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# THE TAX DISPUTES AND LITIGATION REVIEW

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THIRD EDITION

EDITOR  
SIMON WHITEHEAD

LAW BUSINESS RESEARCH

# THE TAX DISPUTES AND LITIGATION REVIEW

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THE TAX  
DISPUTES AND  
LITIGATION  
REVIEW

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Third Edition

Editor  
SIMON WHITEHEAD

LAW BUSINESS RESEARCH LTD

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# EDITOR'S PREFACE

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The objective of this book is to provide tax professionals involved in disputes with revenue authorities in multiple jurisdictions with an outline of the principal issues arising in those jurisdictions. In this, the third edition, we have continued to concentrate on the key jurisdictions where disputes are likely to occur for multinational businesses.

Each chapter provides an overview of the procedural rules that govern tax appeals and highlights the pitfalls of which taxpayers need to be most aware. Aspects that are particularly relevant to multinationals, such as transfer pricing, are also considered. In particular, we have asked the authors to address an area where we have always found worrying and subtle variations in approach between courts in different jurisdictions, namely the differing ways in which double tax conventions can be interpreted and applied.

It is noticeable in this third edition that the past year has seen a general increase in litigation as tax authorities in a number of jurisdictions take a more aggressive approach to the collection of tax; in response, no doubt, to political pressure to address tax avoidance. In the UK alone we have seen the tax authority vested with broad new powers not only of disclosure but even to require tax to be paid in advance of any determination by a court that it is due. The provisions empower the revenue authority, an administrative body, to compel payment of a sum, the subject of a genuine dispute, without any form of judicial control or appeal. A further announcement has just been made to introduce a 'diverted profits tax' to impose an additional tax in the UK when it is felt that a multinational is subject to too little corporation tax. These are, perhaps, extreme examples, reflective of the parliamentary cycle, yet a general toughening of stance seems to be felt. In that light, this book provides an overview of each jurisdiction's anti-avoidance rules and any alternative mechanisms for resolving tax disputes, such as mediation, arbitration or restitution claims.

We have attempted to give readers a flavour of the tax litigation landscape in each jurisdiction. The authors have looked to the future and have summarised the policies and approaches of the revenue authorities regarding contentious matters, addressing

important questions such as how long cases take and situations in which some form of settlement might be available.

We have been lucky to obtain contributions from the leading tax litigation practitioners in their jurisdictions. Many of the authors are members of the EU Tax Group, a collection of independent law firms, of which we are members, involved particularly in challenges to the compatibility of national tax laws with EU and EEA rights. We hope that you will find this book informative and useful.

Finally, I would like to acknowledge the hard work of my colleague Alice McDonald in the editing and compilation of this book.

**Simon Whitehead**

Joseph Hage Aaronson LLP

London

February 2015

## Chapter 14

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# HUNGARY

*Anna-Mária Veres and Balázs Kutasi<sup>1</sup>*

### I INTRODUCTION

The Hungarian regime of resolving tax disputes is rather conventional and conservative in comparison to some other jurisdictions. As a general rule, taxpayers assess and pay their taxes themselves and sometimes they face a tough challenge in attempting to comply with the rules of the ever-changing legal environment. With the exception of local taxes, the collection of all taxes, customs and social security contributions, as well as the supervision of tax returns and their payments, fall within the competence of a large and integrated organisation of the National Tax and Customs Administration (NAV), that will be referred to in this article as the tax authority.

A tax dispute usually begins as the result of a tax audit, when the tax authority makes statements on the tax treatment of a certain business transaction that conflict with the opinion, conduct, or both of the taxpayer.

The regulations provide various methods to resolve legal disputes. Some can be described as remedies against an unfavourable decision. These remedies have several legal forms; however, the most important distinction is that they may be internal or external remedies. Internal remedies are judged within the organisation of the tax authority, whereas external remedies are judged by the independent courts in tax lawsuits.

Since tax litigations are usually lengthy and costly procedures, there are several legal instruments aimed at avoiding future disputes, such as the preliminary rulings and opinions that can be requested from the authorities to clarify the tax treatment of a certain transaction beforehand, or the advance pricing agreements (APAs) in which

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<sup>1</sup> Anna-Mária Veres and Balázs Kutasi are attorneys-at-law at Gide Loyrette Nouel. The authors would like to acknowledge and thank Eszter Kamocsay-Berta, Dániel Gera and Márton Hajnal for their contribution to previous versions of this chapter.

taxpayers may agree with the tax authority on the principles of defining the arm's-length prices to be applied in transactions between related entities.

