

## Hungarian Minister of Finance proposes local business tax cut for manufacturers, principals and R&D activities

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The Hungarian Minister of Finance announced proposed local business tax changes at a press conference during the first week in February.

It has been the clear intention of the Hungarian government during the last decade to make Hungary one of the most attractive Central European destinations for foreign investors by establishing one of the most competitive and business-friendly tax environments in the European Union. Hungary reduced its statutory corporate income tax rate to a flat 9% in 2017 and carried out significant payroll tax cuts in recent years. The current proposal concerning local business tax (LBT) is a further step which follows this trend.

### Background

LBT is a local tax in Hungary which is regulated at the national level but levied by the local municipalities where the businesses that are subject to this tax operate. In general, businesses with trading revenues are subject to LBT.

In summary, trading revenues of businesses, i.e., net revenue from the sale of products and provision of services, are subject to 0% - 2% LBT. The actual rate is determined by the given municipality by taking into account the 2% cap. Under the current rules, the following costs are deductible:

- ▶ Costs of goods sold (COGS)
- ▶ Costs of services which were purchased by the taxpayer and sold to customers in an unchanged form

- ▶ Sums paid to subcontractors by the taxpayer
- ▶ Costs of materials purchased by the taxpayer
- ▶ Costs which are directly attributable to R&D activities carried out by the taxpayer. This generally includes fees for R&D services purchased

Following from the above, Hungarian holding and financing entities with dividend, interest and other types of financial income were never subject to LBT, which would remain unchanged in the future. Furthermore, companies with IP income are only partially affected by LBT as only a portion of their income - which derives from marketing intangibles - may be subject to LBT.

## Proposed changes

The current proposal would significantly increase the amount of deductible costs for LBT purposes. Specifically:

- ▶ Depreciation and amortization costs would become deductible; and
- ▶ Direct R&D costs would be deductible five times the amount.

The proposal includes another simplification concerning the payment mechanism of LBT. Currently, taxpayers are obligated to estimate their annual LBT liability and pay the difference between the estimated annual tax liability and

the tax advances paid by 20 December each year, while the annual return is due by the following 31 May, i.e., in the year which follows the given tax year. The proposal would abolish the payment obligation currently due in December, which provides administrative relief.

Furthermore, according to current assumptions, the changes above would also impact companies' innovation contribution obligations in Hungary. Companies registered in Hungary which do not qualify as small enterprises are subject to innovation contribution. The tax rate is 0.3% while the tax base is calculated the same way as the LBT base. Thus, most likely, the proposed changes would result in the decrease of innovation contribution liability as well.

## Conclusion and next steps

The implementation of the proposed changes would further strengthen Hungary's position as an attractive location for manufacturing, principal and R&D activities.

The expectation is that the administration will prepare a draft bill on the proposed changes in the foreseeable future which, however, could be subject to change in the coming months. According to current expectations, simplification of the payment mechanism may take place this year while the actual tax cut would be effective from the beginning of 2021.

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