit, at the time when competent authorities conclude their agreement.

For unilateral APA, the procedural fee payable amounts to HUF 8 million (approx. 20,000 EUR). For bilateral or multilateral APA, the fee is HUF 12 million (approx. 30,000 EUR). The fees for modification or extension of the APA resolution are half of the original fee.

The APA process should officially be finished within 120 days, but it can be extended 2 times for 90 days. In case of bilateral or multilateral APAs, and the MAP with the foreign competent tax authority shall be closed within 2 years, but it can be extended by one year.

Transfer Pricing Audits

The latest audit guidelines of the Hungarian tax authority identify transfer prices expressly as a priority audit area. Transparency requirements of the OECD are implemented in practice (3-tiered transfer pricing documentation, information exchanges, tax authority and business databases, TP data reporting obligation), the taxpayer can be an „open book“ for the tax authority. The tax authority is paying a continuously high and growing attention to both transfer pricing documentations and benchmark studies, as well as transfer pricing data reporting, and is increasingly examining these in a very in-depth professional manner. The importance of the value creation, added value analysis, the functional analysis and proper characterization is constantly emphasized.

It is worth acting with the utmost caution when preparing the transfer pricing data provision, as the tax authority's audit directions include the investigation of related transactions classified as risky based on the transfer pricing data provision. Special attention is given to taxpayers who carry out manufacturing or distribution activities within a company group and who are loss-making or have very low profits. The tax authority deeply monitors the financial transactions between associated enterprises as well. Auditing of transactions involving the intangible assets of associated enterprises is expected. As for taxpayer specificity, affiliated food businesses can specifically expect transfer pricing audits in 2025.

The Burden of Proof in Transfer Pricing: Theory versus Practice

Beyond the formal approach, in terms of content, the legal requirement of preparing transfer pricing documentation is a rule that imposes a burden of proof. The fundamental and essential starting point is that in case of undertakings subject to transfer pricing documentation obligation, the burden of proving compliance with the arm's length principle lies with the undertaking. Thus, the preparation of transfer pricing documentation is a necessary, but not sufficient, requirement for businesses.

Transfer pricing documentation is an administrative obligation, but it is by no means an end in itself. The role of transfer pricing documentation is crucial. If properly prepared, it is a protective shield for the business.

Businesses should strive to have transfer pricing documentation of adequate quality. Good transfer pricing documentation is: accurate, relevant explains and documents the facts in sufficient depth, reproducible, quality over quantity and follows the principle of uniqueness. In all cases, the principle of individual evaluation must be followed. Transfer pricing documentations and benchmark studies prepared on an assembly line are dangerous. Moreover, transfer pricing documentations prepared at group level without localization generate significant transfer pricing risks for the Hungarian company. The transfer pricing documentations and benchmark studies prepared specifically for the Hungarian market are the ones that can guarantee the appropriate security for the domestic entities.

Transfer pricing documentations are the starting point for tax audits; its appropriate quality can help the business provide evidence and thus protect from legal consequences. Not only can a default penalty be imposed for the lack of transfer pricing documentations, but those affected can also be fined tens to hundreds of millions of Hungarian forints for incorrectly or poorly prepared documents. Moreover, deficiencies in the documentations may give authorities the opportunity to question pricing, which could even have unpredictable financial consequences.

We are already at the era of AI, thus specific and standardized data about transfer pricing, enables the tax authorities for improved risk assessment and focusing on deficient transfer pricing practices. This also brings businesses into action, whose essential purpose is to be prepared for such the increasing tax authority attention and use the burden of proof as a tool.

Transfer Pricing Penalties

In case of non-compliance with the transfer pricing documentation, a penalty of up to HUF 5 million (approx. EUR 12,500) may be levied per transaction per year. In recurring cases, a penalty of up to HUF 10 million (approx. EUR 25,000) may be imposed also per transaction per year. If the CbC

report is incomplete or contains inaccurate information or it is submitted after the expiration of the statutory deadline, a penalty of up to HUF 20 million (approx. EUR 50,000) may be imposed. The same CbCR penalty is also applicable for the lack or incomplete notification as well.

