



HUNGARY

OUTLINE

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PART II. THE AGREEMENTXX

ANNEX.....XXI

LIST OF ABBREVIATIONS

Agreement	Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments
Directive	Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments between associated companies of different Member States
ECJ	European Court of Justice
Finance Amendment Act	az adókról, járulékokról és egyéb költségvetési befizetésekről szóló törvények módosításáról szóló törvény
Magyar Közlöny	Official Journal of Hungary
Merger Directive	Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States
OECD	Organization for Economic Cooperation and Development
OECD MC	OECD Model Tax Convention 2003
Parent-Subsidiary Directive	Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
Savings Directive	Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments
Szamv. tv.	2000. évi C. törvény a számvitelről (Act On Accounting)
Szja tv.	1995. évi CXVII. törvény a személyi jövedelemadóról (Individual Income Tax Act)
Tao tv.	1996. évi LXXXI. törvény a társasági adóról és az osztalékadóról (Corporate Income Tax Act)

LIST OF LEGAL REFERENCES

- 1995. évi CXVII. törvény a személyi jövedelemadóról, Magyar Közlöny 1995/113 (XII.22.) (Sza tv., Individual Income Tax Act).
- 1996. évi LXXXI. törvény a társasági adóról és az osztalékadóról, Magyar Közlöny 1996/98 (XI. 15.) (Tao tv., Corporate Income Tax Act).
- 2000. évi C. törvény a számvitelről, Magyar Közlöny 2000/95 (IX. 21.) (Szamv. tv., Act On Accounting).
- 2003. évi XCI. törvény az adókról, járulékokról és egyéb költségvetési befizetésekről szóló törvények módosításáról, Magyar Közlöny 2003/131 (XI. 14.) (Finance Amendment Act 2003).
- 2004. évi CI. törvény az adókról, járulékokról és egyéb költségvetési befizetésekről szóló törvények módosításáról, Magyar Közlöny 2004/169 (XI.15.) (Finance Amendment Act 2004).
- 2005. évi CXIX. törvény az adókról, járulékokról és egyéb költségvetési befizetésekről szóló törvények módosításáról, Magyar Közlöny 2005/150 (XI.15.) (Finance Amendment Act 2005).

PART I. IMPLEMENTATION OF THE DIRECTIVE

1. INTRODUCTION

1.1. GENERAL INFORMATION ON THE IMPLEMENTATION OF THE DIRECTIVE

Hungary has fulfilled its obligation to implement Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments between associated companies of different Member States (the "Directive") into its national law by way of abolishing Hungarian source taxation on interest and royalty income paid to non-resident legal entities in general. Withholding tax on interest, royalties and remuneration to artists or sportsmen paid to non-resident legal entities was abolished by Finance Amendment Act of 2003 with an effect from 1 January 2004 (Art. 209 par. 2 of the Finance Amendment Act). Consequently, as of that date interest and royalty income derived by non-resident corporate entities is not subject to tax in Hungary. The exemption applies irrespective of the legal form of the recipient of the income (corporate entities with limited liability, partnerships, transparent or hybrid entities), its place of residence (EU Member State or not) or its affiliation to the payer of the income (associated company or not).

The objective pursued by the overall abolition of source taxation on the items of income previously mentioned was evidently broader than bringing Hungarian tax law in compliance with the provisions of the Directive. The Explanatory Memorandum to the Finance Amendment Act, however, expressly referred to the fact that with the abolition of withholding taxes on certain items of income Hungary fulfilled its obligations under the Directive. The Finance Amendment Act also inserted a reference to the Directive into the list of those EC legal acts with which the provisions of the Tao tv. are intended to comply (Art. 31 par. 1 c) of Tao tv.).

As the result of these amendments, only two types of income of non-resident corporate entities are currently subject to Hungarian taxing jurisdiction, namely, income derived through a Hungarian permanent establishment and dividend received from a Hungarian resident company (Art. 2 par. 4 and 6 b) of Tao tv.). Withholding tax on dividends is also to be abolished with effect from 1 January 2006 (Art. 301 par. 11 of Finance Amendment Act 2004). Therefore, all other types of income, including interest and royalties, are exempt from Hungarian source taxation.