On the other hand, alternative dispute resolution methods and individual arrangements between the tax authority and the taxpayers are not typical in Hungary.

## II COMMENCING DISPUTES

### i Tax assessment overview

With certain exceptions, taxpayers in Hungary generally pay their taxes on a self-assessment basis (i.e., they file their tax returns and perform payments by the due date without receiving any formal notice from the tax authorities). This applies to the most significant taxes, such as value added tax, corporate income tax or personal income tax. However, in certain cases taxes can be assessed in other ways: with respect to employers, by levying; in other cases, by collection; or by the tax authority levying, imposing, or conducting retrospective tax assessments.

In the case of self-assessment, taxes and budgetary subsidies must be assessed, declared and paid by the taxpayers themselves.

An important element of the self-assessment regime is that taxpayers have the option to amend their already submitted tax returns. Such amendments may be requested by the taxpayer within the term of limitation specified for the tax assessment but prior to a tax audit. However, if payable tax is revealed in the course of a self-revision, the taxpayer has to pay 50 per cent (or in the case of a repeated self-revision, 75 per cent) of the late payment penalty as a self-audit surcharge. The amount of the late payment penalty is calculated on the basis of the prevailing base rate applied by Hungary's central bank, the Hungarian National Bank, which must be doubled for a late payment penalty. A late payment penalty is due from the first day following the deadline determined for filing the tax return, and has to be paid for the period ending on the day of the submission of the self-revision sheet.

In respect of an assessment, or other disputable decision of the tax authority, taxpayers are entitled to commence a dispute resolution process before higher-level tax authorities, and ultimately to initiate a judiciary review of the relevant decision before an independent court.

To avoid a subsequent tax dispute, taxpayers are entitled to request a written statement from the tax authority regarding the tax consequences of a prospective transaction, as described below.

### ii Request for a binding ruling, opinion, or establishment of fair market price

#### *Binding ruling*

A binding ruling issued by the tax authority applies to the applicant and the particular arrangement that was the subject of the ruling request. Except for permanent binding tax rulings, as of 1 January 2015 the tax ruling has a binding effect on the tax authority (i.e., it must apply the relevant legal provisions in the manner set out in the ruling) until the last day of the fifth tax year after being issued. However, if international legal obligations (such as the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention) change, the binding ruling is not applicable from

the entry into force of such changes. The binding ruling may be requested not only for proposed transactions, but also, in certain cases, to already completed, performed transactions. In the course of the procedure, the representation of the requesting party by a lawyer, a tax adviser or an auditor is obligatory.

Requesting such a binding ruling is subject to fees, depending on the number of transactions requiring clarification and whether an accelerated procedure is requested. As of 1 January 2015, it will vary from 5 million forints to 11 million forints and the fee of personal consultations will increase from 100,000 forints to 500,000 forints.

### *Opinion*

Apart from the above-mentioned binding ruling, the tax authority, upon receipt of a written request, may issue an opinion to taxpayers looking for clarification on the application of certain taxation rules regarding particular transactions. Although these opinions do not have a binding effect on the tax authority, taxpayers who comply with them are presumed to act in good faith (*bona fide*). This means that the tax authority may mitigate or pass over a fine with regard to the fact that the taxpayer proceeded with due care. Applying for a non-binding opinion is free, and, in contrast to the requirement with a binding ruling, representation by a lawyer or tax adviser is not obligatory, only advisable; however, it often takes longer to obtain.

### *Establishing fair market price*

Upon the request of a taxpayer, the tax authority may issue a resolution declaring the procedure for determining the fair market value to be used in a future transaction between related companies, the facts and circumstances that form the basis for determining the applicable price and, if possible, the fair market price or price range.

In an APA, a multinational taxpayer and at least one government administration can agree in advance the appropriate approach to determine the arm's-length price to be charged in transactions between related entities. Under this regime, unilateral, bilateral and multilateral APAs can be reached in internationally accepted procedures.

APAs involving the competent authorities of more than one tax administration affected by transactions create an assurance in advance for taxpayers that a consistent approach will be taken by the governments involved in a cross-border transaction, thus avoiding the possibility of costly subsequent disputes.

The established market price is valid for a specific term (a minimum of three years and a maximum of five years), and may be extended for an additional three years provided that the factual background of the original resolution has not changed.

