

# Ernst & Young Hungarian Tax News

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### Supreme Court decision on VAT-deduction ban relating to state aid

Pursuant to the Hungarian legislation in force until 31 December 2005, input VAT on asset investments or activities financed from state aid were not fully deductible. Spain and France had previously implemented very similar measures to ban VAT-deduction on investments financed from state aid, but the European Court of Justice (ECJ) ruled these provisions to be against the Community law on 6 October 2005. As of 1 January 2006, the VAT-deduction ban relating to investments financed from state aid also ceased in Hungary, although not retrospectively.

In our previous newsletters (i.e. newsletter of October-November 2005, special edition of October 2005, newsletter of November 2005 on 2006 tax law amendments), we also highlighted that the decision of the ECJ may open up the possibility of full VAT-deduction relating to investments financed from state aid in Hungary, retrospectively from 1 May 2004.

On the basis of the aforementioned decision several taxpayers have submitted administrative claims in the interim, requesting that the amount of non-reclaimable VAT for the period between 1 May 2004 (the date of Hungary's EU accession) and 31 December 2005 be refunded. During one of these court cases, the defending tax authorities submitted a review request to the Supreme Court (SC), which duly gave its decision on the case on 29 November 2007.

The tax authorities argued that the effective VAT Act should also be applied in the period after 1 May 2004, which led to an input VAT pro-rata requirement - in other words, that the taxpayer should be entitled to deduct VAT in proportion to the aid received. The authority also argued that the direct effect of EU directives does not automatically apply in the member states. The tax authority also took the view that the





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ECJ decision, although binding for the Spanish Member State, did not have to be taken into consideration when applying Hungarian state law. In order to comply with Community law, as of 1 January 2006, the effective VAT Act did in fact overrule the pro-rata requirement for state aid; this amendment, however, did not enter into force with a retrospective effect.

As part of the reasoning supporting its decision, the SC found that the ECJ had already pointed out, in several of its decisions, that the 77/388/EEC Council Directive (6th VAT Directive) did not require separate harmonization measures from the Member States and, thus, its rules may take direct effect in all Member States. With stated exceptions, the 6th VAT Directive prohibits restrictions placed on this deduction right. The SC found that the decision with regard to case No. C-204/03 (the Commission of the European Communities vs. the Kingdom of Spain) was, therefore, applicable to the case at hand. The SC emphasized that the Hungarian legislator was clearly aware that the provision of the VAT Act was not in line with the provisions of the 6th Directive and this was the reason for the amendment to the VAT Act entering into force as of 1 January 2006. The SC also found that, from the perspective of the Republic of Hungary, the date of entry into force of the 6th Directive should be regarded as 1 May 2004.

Clearly, the decision of the SC is, therefore, of great significance. On the one hand, the decision creates a precedent when referring to the direct effect of EU directives in a debate with the tax authority. In future, the tax authority may not argue that it can only apply the Hungarian legislation which is in force. On the other hand, the decision may also open up a potential deduction right for those who previously received state aid, but did not take any steps to request a full deduction right under the previous legislation. For advice relating to this issue and with regard to potential action, our advisors would be happy to provide you with any help you may require.

## Domestic Tax News

### **Problems of interpretation in connection with VAT reverse charging**

As reported in our previous newsletter, under Act CXXVII of 2007 on Value Added Tax (“new VAT Act”) the rules of reverse charging are to be extended to more domestic transactions from 2008. Central to the concept of reverse charging is the notion that it is the taxable person customer, not the supplier, who must pay the VAT (and, where entitled, to deduct the VAT in the same return). From 2008, the rules relating to reverse charging are to be extended to include the transfer and sale of real estate property (provided that the seller opts for a VAT-able treatment), as well as to services relating to real estate property (construction/fitting, operation, cleaning, maintenance, repair, conversion and demolition) and also to the associated hire out of labor and secondments.

The new provisions have given rise to several problems with interpretation, primarily because (with respect to services related to real estate property subject to reverse charging) the new VAT Act does not provide a definition for real estate property itself.



On 8 January 2008, the Tax Authority published a press release on its Internet site concerning the application of VAT reverse charging. According to the press release, the rules of reverse charging also apply to horticultural services, chimney sweeping, electrical repair and plumbing service, for example, as these services all relate to real estate property. According to the press release, however, reverse charging is not applicable in the case of security services, where they relate to private persons or property.