1.2. TAX TREATMENT OF INTEREST AND ROYALTY PAYMENTS UNDER GENERAL TAX LAW

1.2.1. Domestic rules

a. Tax treatment at the level of the paying company

Deduction of interest and royalty payments

Interest and royalties are generally treated as a deductible expense in computing the company's income, provided that they are related to the business or profit-making activity of the company. Interest on loans used to acquire a participation in another company is deductible irrespective of the fact that the dividends received from the participation are exempt. The deduction of interest may be disallowed under the thin capitalisation rules or, in

relation to related parties, under the transfer pricing rules. The deduction of royalty payments may be disallowed under the transfer pricing rules.

In respect of Hungarian permanent establishments of foreign companies, the deduction of interest paid to the foreign general enterprise is, in principle, permitted. This follows from the general rule that in calculating the income attributable to the Hungarian permanent establishment, the latter is treated as an independent entity distinct from the general enterprise. There is, however, no specific guidance or ruling by the Hungarian tax authorities, which would confirm the above interpretation.

Thin capitalisation rules

The deduction of interest paid by the company is disallowed on the amount of debt, which exceeds 300% of the equity of the company. The amount of interest disallowed is not re-characterized as dividend. The amount of debt owed to financial institutions is not taken into account for the purposes of calculating the debt-equity ratio.

The application of thin capitalisation rules is not restricted to related parties, i.e. they apply vis-a-vis all creditors of the company. The rules apply both in domestic and cross-border context.

b. Tax treatment at the level of the beneficiary company

Interest and royalty payments to a Hungarian beneficiary company

A Hungarian resident company may deduct from its tax base 50% of the difference between the interest received from related companies and interest paid to related companies. It can also deduct 50% of the amount of the royalties received. The aggregate amount of these deductions, however, cannot exceed 50% of the pre-tax profit of the company.

If the difference of the interest received from and paid to related parties is negative, therefore it represents a cost, a Hungarian resident company has to increase its tax base by 50% of this difference.

Interest paid to Hungarian resident companies is not subject to withholding tax.

Cross-border interest and royalty payments

Interest and royalties paid from Hungarian sources to non-resident legal entities are exempt from Hungarian withholding tax pursuant to the provisions of the Tao tv.

Interest income of non-resident individuals derived from Hungary is also exempt from Hungarian withholding tax (Art. 65 par. 4 of Szja tv.), however, several limitations apply with respect to this exemption. Essentially, interest paid on loans provided by individuals is exempt if the interest rate does not exceed the National Bank interest rate by more than five percentage point and below a threshold of approximately EUR 40 per year per individual (Art. 65 par. 1 of Szja tv.). Interest income paid to non-resident individuals in excess of these limits is subject to the regular progressive income tax rates. Royalty income of non-resident individuals derived from Hungary is subject to the regular progressive rates, instead of being separately taxed as passive income. However, in practice, the tax treaties concluded by Hungary with the other EU Member States may restrict Hungary to a lower level of taxation in the case of both interest and royalty income or may exclude taxation by Hungary as a whole by reserving taxing right on the royalty to the state of residence of the recipient.

c. Transfer pricing

The arm's length principle applies to transactions between related parties (Art. 18 Tao tv.). Failure to apply the arm's length principle results in readjustment of profits.

The concept of related enterprises covers, inter alia, (i) a parent company holding more than 50% participation in a company (ii) subsidiaries if a company holds more than 50% participation in them and (iii) sister companies if a parent holds more than 50% participation in both the company and the sister company. The definition encompasses direct and indirect holdings, as well as de facto control (i.e. right to appoint more than half of the management or supervisory board members). The transfer pricing rules apply both in domestic and cross-border situations.

With respect to interest and royalty payments between related companies, the Tao tv. provides for the re-characterization of the part of the interest or royalty, which exceeds the arm's length amount into dividend (Art. 27 par. 11 h) of Tao tv.). As a consequence of the re-characterization, the income shifted to the related party is taxed in the hands of the recipient as dividend (see *d. Constructive distribution rules* below). As to the payer, the deduction of the excessive interest or royalty is disallowed.

Hungarian resident companies are subject to transfer pricing documentation requirements, they have to record and support with documentation the arm's length price, the transfer pricing method employed for its determination and the underlying facts and circumstances which justify the use of the method employed.

d. Constructive distribution rules

If interest or royalty paid by a Hungarian company or a Hungarian permanent establishment of a foreign company to a related party does not correspond to the arm's length standard, the amount exceeding the arm's length consideration is treated as a constructive dividend in the hands of the recipient. The application of the transfer pricing rules also implies the reintegration of the excess amount to the taxable base of the paying company (see *c. Transfer pricing* above). It is not clear whether the interest or royalty re-characterized into dividend would benefit from the Hungarian general participation exemption regime applicable to dividends if the recipient is a resident parent company. The same question arises for a Hungarian permanent establishment of a foreign company benefiting from the non-discrimination clause of the relevant treaty.

