

NAV's (National Tax and Customs Authority) monitoring guidelines for 2011

NAV (the successor of the former APEH) this year, like every year in compliance with its statutory obligations published its monitoring guidelines for 2011, thereby ensuring their widespread publicity.

The organizational integration of the formerly self-operating tax and customs authorities as from January 2011, was mainly designed to promote stronger official presence, combating harmful tax practices of taxpayers, including faster exploration and reduction of the economic trends presenting high risk for the tax revenues expected to flow into the budget.

A strategic issue for this year's audit is that the tax authority should take quick action against illegally acting taxpayers.

According to NAV's directive, in the process of selecting companies for audit, and when focusing on eliminating the so called „fictitious companies”, the following features are paid much attention by the tax authority and may justify reasons for an individual risk management, even during the period of setting up a company:

- The registered company seat is provided through registered seat service (regulatory tightening is expected in the near future)
- The company's foreign managing director does not have a registered address in Hungary
- Declaring high turnover - particularly in case of low registered capital – as well as high amount of payable VAT and almost the same amount of deductible VAT within tax returns, shortly after the establishment of the company (tax minimizing tactic applied)

Following the period of setting up a company, the tax authority continuing its audit trends set for the previous years, shall especially monitor and control business entities who have not filled their tax returns, including those where common change in registered seat, competence or a change in ownership structure took place, on companies where despite continuous operation permanent losses have been registered, or where the large amounts of accumulated losses were financed through equity loan financing, as such circumstances could lead in fact to the conclusion that a risk for tax minimizing is to be dealt with.

Due to the persisting multi-country fraud risks, high level of attention shall be paid on business entities performing import-export transactions, to billing cycle and billing operations of contractor/subcontractor business relationships' where suspicion of involvement in organized fraud may arise up (with special regard to fictitious billing, distribution channels and chain-billing).

In respect of subsequent tax audits as of 2011 certain new tasks have been set regarding corporate income tax and dividends, practically by extending the control areas examined by inspectors during the previous years. This extension would consist in increased regulatory control focused on transactions performed between related parties and on transfer pricing from the perspective of their corporate structure and market relationship. On the basis of the above, as opposed to 2010, from 2011 not only large corporations currently being obliged to keep a record on transfer-pricing documentation, but also small and medium-sized companies could be subject to transfer pricing audit on their inter-related domestic transactions. Although, under the currently prevailing regulations these entities are not obliged to prepare and keep transfer-pricing records, yet these new guidelines could be an alert to the fact that from now on the tax authority could also examine whether within the contracts signed with their related parties a fair market price has been applied or not.

It is worth mentioning that an audit on how the transfer-pricing records are kept may usually take place during the course of a tax audit examining the performance of certain tax liabilities in general, whereas, when dealing with subsequent tax audits the emphasis shall be rather put on examining the applied price, or an effective control over the content of the price range comes to the fore, with special regard to the true nature of transactions and the parties' true intention thereto. Therefore, during subsequent tax audit, the tax authority shall primarily examine the value of the market price applied in respect of the services effectuated between related parties and in respect of sale of intangible assets and provision of loans, equipment leasing, various commissions, royalties including special financial operations performed between related parties. In the light of the above, should a significant increase in the amount of registered capital, a capital reserve be announced, or if sale of company shares took place at a business entity, special care should be taken in the preparation of transfer pricing documentation thereto in order to avoid high penalties (i.e. up to 2 million HUF /TP documentation).

Finally it must be added, that in 2011, the tax authority shall put greater emphasis on examining the accounting of advertising costs and of subsidies granted to business entities, another new task in respect of reverse charged rules shall be monitoring on the transfer of marketable intangible rights entitling to greenhouse gas emissions, moreover, control over customs duties, excise duties and environment protection tax shall also be included within NAV's competence.

Taking into account the traditional structural features of the Hungarian economy, as well as the different contribution rate of certain sectors in the GDP growth rate, the monitoring guidelines for 2011, continuing the previous directions set forth in 2010, will mainly

affect the service sector, especially market services such as: retail trade, repair, catering, transport, storage, telecommunications, real estate and other financial services.

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