Proceedings for establishing the fair market price are subject to a fee, which varies from 500,000 forints to 10 million forints, depending on the complexity of the case and the number of parties involved.

The fee for extending or amending the APA is 50 per cent of the fee paid in the original proceedings. If the application is rejected, 75 per cent of the fee paid is refunded to the taxpayer.



### iii Procedures available in case of tax disputes

If a dispute cannot be avoided, it is possible to bring legal actions against a resolution of the tax authority. These legal actions may be ‘internal’ remedies (appeal, supervisory measures) and ‘external’ remedies (judiciary review, i.e., litigation).

#### *Appeal*

An appeal may be requested on any grounds, including, but not limited to, a procedural error, an error of fact, or any other ground that affects the correctness and the validity of the proceedings or decision.

An appeal has to be lodged within 15 days from the receipt of the resolution, or in the case of a posterior tax assessment, within 30 days from the receipt of the relevant resolution of the tax authority.

An appeal is subject to stamp duty that is 400 forints for every 10,000 forints of the value affected by the appeal, but a minimum of 5,000 forints and a maximum 500,000 forints. If the value of the subject matter cannot be determined, the stamp duty on the appeal is 5,000 forints.

#### *Supervisory measures*

Supervisory measures may be initiated by the taxpayer, but in certain cases they may even be conducted by the tax authority *ex officio*. This procedure may be initiated in cases where the decision of the tax authority breaches substantive or procedural legal rules.

Supervisory measures can be requested from the supervisory authority (higher level tax authority) or the competent ministry, within the limitation period; in other words, even if the deadline for an appeal has expired.

In general, a supervisory measure is subject to the same amount of stamp duty as an appeal or, when the measure is made by the minister, 500 forints for every 10,000 forints of the value affected by the appeal, with a minimum of 50,000 forints and a maximum of 500,000 forints.

#### *Judiciary review of a resolution issued by the tax authority*

Upon the request of the taxpayer, the final and binding decision of the second-level tax authorities may be challenged before the competent county court in a judiciary review procedure. In course of the review, the court may only examine whether the decision constitutes a material or procedural breach of law. The request for a judicial review has to be submitted within 30 days from the receipt of the relevant resolution.

The court shall adjudge the case in chambers; however, a hearing is held if so requested by either of the parties.

The decisions of the higher-level tax authorities are considered as executable; however, it may be requested from the court to have the execution suspended while the judiciary review is ongoing.

The procedure is subject to stamp duty amounting to 6 per cent of the value of the claim, but not less than 15,000 forints and not more than 1.5 million forints.

### *Request for preliminary ruling at the European Court of Justice*

In the course of a judiciary review, the European Court of Justice might be solicited by the proceeding court, *ex officio*, or based on the request of either party for a preliminary ruling regarding the interpretation or validity of the EU law. During the preliminary ruling procedure the judiciary review is suspended.

In principle, the proceedings before the European Court of Justice shall be free of charge.

### *Amendment and withdrawal of a resolution*

Prior to a revision carried out by a superior authority or by the court, the first instance tax authority may establish that its resolution failed to comply with certain legal regulations and may amend or withdraw its own resolution at its discretion (*ex officio*).

## **III THE COURTS AND TRIBUNALS**

### **i Internal review of a decision**

The procedures detailed in Section II, *supra* (i.e., the appeal, the supervisory measures and the amendment or withdrawal of a resolution) may be considered as internal remedies, as they are carried out within the organisation of the tax authority.

If a taxpayer disagrees with a tax authority resolution, it may file an appeal, or request supervisory measures. As mentioned above, if the tax authority's decision remains unfavourable despite the appeal, the taxpayer may initiate a judicial review.

### *Appeal*

The Hungarian system allows tax appeals for those on whom the tax authority has levied a burden, or who are affected by a tax authority decision.

An appeal has to be filed with the first instance tax authority, which has the right to amend its resolution immediately in response to the appeal. However, this is rather a theoretical possibility, as the first instance tax authority does not usually agree with the taxpayer's appeal, as the appeal contradicts its own resolution.

The first instance tax authority must forward the appeal to the superior tax authority within 15 days. The superior tax authority must adopt a decision within 15 days or, in the case of a retrospective tax assessment, within 60 days of receipt of the appeal.

The superior authority may uphold, change or annul the decision made at first instance. If a breach of law is established, and the decision of the first instance is annulled, the reopening of the administrative procedure may be ordered by the superior authority.