Re-characterized interest or royalties paid to non-resident beneficiaries are subject to withholding tax (to be abolished as of 1 January 2006) at a rate of 20% (Art. 27 par. 1 of Tao tv.). This rate may be reduced under the relevant treaty. Interest or royalty re-characterized as dividend benefits from the exemption granted pursuant to the provisions implementing the Parent–Subsidiary Directive if the related party to whom the non arm's length interest or royalty is paid is resident in an EU Member State and satisfies the other conditions for the exemption.

1.2.2. Treaties

Hungary has tax treaties with all EU Member States (see Annex). The majority of the tax treaties provide for an exemption of interest and royalties at source. The practical relevance of the tax treaties with regard to interest and royalty payments arising in Hungary currently is



very limited since Hungary, in most cases, has relinquished the right to tax these types of income under its domestic law.

In particular, the treaties restrict the taxation of royalties paid to non-resident individuals and impose limits on the withholding tax rate on interest and royalties paid to non-resident related parties and re-characterized as dividends. Re-characterised payments fall under the dividend article of a particular treaty or, if paid to a company resident in an EU Member State, may benefit from an exemption pursuant to the implementing provisions of the Parent-Subsidiary Directive.

The list of treaties set out in the Annex is mainly for the purpose of indicating the rates of the withholding taxes that Hungary would, in principle, be free to impose, pursuant to those treaties, on outbound interests and royalties under its domestic law.

2. SCOPE

2.1. PAYMENTS

2.1.1. Concept of interest

a. Definition

There is no specific definition of interest under the Tao tv. for corporate income tax purposes. Therefore, reference has to be made to the definition of interest set out in the Act On Accounting ("Szamv. tv."). The definition in Szamv. tv. lists, in accounting terms, the items to be recorded in the profit and loss account as interest received (Art. 84 par. 3 and 5). The definition refers, among other items, to interest received from loans granted by a company, including bank deposits, and interest received from securities incorporating debt claims. There is no further specification with respect to the creditor's rights attached to a debt claim.

b. Exclusion of hybrid financial arrangements (Art. 4(1) b-d))

Being formulated in those general terms, the general definition of interest used for corporate income tax purposes (see *a. Definition* above) appears to encompass interest from all types of debt claims, including those which carry a right of the creditor to participate in the debtor's profits or exchange his right to interest for a right to participate in such profits. It follows that Hungary does not exclude from the general exemption the types of interest income referred to in Art. 4(1) b-d) of the Directive. The income from hybrid financial instruments benefits from the exemption just as income from regular debt claims.

c. Exclusion of interest reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

Interest paid to related parties exceeding the arm's length interest are re-characterized as constructive dividend under the rules previously described (see Introduction, 1.2.1. *c. Transfer pricing* and 1.2.1. *d. Constructive distribution rules*). Re-characterized income is subject to withholding tax (to be abolished as of 1 January 2006) at a rate of 20% or a reduced dividend withholding tax under the tax treaty unless it falls under the exemption granted pursuant to the Parent-Subsidiary Directive.

2.1.2. Concept of royalties

a. Definition

According to Art. 4 20) of Tao tv., the concept of royalties includes payments of any kind received as a consideration for the use of, or the right to use, any patent, protected process, trade mark or similar right, know how or business secret, any copyright of literary, artistic or scientific work and neighbouring rights.

The definition does not explicitly mention cinematograph films, software, design, model, plan and secret formula listed Art. 2 (b) of the Directive. The definition, however, is to be interpreted by reference to the general concepts and definitions under intellectual property

law, therefore, the latter rights are included therein. In particular, copyright includes rights related to cinematograph films and design, model, plan and secret formula are protected under rights similar to patent.

The concept of royalties under Tao tv. does not include payments for the use of, or the right to use, industrial, commercial or scientific equipment, since the latter are not protected rights under intellectual property law. The narrower scope of the definition does not, however, produce a result contrary to the Directive as these payments are not subject to any withholding tax in Hungary.

b. Classification of revenue from leasing and software

The definition of royalties under Art. 4 20) of Tao tv. includes payments for the use or the right to use software. The definition does not include payments from leasing, i.e. use of, or the right to use, industrial, commercial or scientific equipment.

c. Exclusion of royalties reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

Excessive royalties that conflict the arm's length principle fall under the general transfer pricing rules (see Introduction, 1.2.1. c. *Transfer pricing*).

