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SME INFO HU

ACT ON THE GLOBAL MINIMUM TAX

With the announcement of the Global Minimum Tax Act on 30 November 2023, the EU GloBE Directive 2022/2523 has been introduced into the Hungarian law system, with an entry into force date of 31 December 2023. In this newsletter we provide a framework for the Hungarian legislation, highlight the most important deadlines, present the operating mechanism and draw attention to the points that require decisions and possibly consultation with tax advisors.

With regard to the novelty and complexity of the regulation, there are no well-developed professional interpretations available yet, so further questions are likely to arise during the analysis of the detailed rules and the preparation of specific calculations. Therefore, it is important that those who are already affected by the top up tax or will become so in the near future, keep themselves informed and follow the professional forums in 2024, as well.

the SME Team

The purpose of SME INFO is to provide general information and to draw the attention to the current changes in law which we believe to be important for the business operation of our clients. It is not a replacement for careful review of the acts and rules, and the consultation with your tax advisor.

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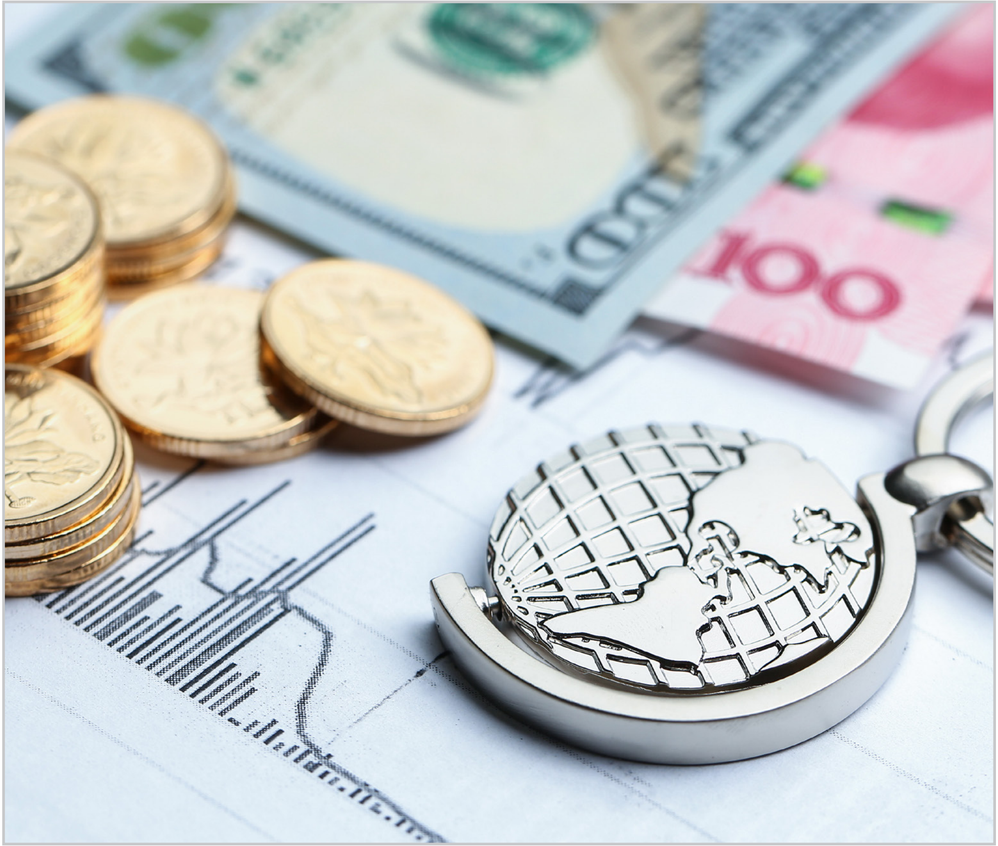
Content



I. The regulatory background to the introduction of the global minimum tax

A key milestone of tackling aggressive tax planning and tax avoidance is the BEPS (Base Erosion and Profit Shifting) package, adopted in 2015 by OECD, which sets out a 15-point action plan to achieve fair taxation and tackle the use of tax system differences to avoid taxes.