The decision made by the superior authority may be less favourable to the applicant than the first instance resolution. However, such an unfavourable decision may only be adopted within one year of the conclusion of the tax audit. This limitation also applies to cases in which a new proceeding is ordered by the superior tax authority, or where the first instance tax authority withdraws its resolution.

### *Supervisory measures*

In practice, there are two cases where taxpayers usually request supervisory measures: if the deadline for submitting an appeal has expired, or if the decision challenged by an appeal was upheld at second instance.

The superior tax authority or, if the superior tax authority has already made its decision, the minister in charge must adopt a decision within 30 days or, in the case of a retrospective tax assessment, within 60 days. The procedure before the minister is of a professional nature, thus the well-founded argumentation of the taxpayer would not be rejected on tax policy grounds.

The superior tax authority or the minister may change or annul the resolution breaching legal regulations, and decide that a new procedure has to be carried out or instruct the first instance authority to conduct a new procedure.

### *Amendment and withdrawal of a resolution*

The tax authority may amend or withdraw its decision *ex officio* at first instance. The deadline provided is one year from the resolution becoming legally binding, if the result of the procedure would be detrimental to the taxpayer; or is equal to the usual term of limitation specified for tax assessment (in general, five years), if the result is to the benefit of the taxpayer.

## **ii External review of a decision – review by independent tribunals**

Taxpayers are entitled to initiate a judicial review regarding the decision of a second level tax authority before independent Hungarian courts. There are no specific ‘tax courts’ in Hungary; however, administrative actions such as tax lawsuits shall fall within the jurisdiction of courts of public administration and labour. Tax lawsuits are usually handled by judges who specialise in tax law.

In general, a single judge proceeds with the review; however, if the complexity of a particular case requires it, the court may proceed with a panel of three professional judges.

The court may change or annul the decision of the tax authority, or instruct the tax authority to conduct a new procedure, if it establishes that the background of the case has not been sufficiently revealed.

In principle, no appeal can be lodged against the court decision; however, if the parties become aware latterly of a novelty that existed at the time of the previous procedure regarding the merits of the case, a request for reopening may be initiated at the court of first instance. The reopening may be initiated within six months, with a final limit of five years of the decision becoming legally binding.

If tax liability is established or a penalty is imposed in an amount of a minimum of 1 million forints in a particular case, a legal supervision procedure may be requested in case of a presumed breach of law. The legal supervision procedure must be initiated before the Supreme Court within 60 days of the delivery of the decision, which decides the request within 120 days.

Tax lawsuits and the steps preceding the initiation of a lawsuit are usually lengthy procedures and it may take years to reach a final decision. On top of this, if the process is

not suspended by the court, the taxpayer may only pursue the amounts already collected by the tax authority.

### iii Request for preliminary ruling at the proceeding court

The national courts in each EU country are responsible for ensuring that EU law is properly applied in that country.

In the course of a judicial review, if the interpretation or validity of EU law is uncertain, the ECJ may be solicited by the proceeding court for a preliminary ruling.

The right to request preliminary rulings is commonly exercised by Hungarian courts. Recently, in case C-385/12, in the course of the judicial review regarding the ‘crisis tax’ on retailers, the court raised the question of whether the special tax levied on retailers discriminates against foreign-owned companies.

Despite the fact that preliminary rulings are issued regarding the applicable law and not on the merits of the case, and are applicable only for the parties involved, such decisions have a significant effect on the practice of the tax authority and the decision making of the courts.

## IV PENALTIES AND REMEDIES

Failure to fulfil tax obligations, declare or pay taxes may lead to administrative penalties. In certain cases the non-compliance with tax obligations may qualify as a criminal offence. In such cases criminal sanctions might be applied in a criminal court proceeding; such a proceeding is independent of the tax authority’s administrative procedure.

### i Administrative penalties

In the case of non-compliance with the relevant regulations, late payment penalty, tax penalty and default penalty may be applied (even simultaneously).

#### *Late payment penalty*

In the event of delayed payment of taxes, duties, contributions or other charges, taxpayers have to pay a late payment penalty for each day of the delay. The late payment shall be calculated at a rate of 1/365 part of the double of the prevailing central bank rate, the Hungarian National Bank’s base rate for each calendar day.

#### *Tax penalty*

Tax penalties may be levied by the tax authority on unpaid taxes owed to the central budget. Unjustified application for subsidies and tax refunds may also trigger tax penalties.