In our opinion, however, the application of reverse charging is in many instances unclear, because such services do not necessarily relate to real estate property and, therefore, it may be vital that the specific circumstances (and the appropriate documentation) are taken into full consideration. Although the objective of the legislation is understandable, there is a danger that due to the rather general wording, the issuer and the addressee of the invoice will find it necessary to debate interpretation unreasonably often, due to the fact that both parties could experience significant risk arising from the failure to charge VAT or due to the unauthorized deduction of VAT.

It should also be noted, however, that the Hungarian regulation may not necessarily be in accordance with the VAT Directive of the EU. It is explicitly stated in the Directive that the possibility of reverse charging fundamentally relates to the supply of construction work, including repair, cleaning, maintenance, alteration and demolition services connected to real estate properties. In the Hungarian legislation, however, this definition is extended to the point where reverse charging is prescribed for all services relating to real estate property.

The deadline for filing the first VAT return in which the rules of reverse charging (set forth in the new VAT Act) have to be followed is the 20 February 2008 for monthly filers. We recommend that our Clients proceed with due caution when purchasing a service that may be subject to reverse charging. Should you have questions regarding the classification of the service, we are happy to provide any assistance necessary.

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### **Numbering invoice copies continues to be a requirement**

Decree No 47/2007 (XII. 29.) of the Ministry of Finance on the Issuance of Invoices amending Decree No. 24/1995 (XI.22.) on the Identification of Invoices, Simplified Invoices and Cash Receipts for Tax Administration Purposes and on the Use of Cash Registers and Taximeters Providing Cash Receipts has been published. Contrary to expectations, the Decree stipulates that, in addition to the continuous numbering of invoices, the numbering of invoice copies should also continue to be a requirement.

### **Information on the personal income tax return for 2007**

Please find below a summary of the most important changes and deadlines concerning the 2007 personal income tax return.

In line with the Act on Solidarity Surtax, in force as of 1 January 2007, those private individuals who realized an income of more than HUF 6,748,850 have to file a return on solidarity surtax this year for the first time. The solidarity surtax return is a separate part of the personal income tax return. It is emphasized that foreign-sourced income bearing no tax burden is not subject to solidarity surtax; however, any such foreign-based income will be included in the consolidated tax base.



If the return contains reclaimable tax or social security contributions, they can only be refunded after 1 March 2008; if the return is filed electronically, any refund can only take place as of 1 February.

There is no significant change to the method of filing of a personal income tax return. Private individuals continue to have three options to choose from: (a) they prepare the return themselves, (b) they request their employer to do so on their behalf or (c) the tax authority prepares a return for them, which has been tax assessed by the tax authority. Those who do not prepare the return themselves, have to declare before 15 February whether they would prefer their employer or the tax authority to establish the tax liability. Employers must prepare a certificate for employees by 31 January. Only those taxpayers who have not changed their workplace by 15 February 2008 (i.e. work at the same employer) may request tax assessment from their employer. If the taxpayer asks its employer to prepare the tax assessment, it is still up to the employer to decide whether it will undertake to prepare it or not. If the employer agrees, then private individuals must provide the employer with the certificates required for tax benefits before 20 March.

The table below summarizes the tasks and the related deadlines:

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Deadline	Tasks
15 February 2008	<ul style="list-style-type: none"> <li>▪ Filing the 0753 return of individual entrepreneurs, private individuals subject to VAT, and payment of tax and solidarity surtax.</li> <li>▪ Declaration requesting tax assessment by the employer.</li> <li>▪ Declaration requesting tax assessment by the tax authority.</li> </ul>
12 March 2008	The employer forwards to the tax authority the declaration required for tax assessment by the tax authority.
20 March 2008	Transfer of certificates required for the utilization of benefits to the employer.
10 May 2008	Providing the 1+1 percent declarations to the employer.
20 May 2008	<ul style="list-style-type: none"> <li>▪ Filing the personal income tax return for private individuals who are preparing their own tax returns, as well as actual payment of the tax.</li> <li>▪ Final deadline for sending the 1+1 percent declarations.</li> <li>▪ Preparation of tax assessment by the tax authority and by the employer.</li> </ul>
10 June 2008	The employer sends the employer's tax assessment to APEH.
20 June 2008	<ul style="list-style-type: none"> <li>▪ Payment or refund of tax on the basis of tax assessment by the tax authority.</li> <li>▪ Deduction of tax on the basis of tax assessment by the employer.</li> </ul>
31 December 2013	Period of necessary retention for all documents, certificates, cash receipts used in the 2007 tax return.



