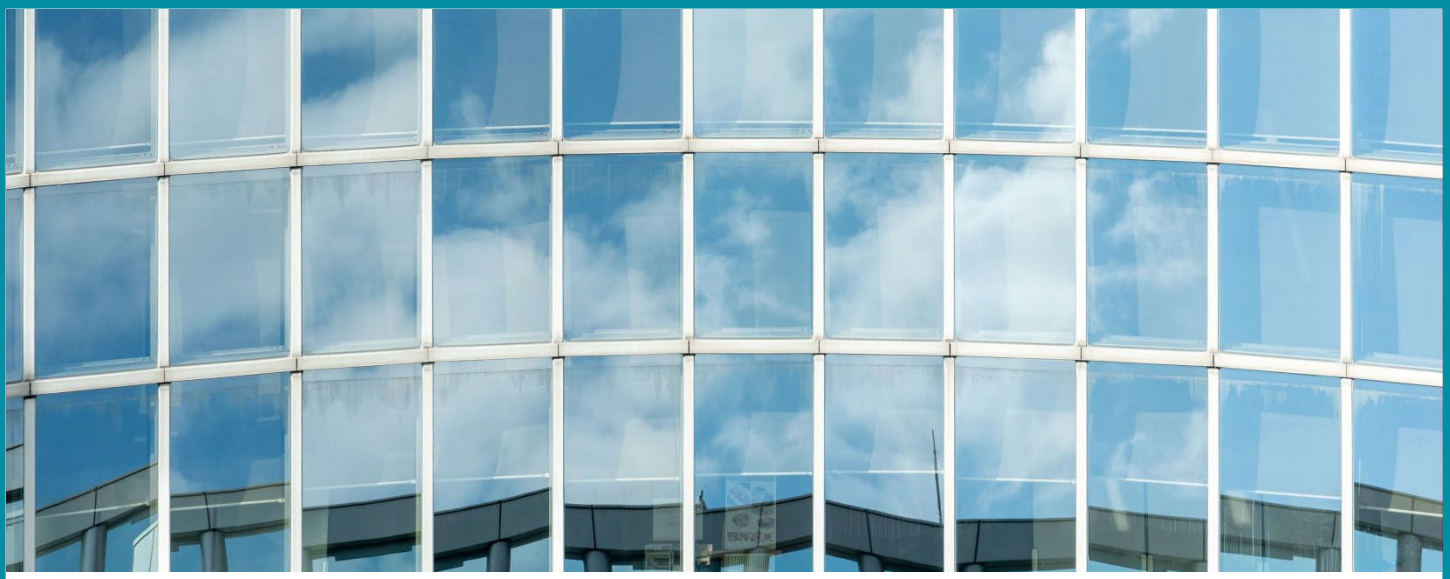

Significant tightening in transfer pricing regulations in the 2023 state budget proposal

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The government has submitted Proposal T/360 on the foundation of the 2023 state budget, which affects several types of taxes. Transfer pricing regulation is highly emphasized in the proposal package, defining significant tightening in the rules, a new reporting obligation, as well as significantly higher penalties and fees of proceedings. The new rules of transfer pricing adjustments may result in a major additional burden for several taxpayers in terms of the extra taxes to be paid.

New reporting obligation in the annual tax return

The corporate tax returns to be filed after December 31, 2022 will be complemented by a new reporting obligation related to the establishment of the arm's length price. Therefore, the new obligation will already affect the current year of 2022.

Further details will be laid down in a ministerial decree.

Extension of the mandatory use of the interquartile range

When testing intra-group transactions from a taxation perspective, taxpayers should identify comparable transactions or entities. Using the financial data from these third party transactions or independent entities, the taxpayers should identify the arm's length range of prices or profit margins and such ranges should be compared against the pricing or profit margins of related party transactions.

In line with the current rules, if certain conditions are met, the taxable entity may be exempted from considering the interquartile range instead of the full arm's length range involving the minimum and maximum values. Such exemptions include if the taxpayer

- Uses so called 'internal comparable data', or
- when using external comparable data and thereby preparing a database search, the comparability analysis takes into account the (3-year) financial data of less than 10 comparable entities or less than 30 observations, or the extent of full arm's length range involving the minimum and maximum values does not exceed 15% points.

Based on the proposal package, the exemptions related to the use of external comparable data and database searches would be eliminated. Accordingly, if the taxpayer prepares a database search to identify the arm's length range of prices or profit margins, the use of interquartile range will be mandatory. The new rules will already be applicable from FY2022.

With regards to the use of internal comparable data, the proposal does not define any amendments, therefore it is still assumed taxpayers may consider the full range as arm's length in such cases.

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Mandatory adjustment to the median value

While the current legislation does not provide any precise clarifications, based on the current practice, if the pricing applied in the related party transactions or the profit margin of the taxpayer/tested party is outside the arm's length range, the taxpayer may consistently adjust the tax base taking into consideration the closest arm's length value (e.g. lower or upper quartile).

The filed proposal package, however, clearly defines that if the pricing applied in the intra-group transactions or the profit margin of the taxpayer/tested party is outside of the interquartile range, it is mandatory to adjust to the median value instead of the closest arm's length value. Exemptions only involve cases if the taxpayer manages to prove that a value differing from the median value is more in line with the tested intra-group transaction, therefore a different value may comply with the arm's length price the most.

The mandatory adjustment to the median value may be a significant burden for several taxpayers, since in the case of a large volume intra-group transaction, the absolute amount of the transfer pricing adjustment may be significantly higher than that of the adjustment to the closest arm's length value (e.g. lower or upper quartile). In several cases, it may lead to excessive payable tax amounts.

Due to these changes, we highly recommend taxpayers considering whether the pricing applied in the related party transactions, or the profit margin of the taxpayer/tested party lies within the arm's length range and preparing the necessary database searches before the accounting closure. Thus, the related parties may undertake the potentially necessary transfer pricing adjustments in the frame of modifying their agreement.

Increasing default penalties in the case of missing transfer pricing documentation

In the case of a missing or incomplete transfer pricing documentation, the current default penalty is up to 2 million HUF, or 4 million HUF in the case of repeated infringement. Based on the proposal package, these amounts will be raised to 5 and 10 million HUF, respectively, justifying the increased penalties by discouraging effect.

Increasing fees for advanced pricing agreement (APA) procedures)

Taxpayers should pay an amount of 5 million HUF instead of 2 million HUF for unilateral advanced pricing agreement (APA) procedures. In the case of bilateral and multilateral procedures, the fee will be uniformly 8 million HUF, irrespective of the number of countries of competent authorities involved in the procedure.

We hope you will find our tax newsletter informative. Since some practical rules will be laid down in ministerial decrees, we will inform you on these in one of our upcoming newsletters. Should you have any questions with regards to the above, our experts are at your disposal.

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Gabriella Nagy
Head of International Transfer Pricing Center
T: +36 1 429 3010
gabriella.nagy@mazars.hu

Dénes Baranyai
Senior Transfer Pricing Manager
T: +36 1 429 3010
denes.baranyai@mazars.hu

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