The OECD's first Action Plan addresses tax challenges arising from the digitalisation of the economy and is based on two pillars.

- The first pillar is to ensure that the profits of the largest companies are taxable and distributed across all countries of income generation, so reflecting their real economic activity and value creation.
- The second pillar – referred to as GloBE (Global Anti Base Erosion) – aims to ensure that MNE (multinational enterprises) groups above a specified threshold pay an effective tax of at least 15% in all countries to ensure equal competitive conditions. The GloBE Directive 2022/2523 was adopted by the European Union in December 2022.

In Hungary, in accordance with the adopted GloBE Directive, the Act „Act LXXXIV of 2023 on top up tax ensuring the global minimum tax level and amending certain tax acts in connection" was announced on 30 November 2023 and will enter into force on 31 December 2023.

II. Key dates for the introduction of the global minimum tax regulations

Below is a summary of the key dates for the new legislation:

Implementation

31 December 2023: minimum tax rules enter into force (applies for the first time for the financial year starting in 2024, except for the under-taxed payments rule (UTPR)) (1)
For tax years beginning on or before **31 December 2026**, MNE groups may choose to calculate any minimum tax exemption for a state on a simplified basis (by which is meant that the amount of top up tax payable is treated as zero).(2)

MNE groups in initial phase, if certain conditions are met, may be exempted from the regulations for the first 5 years of their international activities and 5 years from the start of falling within the scope of the global minimum tax.(3)

If relevant, we recommend consulting with a tax advisor for the details of the conditions.

§ (1) Act LXXXIV of 2023, 52.§, 53.§ (1), (4) (2) Act LXXXIV of 2023, 53.§ (2)
(3) Act LXXXIV of 2023, 47.§

Notification [4]

Until 31 December 2024: the calendar year top up taxpayer in 2024 must notify the tax authority of this status. Otherwise, the notification must be made within 12 months of the start of the tax year in which the top up tax liability arises.

Tax assessment [5]

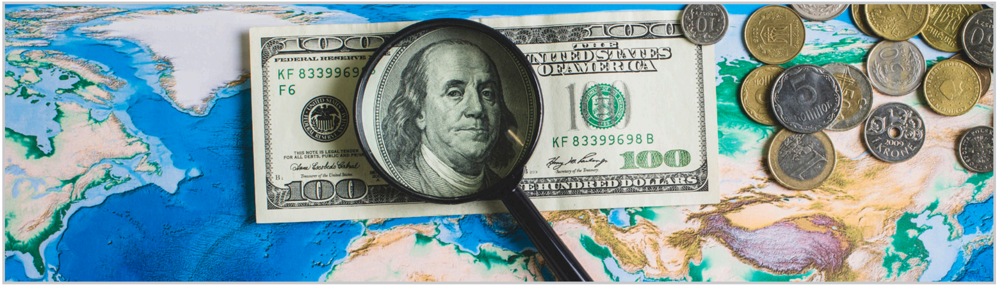
30 June 2026: the deadline for filing the 2024 top up tax return for a normal financial year. In other cases, the return must be filed (and the top up tax paid) no later than 15 months after the last day of the tax year to which the return relates and, in the case of a transitional year (the first tax year in which a MNE group is subject to the GloBE for a given state), within 18 months.

Penalty [6]

For tax years beginning before **31 December 2026**, no penalty may be imposed for non-compliance with the statutory obligation, provided that the given company has acted as he was expected to act in the circumstances.

Transition rules [7]

30 November 2021: This is the date when OECD adopted the GloBE rules, so from this date onwards, transactions between group members should be monitored and special rules may apply (e.g. in the case of a transfer of tangible assets between group members, the book value in the calculation of the deferred tax asset/liability will be the asset value in the transferring party's books at the time of the transfer).