In general, the amount of the tax penalty is 50 per cent of the tax arrears or tax refund claimed. However, it might be up to 200 per cent of the tax arrears if the taxpayer falsified or destroyed records, books and accounting documents to conceal its income.

#### *Default penalty*

A default penalty is imposed in the event of failure to fulfil tax obligations, such as filing tax returns, and keeping books or records. The fine may vary widely, starting from the

amount of 10,000 forints. It is important to note that in some cases the amount of default penalty can be particularly high (e.g., the default penalty for a failure to keep appropriate transfer pricing documentation may be up to 4 trillion forints per documentation).

### *Measures*

As of 1 January 2015, rules on the seizure of goods will change in a way that in case of non-compliance with the obligation to report to the newly introduced Electronic Trade and Transport Control System (EKAER), the transported goods qualify as unverified and are seizable up to the amount of the default penalty.

### *Criminal sanctions*

If the breach of tax law causes pecuniary damage to the central budget, criminal penalties may be applied in a court proceeding. Tax fraud may be sanctioned up to 10 years of imprisonment depending on the magnitude of the pecuniary damage.

## **V TAX CLAIMS**

### **i Recovering overpaid tax**

Both Hungarian and foreign taxpayers, irrespective of whether they are resident within the European Union or in third countries, may claim tax refund regarding overpaid taxes.

With respect to VAT, it is not necessary to appoint a Hungarian fiscal representative to claim a VAT refund on the basis of Directive 2008/09/EC applicable to EU businesses and of the 13th VAT Directive applicable to non-EU businesses. According to Directive 2008/09/EC, a foreign taxable person is entitled to recover Hungarian input VAT if the business does not have a permanent residence or a fixed establishment in Hungary, and the business has not carried out any taxable supplies in Hungary, with certain exceptions (cross-border transportation from or to third countries, etc.).

In the case of non-EU businesses, reciprocity is required between Hungary and the country of establishment.

### **ii Challenging administrative decisions before the Supreme Court**

The tax authority and the Ministry of National Economy issue guidelines, opinions, newsletters and interpretations from time to time regarding the application of tax laws and their practice. Such information, however, only reflects the authority's official standpoint, and may be challenged by the taxpayers.

In 2012 the Supreme Court declared in a lawsuit that, in contrast to the official opinion of the tax authority and the ministry, taxpayers are allowed to deduct the amount of local business taxes – which is among the main burdens for companies in Hungary – from their corporate income tax base even if they have a liability against the tax authorities in respect to one of the taxes.

Although the decision of the Supreme Court does not have a binding effect on the tax authorities or the courts, it is expected that the decision will influence the practice of the courts in similar cases.

### iii Invoking the ECJ

In other cases the practice and the underlying policies and principles of the tax authority were referred to the ECJ.

In one of the most recent cases (C-444/12), the ECJ established that the tax authority may not refuse the right to deduct input VAT on the grounds of irregularities committed on earlier sales and purchases in the supply chain and that the taxable person did not examine the origin of the acquired goods, unless the tax authority proves that the taxpayer knew or should have known about the irregularities.

In one of the other cases, the main question under consideration by the ECJ was whether a provision of the Hungarian VAT act is contrary to the VAT Directive if it forbids the return of the *ex-ante* charged VAT on the grounds that the counter-value of the transaction was not entirely paid. The ECJ declared this practice non-compliant with European law, as a result of which the questionable provision of the Hungarian VAT act was abolished.

In case C-654/13 (the *Delphi* case), the ECJ went further and, contrary to the view of the Hungarian tax authority, declared non-compliant with the VAT Directive the exclusion of payment of default interest in cases where the national regulation being non-compliant with European law made it impossible to demand tax return in reasonable time.

In the *Delphi* case, a company submitted a request asking for the disbursement of 215 million forints of default interest which was established on the basis of the non-compliant national regulation forbidding tax return between 2007 and 2011.

The tax authority, on the first and second level, denied the request; however, in the framework of judicial review the court referred the case to preliminary ruling. The ECJ emphasised that, on the grounds of the abolishment of the non-compliant provision of the VAT act, taxpayers became entitled not only to the immediate repayment of the *ex-ante* charged VAT, but also to the payment of default interest.

The judgment of the ECJ opened ways to the disbursement of default interest for tax payers. However, the decision also stated that, because of the lack of relevant EU regulation, it is up to the national legislator to lay down the exact rules concerning the repayment of default interest in reasonable time, and the judges are obliged to set the non-compliant national rules apart when deciding in specific cases.

