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wts klient newsletter

WTS Klient.
The Bridge.

Dear Readers,

In the second part of our video series on the employment of foreigners in Hungary, we focus on the major tax implications of expats working here. First we highlight the importance of defining tax residence, and the aspects that have to be taken into account when determining such residence. Then we focus on the tax aspects of the individual types of income.

You can reach our video presenting these tax aspects by clicking on the following link: wtsklient.hu/en/2017/09/13/tax-aspects-employing-foreigners/ Please switch to English subtitles by clicking on "settings" in the right-hand corner of the video!

In addition to the video, I trust you will also find our weekly articles interesting, which discuss the relationship between the corporate tax rate and transfer pricing, and the potential methods of financing.

Zoltán Cseri
manager

Financing

Choose a loan that fits the payback period of the asset financed, but take the other financing options into consideration as well (e.g. leasing or factoring)! » page 1

Corporate tax rate and transfer pricing rules

Decreasing the corporate tax rate provides tax planning opportunities, but transfer pricing rules also need to be considered for transactions between related parties. » page 3

Financing

Depending on its possibilities, a company can choose from various options to finance its activity:

- equity
- bank or other loan
- asset leasing
- invoice factoring

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There are essentially two ways for a company to finance its activity: using own or external resources. In reality, financing using external resources only is not possible for most companies due to equity rules, but it is possible to use just own resources for financing. Nevertheless, the **most common approach** for companies is to obtain resources for their operations through **mixed financing**.

Of course, the actual composition of the financing largely depends on the financial possibilities and future plans of the owners, the capital requirements of the activity and the attractiveness of the company for investors. The amount of capital provided by owners for the company sends an important message to investors, since it clearly shows how confident the owners are regarding the success of the company.

Raising external funding

It is very important to **align the duration of financing to the payback period of the financed asset**, meaning it is not advisable to use short-term loans to finance tangible assets that generally have a payback period spanning several years. Such short-term loans, however, can be perfectly suitable for financing stocks on which the company expects a relatively quick return.

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Wim Wuyts is the new CEO of WTS Global

WTS Global is positioning itself for additional international growth by creating a new Chief Executive Officer role. Wim Wuyts, a proven tax expert, comes to the network from Bekaert, a Belgian based multinational corporation and supplier of steel wire for the automotive and construction industries. The CEO introduced himself to the regional executives of WTS at the WTS CEE conference in Poznan.

Please find further information about his appointment to the post here and information about the Poznan meeting here.

Bank or other loans

Owners of small companies typically obtain additional resources from their own network of acquaintances, from family and friends. In this case, the personal contacts mean it is a relatively easy way to gain resources without long loan approvals and other procedures, and in many cases it can be more favourable than bank financing in terms of the interest, repayment and duration conditions. The fact the lenders are relatives and the loan they provide is a substantial part of their savings can be a drawback too, however, as they want to have a say in the management of the company. Another disadvantage is that the limited resources mean it is difficult to carry out large projects with this financing method.

Borrowers have to meet stricter and more complex requirements in the case of **bank financing**, not only before taking out the loan but during the entire repayment period. In return, however, they have access to greater financial resources. In contrast to **loans from family and friends**, the company certainly retains power over its daily operative management because banks normally do not want to interfere. However, in the event of strategic decisions the bank reserves the right not to allow the company to make any decision without its approval, which acts as a kind of security for the bank.

Leasing

Leasing is basically a cash saving way for **financing tangible assets**. It can be of great assistance for companies starting to operate in a sector that requires substantial assets if they finance their initial, large-scale investments through leasing. So instead of having to pay a considerable amount in one go, the company's cash flow handles a monthly payment consisting of principal and interest on a much smaller scale, which means the investment can be financed from future revenues.

Factoring

Factoring basically means **selling a debt before the due date**, which greatly helps to maintain a company's liquidity. In addition, based on the type of factoring there can be a number of other advantages for companies. If a credit insurer is involved, a company can be completely protected from the risk of non-payment by customers for example. However, as the factor's coverage is normally the trade receivable itself, the customer portfolio of the given company is very important. Factoring can be a useful tool for companies in financing trade receivables because at a certain cost they not only receive the given amount earlier, but depending on the structure they can also be fully protected from the risk that the customer may not pay the purchase price.

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"For each employee and each transnational corporate agreement it must be examined where the tax, social security and other contribution payment liabilities arise."