(4) Act LXXXIV of 2023, 44.§ (1)
(5) Act LXXXIV of 2023, 44.§ (9), (10), 49.§
(6) Act CL of 2017 - on the Rules of Taxation, 274/R.§
(7) Act LXXXIV of 2023, 46.§ (6)

III. Temporary exemption calculated on the basis of the Country by Country (CbC) report [8]

For the first 3 years after entry into force, it will be possible for companies, resident in the same state, to apply a simplified procedure for determining any top up tax exemptions.

Each of the available tests (de minimis, simplified effective tax and routine profit) works basically from the CbC report data and has the advantage that if one of the three is met by the aggregated data of the group members in a state, the group can choose to treat the top up tax as zero for that tax year for that state.

The regulation refers to the corporate tax information report regarding the thresholds, but under the Accounting Act, a Hungarian member of a group with consolidated revenues above EUR 750 million is exempt from this reporting, with regard to the CbC report requirement.

If a simplified effective tax test is used, it is worth checking with the report preparer the source of the data and possible modifications to the data included in the report, taking into account that the covered taxes include local business tax and innovation contribution under the qualified domestic top up tax calculation mechanism, which are most likely included in the pre-tax profit of the Hungarian members' CbC report and thus reduce the calculated effective tax rate.

IV. Subjects of the global minimum tax

The global minimum tax is payable by a Hungarian tax resident member of a multinational or large-scale domestic group, which group's[9]:

- annual revenue
- according to the consolidated financial statements of the ultimate parent company
- in at least two of the four tax years immediately preceding the tax year (any one of the four years)
- reaches or exceeds EUR 750 million (=CbC report threshold)

(8) Act LXXXIV of 2023, 32.§, 53.§ (2), (3)
(9) Act LXXXIV of 2023, 1.§ (2)

Certain companies are excluded entities, e.g. ultimate parent investment funds, non-profit institutions, whose figures are included in the threshold calculation, but are not subject to the top up tax.

Group members resident in a given state below a certain threshold can choose exemption from the top up tax, such election must be made annually.[10]

V. Effective tax rate (ETR), top up tax liability and collection mechanisms

If the group is subject to the global minimum tax, it must calculate its **effective tax rate** in that country as follows [11]

> ***effective tax rate (ETR)*** *= adjusted covered tax of group members resident in the given state/ net qualifying income of group members resident in the given state*

If this value is less than **15% (minimum tax rate), top up tax payment obligation** arises in the given state, for the collection of which the Directive (and thus the Hungarian legislation) provides 3 different mechanisms.[12]

1) Qualifying domestic top up tax (QDMTT)

The Directive allows for the top up tax to be levied locally (in a given state) on the excess profits of resident group members. QDMTT reduces (up to a maximum of zero) the tax collected under IIR.

> If the qualifying domestic top up tax is also granted an exemption during the so-called „peer review" validation („safe harbour QDMTT"), the IIR tax is automatically presumed to be 0 for that state. [13]

§ (10) Act LXXXIV of 2023, 30.§
(11) Act LXXXIV of 2023, Appendix 2
(12) Act LXXXIV of 2023, 1.§ (5)
(13) Act LXXXIV of 2023, 32.§ (3)

2) Income inclusion rule (IIR)

The ultimate parent company resident in a given country must determine and pay its own share of the top up tax and that of its domestic and foreign group members with a low tax burden. The IIR tax so calculated is reduced by the qualifying domestic top up tax paid by the members (QDMTT).

3) Undertaxed profit rule (UTPR)

If the ultimate parent is resident in a state that does not apply the IRR (and neither is an intermediate parent) or, for example, the parent is an excluded entity, the top up tax will be assessed, distributed and paid by the group members - applying the global minimum tax - among themselves according to a specific rule.

VI. Status and calculation method of the Hungarian top up tax

According to our current information, the Hungarian domestic top up tax is planned by the government to become a „safe harbour QDMTT", i.e. it will qualify for exemption under the OECD model rules, but this status still requires international validation, which we expect to be granted in 2024.