## VI COSTS

In the course of a tax administrative procedure, if the resolution of the tax authority reviewed by a superior tax authority, or by the court, violates the law to the detriment of the taxpayer, all stamp duties paid for remedies must be refunded to the taxpayer.

Fees paid for legal assistance in tax administrative procedures, however, cannot be reimbursed.

In court procedures, taxpayers may request the reimbursement of the fees paid for legal assistance; however, based on the practice of the courts, the adjudged amounts are usually far below the effective fees.

## VII ALTERNATIVE DISPUTE RESOLUTION

Alternative dispute resolution methods are not available in tax administrative procedures. However, there are several legal instruments aimed at preventing future disputes. Taxpayers may request binding rulings or non-binding opinions from the tax authority, or may request that the tax authority establish fair market prices to be applied between related entities (see Section II, *supra*).

## VIII ANTI-AVOIDANCE

### i General anti-avoidance rules

The substance-over-form principle applies (i.e., agreements and transactions are examined in accordance with their true content). The tax authority may disallow benefits derived from agreements or transactions that were performed to evade tax.

In addition, it is generally required that all rights in tax-related matters are exercised within their meaning and intent. In the application of tax laws, agreements and transactions contrived with the intent to evade the provisions of tax laws may be disregarded, and the tax authority may disallow benefits derived thereof.

As of 1 January 2015, an earlier tax procedural principle was extended as a result of which, in the course of auditing the status of subjects in legal relationships concerning tax liability, the tax authority may not establish different classification for the same legal relationship, previously audited and classified. In light of the tax authority's practice, taxpayers may expect thorough investigations regarding transactions whose business reasons are not clearly visible and understandable by the tax authority.

### ii Controlled foreign companies (CFCs)

The Hungarian CFC regime targets companies that are ultimately owned by Hungarian tax-resident private individuals.

In corporate income taxation under the CFC regime, certain income received from CFCs that would normally be exempt is taxable, while certain expenses incurred that would be deductible under the general rules are not deductible if incurred from a CFC.

In addition, undistributed profits of the CFCs are subject to Hungarian personal income tax, and taxable in the hands of the Hungarian-resident shareholders.

Although CFC rules have become more complex in recent years, they are generally not relevant for non-Hungarian controlled groups. As a consequence, foreign-owned Hungarian companies do not face any restrictions in terms of the location and activities of their subsidiaries. However, nominee shareholding is not allowed in respect of Hungarian companies; thus the ownership structure of foreign-owned Hungarian companies may be subject to investigation by the tax authority. In addition, according to the regulations introduced as of the beginning of 2012, Hungarian entities must prepare special documentation supporting the business substance of their transactions with their CFC partners.

A non-resident 'person' is considered as a CFC if Hungarian resident private individuals ultimately control the majority of the foreign entity, or the majority of its

income is Hungarian-source income; and the effective tax rate applicable regarding the foreign entity is less than 10 per cent.

Hungary has a white list of countries that are not considered low-tax jurisdictions for the purposes of the CFC rules (i.e., EU and OECD Member States, and countries that have concluded a tax treaty with Hungary) if the foreign entity has real business presence in that country.

### iii Transfer pricing

Hungarian transfer pricing regulations are in harmony with the OECD Regulations. Related parties are required to apply arm's-length prices in transactions performed amongst each other (i.e., they have to set prices in their agreements that are normally used among independent parties under the same conditions). If related parties apply a higher or lower countervalue in their agreements than independent parties would do under similar conditions, their corporate income tax base must be modified with the difference between the customary market price and the applied countervalue. A transfer pricing document is required for each agreement concluded between related parties, except for taxpayers who qualify as microbusinesses or small businesses. Although the tax authority used to check only the existence of transfer pricing documents, nowadays it performs deeper investigations covering, among other matters, chosen methods and reference data. Upon request, the tax authority establishes fair market prices (see Section II, *supra*).

As of 1 January 2015, the term 'related parties' is also extended to cases where decisive influence is exercised between the taxpayer and another person due to common control of management.

### iv Thin capitalisation rules

In accordance with thin capitalisation rules, if the liabilities of a company (except for those against financial institutions) exceed triple the company's equity, the proportionate value of the interest accounted increases the corporate tax base. Equity is calculated as an average daily balance of registered capital, capital reserves, retained earnings and tied-up reserves. Liability means the average daily balance of outstanding loans (except for bank loans), outstanding closed securities demonstrating creditor relationship and bills payable, excluding those that are payable to suppliers.