Excessive royalties are also subject to the constructive distribution rules (see Introduction, 1.2.1. d. *Constructive distribution rules*). Re-characterised income is subject to withholding tax at a rate of 20% or a reduced dividend withholding tax under the tax treaty unless it falls under the exemption granted under implementing provisions of the Parent-Subsidiary Directive.

2.2. COMPANIES

2.2.1. Types of companies benefiting from implementing provisions (Art. 3(a)(i))

a. Types of entities

Hungary does not levy any withholding tax on interest and royalties paid to non-resident entities irrespective of the legal or corporate form of both the payer and the recipient of the income. The exemption from withholding tax is available to a much broader list of entities than that one in the Annex to the Directive.

As to the payer:

Since Hungary does not exercise any taxing jurisdiction over these types of income, there are no sourcing rules for these payments in the system of corporate income tax laws. Consequently, the legal form of the payer of the interest or royalty is irrelevant in this context.

As to the recipient:

In the system of Hungarian corporate income tax laws, non-resident taxpayers who are subject to Hungarian source taxation are defined as (i) foreign persons who exercise business

activity in Hungary through a permanent establishment and (ii) foreign persons who receive dividend from Hungary. Foreign persons are defined as legal persons, companies without a legal personality or any other corporate entity or organization formed under foreign laws. Since the exemption from withholding tax on interest and royalty derived by non-resident taxpayers is overall under Hungarian law, the issue of the type of the company or entity receiving the income has no relevance.

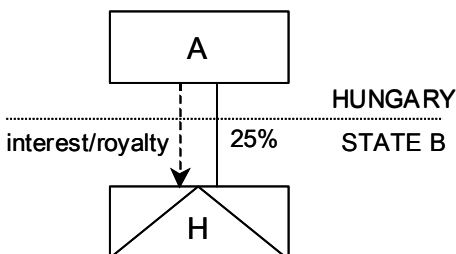
b. Hybrid entities

The issue of tax treatment of payments in situations involving hybrid entities can be anticipated to have no specific relevance in the context of Hungary for the reasons explained above (see *a. Types of entities*). As a confirmation, three hypothetical situations are briefly discussed below:

- Case 1: a Hungarian company pays interest and royalties to a hybrid entity H located in Member State B;
- Case 2: a Hungarian hybrid entity H pays interest and royalties to a company in Member State A;
- Case 3: a Hungarian company pays interest and royalties to a company through a hybrid entity H, the latter two located in Member State A.

Case 1: Payment to a hybrid entity

A Hungarian company A pays interest and royalties to a hybrid entity H situated in Member State B. Hungary treats the hybrid entity H as a transparent entity.

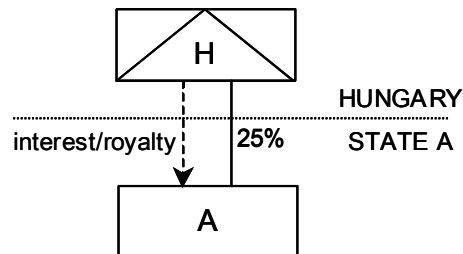


In this case from the point of view of Hungary the interest or royalty flows through the entity H and is attributed to its members or partners.

Interest paid through the hybrid entity H will be exempt from tax in Hungary provided that the partners are legal entities. If the partners are individuals the exemption will apply only to the amount of interest not exceeding the statutory thresholds (see Introduction, 1.2.1. *b. Tax treatment at the level of the beneficiary company*). The only case when Hungary would levy a tax on the outbound income flow is when interest above the statutory thresholds or royalties are paid from Hungary and attributed to an individual who is a partner of hybrid entity H and the tax treaty between Hungary and State B allows Hungary to tax this income. If hybrid entity H is on the list of companies in Annex to the Directive this result would contradict to the Directive.