If the exemption will be met, the qualified domestic top up tax is to be calculated as follows:

> ***Top up tax rate for Hungary*** [14] *= minimum tax rate - effective tax rate*
>
> ***Top up tax for Hungary*** [15] *= top up tax rate × excess profit*

where ***excess profit*** *= net qualifying income – substance- based income exclusion (for payroll cost + fixed assets)*

where:

- the group member's income exclusion per wage cost equals to 5% of the eligible wage costs of the eligible employees of the MNE group or large-scale domestic group operating in the country of residence of the group member (starting from 10% up to 5.8% in the transitional period from 2024 to 2033)
- the group member's income exclusion per tangible asset equals to 5% of the book value of the eligible tangible assets in the group member's state of residence (starting from 8% to 5.4% in the transitional period from 2024 to 2033) [16]

§ (14) Act LXXXIV of 2023, Appendix 4
(15) Act LXXXIV of 2023, Appendix 6
(16) Act LXXXIV of 2023 28.§, Appendix 9

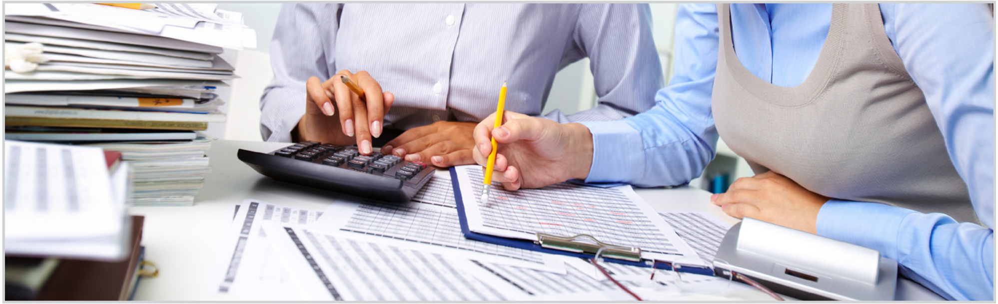
VII. The specialities of the Hungarian „safe harbour" QDMTT and decision points

In the following, we draw your attention to the specialities of the Hungarian domestic top up tax, which are currently the most frequently raised on professional forums and which can be identified in the corresponding new regulations, and we emphasise that most of them require the involvement of a tax advisor or the central tax department of the group.

1) The **excess profit of domestic group members** must be determined in accordance with the **local financial accounting standard** under which their corporate tax liability is determined (Hungarian Accounting Act or IFRS) or, in the lack of a corporate tax liability, their records have been audited by an independent auditor. If the tax year determined according to the local financial accounting standard is different from the tax year applied by the group, the accounting standard applied by the ultimate parent company should be used. [17]

It is not clear from the wording of the law whether, if domestic group members do not apply the same local accounting standard (i.e. for example, in the case of 2 members, one applies the Accounting Act and the other IFRS), their figures can be added together in the necessary calculations or whether the consolidation standard should also be applied for both companies.

2) The concept of **covered taxes** in Hungary includes in particular corporate income tax, income tax of energy suppliers, local business tax and innovation contribution. [18]



(17) Act LXXXIV of 2023, 11.§ (8), (9)

(18) Act LXXXIV of 2023, 20.§ (2)

This list is not exclusive, other types of corporate income taxes may also be considered in the calculation. If they are significant and no official statement will be available later on, it is advisable to consult with a tax advisor.

The covered taxes include deferred tax, which is already optional for those applying the Hungarian Accounting Act. The deferred tax reduces the inter-annual volatility of the calculated effective tax rate due to temporary differences, so its introduction in the Hungarian books should definitely be considered. The choice is particularly worth considering for companies that would be able to take into account a significant deferred tax asset, for example due to unused tax loss. Although the recognition of a deferred tax asset in the books depends on if it can be utilized by the entity, the GloBE rules allows for the possibility of taking into account the opening deferred tax asset of the transitional year even if it is not recognized in the books, due to the uncertainty in the utilization. Considering that the choice can already be made for 2023, in case of involvement, we recommend consultation with the auditor as soon as possible, to consider the introduction and its optimal timing.

3) The global minimum tax legislation pays special attention to the tax-free treatment of **share related impairment/impairment reversal and gain on sale** accounted for in the books.