Tamás Dely, WTS Klient Hungary Business Development Director CEE

Source: inforadio.hu

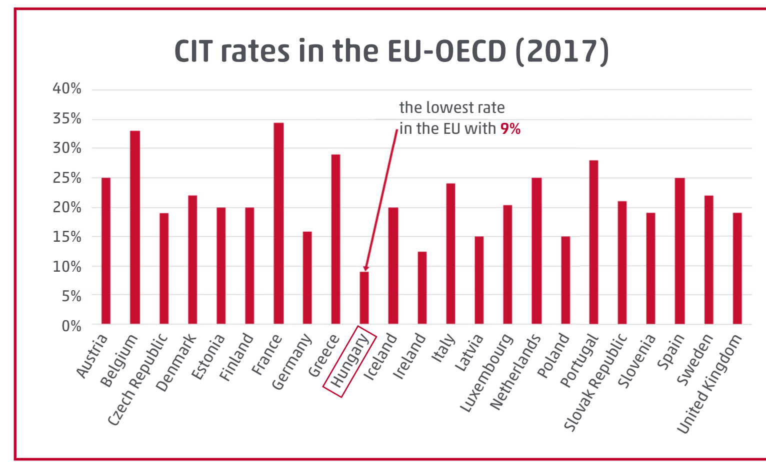
Turn on your radio!

"When a foreign employee arrives at a company, the most difficult question is what tasks the HR, tax, accounting, payroll, legal or compliance departments have to carry out. A well-coordinated solution is needed here." – says Tamás Dely, WTS Business Development Director responsible for Central and Eastern Europe, who will be discussing the strategic aspects of foreign employees working in Hungary on the evening of 14 September on InfoRadio.

Listen to the conversation at this link!

Please note that the conversation is available only in Hungarian.

Relation between corporate tax rate and transfer pricing rules



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We are accustomed to the fact that taxes are always present in our lives, and the rates are constantly changing. The percentage changes can have a major impact on us, they can prompt us to make significant changes to our business plans, boost new investments, or even motivate us to rethink the operation of a group of companies active in several countries.

Changes to corporate tax rate in Hungary

The recent trend clearly emerges if we examine corporate tax rate changes. The Hungarian **corporate tax rate** has been steadily reduced, and from 2017 is now a one-digit number, 9% across the board. There used to be two rates, 10% and 19% (the 19% rate was applicable from a tax base of HUF 500 million or more). The trend for the **VAT rate** is the opposite, where we have seen a **continuous increase**, currently peaking at 27%.

Revised transactions

The transfer pricing model was created in response to the different corporate tax rates and tax bases. Using the following example, let us imagine how simple it would be to optimise corporate tax expenses within a group if there were no transfer pricing regulations.

Analysts of a group consisting of a Hungarian and a German company continuously monitor the profitability of the two manufacturing units and the amount of corporate tax paid by the companies. Based on the trends over a few years they "realise" that the **corporate tax they pay in Germany is considerably higher**, despite the fact the two companies have similar revenue and cost levels. In the meantime, the corporate tax payable in Hungary is continuously decreasing as a result of the falling tax rate. At this point, they decide to make better use of the opportunity offered by the steady decrease in the corporate tax rate in Hungary. The only question is how they can move the profit from Germany to Hungary before paying tax, whilst maintaining the profitability of the German manufacturing unit.

The group is currently rethinking its logistic processes, including supplier contracts, and the group managers think that the raw materials should be placed under the authority of the German company, which has a longer history and more extensive relationships (meaning a stronger bargaining position). The German company negotiates the purchase price of the raw materials based on the needs of the whole group, and on this basis they can expect a significant bulk discount. Then the volume required for production in Hungary is resold to the Hungarian company at a discounted price, thereby substantially reducing the material purchase costs of the Hungarian company whilst generating low revenues for the German company. **The result is clear**: thanks to the cheap raw material, the Hungarian company closes the year with a substantial increase in profit, while the German company generates a low profit owing to the reduced revenues. According to international transfer pricing rules, the tax planning method detailed above does not require a tax base increase in Germany as long as it is proven that by applying this pricing method the German company sold the raw materials to the Hungarian company at **arm's length**.

Changing business model

We can move forward using the previous example. The management body of the company convenes and they make a decision: **the tax environment Hungary has created is favourable enough** to relocate 6 of the 8 main manufacturing units from Germany to Hungary. In this case, they close down the manufacturing units in the German factory and relocate them to Hungary. Tax and transfer pricing rules are very sensitive to such moves, and based on economic realities German legislation is prepared for such changes in business models. **It is always worth consulting with an adviser** before setting up a structure like this: German legislation has been using the term "Funktionsverlagerung" for a long time, which covers the transformation process described above. Taking into account the business potential of the relocated business units, it endeavours to use various taxation methods to impose taxes on them.

This WTS information does not constitute advice and it serves only to provide general information about selected topics.

Any information contained herein shall thus not be considered exhaustive, and nor may it be relied upon instead of advisory services in individual cases. We accept no liability for the accuracy of the content.

Should you have any questions regarding the above or any other professional issues, please do not hesitate to get in touch with your WTS advisor or use any of the contact details below.

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