Thin capitalisation rules also apply to transactions between unrelated parties.

## IX DOUBLE TAXATION TREATIES

Hungary has a broad tax treaty network with over 70 countries. The treaties generally follow the OECD Model Tax Convention, and provide credit for foreign tax paid or an exemption of the foreign income.

Hungary has implemented OECD-compliant exchange of information provisions.

With respect to transfer pricing, the EU Arbitration Convention, to which Hungary is a party, establishes a procedure to resolve disputes where double taxation occurs between enterprises of different Member States as a result of an upward adjustment of profits of an enterprise of one Member State. While most bilateral double taxation



treaties include a provision for a corresponding downward adjustment of profits of the associated enterprise concerned, they do not generally impose a binding obligation on the states to eliminate the double taxation.

## **X AREAS OF FOCUS**

The tax authority always pays particular attention to tax reclaims (with special attention to VAT, since the tax authority performs VAT audits prior to all disbursements), transfer pricing matters and intra-community transactions.

Transactions that are subject to the greatest scrutiny regarding transfer pricing are tangible goods transactions, intangible property transfers, cost-sharing and cost-pooling arrangements, and intra-group services (payment of management fees, etc.).

Parties entering into agreements with foreign entities must pay special attention to the proper VAT treatment of their transactions and their partners' CFC status.

In the recent past, several high-level cases affected the tax implications of the structures and schemes used by companies in the field of R&D activities. Until 2012, companies could have deducted from the payable innovation contribution the cost of the R&D activities ordered by them. This practice urged companies to order R&D up to the value of their innovation contribution.

Consequently, in past years many innovations were brought into existence lacking any reasonable R&D activity. Using the expertise of the Intellectual Property Office (the HIPO), the tax authority started raids aiming at the elimination of the pseudo-innovations and, on the grounds of its statements regarding the lack of innovation contributions, it inflicted on companies penalties which, together with the contributions, almost exceeded 100 million forints.

The tax authority performs several comprehensive tax audits according to the same scenario; if it finds an R&D activity whose innovative content is disputable, the HIPO is appointed to qualify the activity from an R&D point of view. The latest experiences manifest that if the HIPO contests the R&D nature of the activity, tax authorities will decide against the company. In such cases the researchers should be involved in the proceedings as soon as possible, because only they are capable of explaining to the tax authority the real R&D nature of their works.

## **XI OUTLOOK AND CONCLUSIONS**

The general trend in tax disputes, that the courts follow the legal interpretation of the tax authority unless there is an overwhelming argument in favour of the taxpayer or a significant procedural error on the part of the tax authority, seems to be changing slowly. Nowadays in more and more cases the courts judge for the benefit of the taxpayer; however, in such cases the ECJ is usually invoked by the court, which can significantly hinder the swift closing of a tax dispute.

On the other hand, the increasing number of ECJ decisions are guiding the professional work of the Hungarian courts, and helping the development of a uniform interpretation of tax laws and the evolvement of a uniform judicial practice.

## Appendix 1

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# ABOUT THE AUTHORS

### **ANNA-MÁRIA VERES**

*Gide Loyrette Nouel*

Anna-Mária Veres joined the Budapest office's team of Gide Loyrette Nouel in May 2014. She is registered and has worked as an attorney at law in both Romania and Hungary, based in Budapest since 2007. She gained international experience at well-known law firms that focus strongly on business law, joining Gide Loyrette Nouel from a Big Four audit and tax advisory firm. She has significant experience in advising international groups in complex cross-border M&A transactions, group restructurings and corporate financing projects. Her native tongue is Hungarian, she is fluent in English, French and Romanian and also speaks German and Italian.

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Balázs Kutasi joined Gide Loyrette Nouel in 2014 from a reputable international law firm, where he was a senior attorney focusing on dispute resolution and complex M&A matters. Balázs has significant experience in civil, commercial and employment-related litigations. He regularly represents well-known international companies and financial institutions in various international and domestic disputes. Balázs has developed specific expertise in the telecommunication, HORECA and financial sectors. He is a qualified Hungarian attorney-at-law and member of the Budapest Bar Association. He holds an LLM from the University of Heidelberg. Balázs speaks Hungarian, English, German and French.

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