Currently, under Hungarian law, corporate income tax is not payable on the gain on the sale of a notified share and, at the same time, the tax base cannot be reduced by the loss on the sale, thus the above principle is met.

The current amendment[19] to the CIT Act is also linked to this principle, which allows taxpayers to make use of a **one-off option to declare** their non-notified shareholdings (but meet the conditions) **by 31 May 2024** (for calendar year taxpayers, otherwise by the last day of the tax return deadline for the 2023 tax year), with the provision that:

- 20% of the positive difference between the market value of the shareholding and its book value on 31 December 2023 must be declared as a taxable income and tax shall be paid on it
- an independent auditor's or expert's opinion on the market value must be available at the time the return is filed.

(19) Act LXXXI of 1996 – on Corporate Tax and Dividend Tax, 29/A.§ (119)-(123)

To avoid asymmetric situations, the OECD model rules provide the option for the taxpayer to treat the income accounted on shareholdings in accordance with the local corporate tax rules for the purposes of determining the effective tax rate.[20] In view of these options, the further treatment of the non-notified shares (to submit the notification or to make use of the option under Chapter 2.9 of the February 2023 Administrative Guidelines) should be considered on a share-by- share basis with the assistance of a tax advisor.

4) The OECD model rules introduce the concept of **qualified and non-qualified refundable tax credits**, the key difference being that qualified tax credits reduce the effective tax rate less than non-qualified tax credits by:
   - the amount of the credit increases the net qualifying income [21]
   - covered tax is not reduced by the tax credit [22]

In response to the OECD rules, a new R&D tax allowance, which is a qualifying refundable tax credit, has been introduced in the CIT Act for the year 2024, with the following main parameters [23]:

- based on a 5- year taxpayer choice,
- applies to the total eligible costs of basic research, applied research and experimental development incurred over 5 consecutive years,
- available in the year in which the eligible costs are incurred and for 3 years thereafter,
- the company is entitled to reimbursement by the State of tax credits not used as tax deductions in the year in which the costs are incurred and in the 3 years following,
- limits on the amount of the allowance that may be claimed:
  - 10% of the costs incurred may be deducted,
  - there is a further limitation on the amount of the tax credit for a given project,
- the choice of the tax credit must be made in the tax return for the year first concerned,
- tax and tax base R&D allowance cannot be applied to 2 separate projects in the same year,
- taxpayer's choice can be changed from the 6th tax year.

(20) Act LXXXIV of 2023, 16.§ (1) c
(21) Act LXXXIV of 2023, 16.§ (9)
(22) Act LXXXIV of 2023, 21.§ (2) d
(23) Act LXXXI of 1996 – on Corporate Tax and Dividend Tax, 22/G.§

If the company subject to the top up tax has already made use of the R&D tax base allowance or plans to do so in the future, it is recommended to consider and consult with a tax advisor whether to continue to make use of it in the form of the tax base allowance or the new tax credit, given that the two cannot be applied together.

5) The introduction of a global minimum tax at international level requires **cross-group communication and coordination**, for which the groups concerned must be prepared.

Below are some examples of tasks that require coordination within the group:

- the global minimum tax status (whether the group is subject to it in 2024, whether it is expected to be subject in the next few years)
- identification of the companies resident in Hungary, management of their data, coordination of data collection, execution of calculations (who will prepare, validate?)
- CbC report exemption test for Hungarian resident members
- taking the necessary decisions on the basis of the Hungarian legislation (introduction of deferred tax, notification of non-notified shareholdings, applying R&D allowances)
- clarification of possible uncertainties in the interpretation of the law
- establishing a calculation, management and legal reporting process.

To summarize, we can say that although the due date for the first returns seems far away, given the international nature, novelty, complexity, the need for coordination and the specific deadlines by which notifications and certain accounting (deferred tax) and corporate income tax elections (non-notified shares, R&D tax and tax base allowance) must be made, we strongly recommend that intra-group communication, information exchange and coordination should start as soon as possible, taking advantage of the time available for preparation.