## EU and International Tax News

### New place of supply regulation for services as of 2010

At its meeting of 4 December 2007, the ECOFIN Council, composed of the economics and finance ministers of the European Union, reached political agreement over two draft directives and a draft regulation. The decision is aimed at ensuring that cross-border services are taxed from a VAT perspective in the country where consumption occurs; in this way, competition between Member States operating different VAT rates may be eliminated.

As we reported in our previous newsletters, the legislative package relating to the simplification of VAT rules on an EU level is to enter into force as of 1 January 2010. The draft legislative package adopted by ECOFIN on 4 December 2007 contains:

- A draft directive on the place of supply of services,
- A draft directive on procedures for VAT refund,
- A draft regulation on improved administrative co-operation as regards VAT and the exchange of information between Member States.

The most important element of the package is the amendment to the place of supply of services. Currently, in general terms, the place of supply of business to business (B2B) services is where the registered seat or permanent establishment of the supplier is located. As of 1 January 2010, the place of supply of services (with certain exceptions) in a B2B relationship for VAT purposes, will be the registered seat of the customer. This general rule, however, would not apply for example to the services relating to real estate property.

For business to consumer (B2C) services, however, the place of supply rule will not change. These services continue to be taxable in the state where the registered seat of the supplier is located. B2C regulation, however, will not apply to broadcasting, telecommunications and electronic services, for which the place of supply will be the Member State of the customer of the service as of 1 January 2015. Parallel with this, a one-stop system would be introduced to make it easier for service providers to fulfill their VAT liabilities. Under this system, service providers would no longer be required to register in the Member States of every customer; instead, they will be able to fulfill their VAT liabilities (registration, declaration, payment) in their home Member State.

### Commission proposal to simplify the VAT rules relating to financial and insurance services

On 27 November 2007, the European Commission adopted a proposal to simplify the VAT regulation of financial and insurance services and published its proposal to amend the 2006/112/EC VAT Directive accordingly.

Financial and insurance services are generally VAT exempt services in all Member States. The relevant regulation however, dates back to 1977 and has never been

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amended despite significant changes to the market since that time. As a result, VAT exemption is no longer uniform across the Member States. One result of this, is that the ECJ has received a large number of requests concerning the appropriate interpretation of the regulation. The objective of the proposal of the Commission is, therefore, to determine the range of VAT-exempt services in this field in a modern and unambiguous manner which would enhance legal security for both the Member States and the financial and insurance companies.

The proposal intends to implement the following major changes:

- Reformulating the definition of VAT-exempt services, updating the wording and substance of the relevant regulation and clarifying its application.
- Providing companies rendering financial and insurance services the possibility to choose VAT-able treatment and accordingly, to deduct VAT.
- Ensuring VAT-exemption for cost-sharing agreements concluded in the financial sector.

### **Commission proposal to amend the EU VAT Directive (2006/112/EC)**

On 7 November 2007, the European Commission made a proposal to amend the VAT Directive (2006/112/EC). The deadline for the transposition of the new rules into national law in each member state is 1 July 2008.

The proposal incorporates several smaller motions, of which the most important ones are:

- Gas, electricity, heating and cooling

Regarding the acquisition and importation of natural gas and electricity, the proposal extends the scope of the special VAT rules (currently applicable to the supply system) to all types of acquisition whether pipeline or vessel. Furthermore, the proposal extends the special VAT rules applicable to the acquisition and importation of heating and cooling to the acquisition and importation through heating and cooling networks. According to the proposal, services relating to access to electricity, natural gas, heat and/or refrigeration networks will be subject to VAT at the place where the customer is resident.

- Joint undertakings

The new rule would ensure that VAT immunity is available to international organizations and also to those joint undertakings established by the European Commission which are also legal persons and, as a result, receive EU funds from the Commission. This VAT exemption, however, will not apply to those acquisitions of joint undertakings that serve a private purpose.

- Use of real estate property for business and non-business purposes

According to the proposal, in the case of the acquisition, construction, refurbishment or major conversion of real estate property (where the real estate property is used for both business and non-business purposes) the VAT-deduction right will already be applicable upon acquisition only in proportion to business use.

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