In case of any discrepancies identified in transfer prices by the tax authorities resulting in the correction of the corporate income tax base, the adjustment may be subject to a corporate income tax of 9% over the profit and the local business tax of 2% over an adjusted turnover. In addition, a penalty of up to 50% of the tax deficiency amount and late payment interest calculated at the Central Bank base rate and increased by 5% may be imposed.

Local Hot Topics and Recent Updates

Considering the transfer pricing strictures introduced as from 2022 (transfer pricing reporting in the yearly tax return, obligatory median adjustment, increased penalties), the Hungarian companies have to count on far more stricter Hungarian transfer pricing rules, and the possibility of more efficient tax authority actions.

Transfer pricing reporting in the yearly corporate income tax return

A new obligation was introduced for the 2022 tax year, according to which it is necessary to report detailed transfer pricing and related party data in the yearly corporate income tax return in connection with the determination of the arm's length price. The transaction-based, detailed data provision is another incentive tool to ensure that the transfer pricing documentation is prepared together with the corporate income tax return. The provision of data means additional information to make the tax authority's risk analysis more efficient.

By now, the structured data from these transfer pricing reports created a huge database in the hand of the Hungarian Tax Authorities, by which they are able to point non-compliant businesses in a more focused manner. Increased volume of tax audits also gives possibility for data clearing and further improvement of risk assessment methods. In such an era, it is essential for multinational and local corporate groups to be cautious with the transfer pricing documentation and benchmarking, especially in Hungary with its record high penalties and compliance rules stricter than usual.



Significant increase of transfer pricing default penalty

The default penalty in connection with the obligation to prepare and preserve of transfer pricing documentation was increased to 2.5-times than earlier. Painful, especially in case of the significant number of transactions for which transfer pricing documentation is required.

Widening the obligation to use the interquartile range

During the analysis based on the database – among others for the most widely used TNMM methods –, the obligation to use the interquartile range has become general.

Introduction of legal provisions on transfer pricing adjustment

The obligatory rule for median adjustment was also introduced starting from the 2022 tax year. In case of companies where the applied transfer pricing results in a value below the lower or higher as the upper quartile (i.e. PLI is out of the IQR), the adjustment must be made to the median value, as required by law, and not to the lower quartile value anymore.

From this perspective, we call the attention for special focus tax investigations, as the method and form of transfer pricing adjustments and year-end true-ups not always accepted by the Hungarian finance authorities, potentially generating double taxation situations. It is also essential to handle not only the transfer pricing aspects of these adjustments, but correctly cover the related invoicing, tax-compliance, VAT, Local business tax and other consequences too.

Increased default penalty regarding the notification obligation of associated enterprises

In connection with the transfer pricing, one of the administrative obligations in Hungary is that the associated enterprises must be notified to the tax authority, moreover, within 15 days of their first contract. This obligation extends to all associated enterprises with which the Hungarian company conducts transactions, regardless of any threshold. The administrative notification obligation also occurs if the associated enterprise relationship with an associated enterprise is terminated.

While transfer pricing default penalties remain at record highs in Hungary, it is recommended to pay special attention to the fulfillment of the above notification obligations as well, especially considering that, the default penalties have doubled, as a result of which the tax authority can now impose default penalties of up to HUF 1 million (EUR 2,500) for these notification deficiencies.

HUNGARY



Documentation threshold

Master file	HUF 100 million, approx. EUR 250,000.
Local file	HUF 100 million, approx. EUR 250,000.
CbCR	EUR 750 million

Submission deadline

Master file	Submission: within 3 business days upon request of the competent tax authority Preparation deadline: until the deadline for preparing the MF for the ultimate parent company of the group, but not later than the end of the year following the tax year
Local file	Submission: within 3 business days upon request of the competent tax authority Preparation deadline: by the submission of the yearly corporate income tax return, which deadline is 150 days following the tax year
CbCR	Submission and preparation: within 12 months following the end the reporting period

Penalty Provisions

Documentation – late filing provision	up to HUF 5 million (~ EUR 12,500), in recurring cases up to HUF 10 million (~ EUR 25,000) / per transaction per year
Tax return disclosure – late/incomplete/no filing	up to HUF 1 million (~ EUR 2,500) per return
CbCR – late/incomplete/no filing	up to HUF 20 million (approx. EUR 50,000) – also in the event of a violation of the notification obligation



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