Case 2: Payment from a hybrid entity

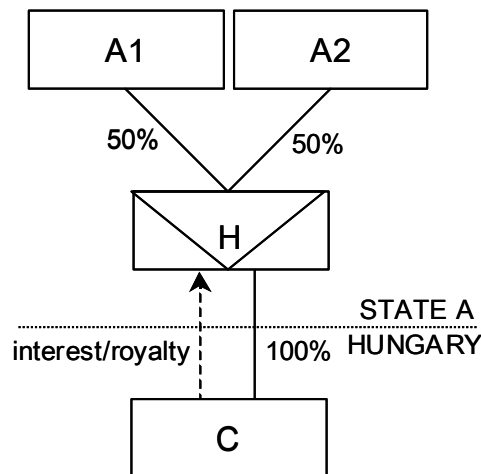
A hybrid entity H in Hungary pays interest or royalties to a company A in Member State A.



In the case at hand the hybrid entity H would benefit from the tax exemption. In the absence of source rules for interest and royalty income in the context of Hungarian corporate income tax, the issue of the type or legal form of the payer has no relevance for the application of exemption from withholding tax.

Case 3: Payment through a hybrid entity

Companies A1 and A2 are the members of the hybrid entity H, all located in Member State A. The hybrid entity H holds all the shares in company C, located in Hungary. Hungary treats hybrid entity H as a transparent entity. Company A1 grants a loan to the hybrid entity H and the hybrid entity H grants a loan to the company C. Interest flows from the company C to a member A1 through the hybrid entity H.



Hungary treats A1, which is a corporate entity, as the recipient of the income, therefore, A1 will benefit from the overall withholding tax exemption provided under Hungarian law to non-resident corporate entities.

2.2.2. Residence requirement (Art. 3(a)(ii))

a. Implementation of the requirement

For the purposes of the withholding tax exemption under Hungarian law, the residence of the recipient has no relevance, as any non-resident benefits from the exemption on interest and royalty income. The residence of the payer is also irrelevant, since Hungary does not tax outbound interest and royalties.

b. Application of the requirement in dual residence cases

Dual residency or dual source issues do not arise in Hungary in application of the exemption from withholding tax with respect to interest and royalty payments. The residence of the recipient company has no relevance because of the general character of the exemption. The Hungarian corporate income tax law does not address the question of the source, therefore, dual source problems cannot arise.

2.2.3. Subject-to-tax requirement (Art. 3(a)(iii))

a. General

Hungary does not levy any withholding tax on interest and royalties paid to non-resident entities and this is not conditional upon whether the recipient of the interest or royalty income is subject to tax on these items of income in its residence country.

b. Proof to demonstrate compliance with the subject-to tax requirement

No relevance in the context of Hungarian law.

c. Application of the requirement to hybrid entities

No relevance in the context of Hungarian law.

2.2.4. Associated company (Art. 3(b))

Hungary does not levy any withholding tax on interest and royalties paid to non-resident entities irrespective of the affiliation of the recipient to the payer.

2.2.5. Beneficial ownership (Art. 1(4))

No relevance in the context of Hungarian law.

2.3. PERMANENT ESTABLISHMENTS

2.3.1. Definition (Art. 3(c))

The definition of permanent establishment under Hungarian domestic law does not have relevance with respect to the exemption of interest and royalty income derived from Hungary

by non-resident corporate entities. From the point of view of the recipient, the exemption is overall and applies to all non-resident entities or their permanent establishments. From the point of view of the payer, the issues of source associated with permanent establishments does not arise in the context of Hungarian law.

2.3.2. Application of source rules (Art. 1(2))

No relevance in the context of Hungarian law.

2.3.3. 'Tax-deductible expense' requirement (Art. 1(3))

No relevance in the context of Hungarian law.

2.3.4. Beneficial ownership (Art. 1(5))

No relevance in the context of Hungarian law.

2.3.5. Permanent establishment in a third country (Art. 1(8))

No relevance in the context of Hungarian law.

3. PROCEDURE

There are no procedural requirements to be fulfilled in order to benefit from the general withholding tax exemption under Hungarian law. Since there is no tax at source there is no need to request a refund.

3.1. MINIMUM HOLDING PERIOD (ART. 1(10))

3.1.1. General

No affiliation between the payer and the recipient, thus, no holding period is required.

3.1.2. Relief before the holding period requirement is satisfied

No relevance in the context of Hungarian law.

3.1.3. Appeals

No relevance in the context of Hungarian law.

3.2. ATTESTATION (ART. 1(11) AND 1(13))

3.2.1. General

No relevance in the context of Hungarian law.

3.2.2. Appeals

No relevance in the context of Hungarian law.

3.3. DECISION ON APPLICATION OF THE RELIEF (ART. 1(12))

No relevance in the context of Hungarian law.

3.4. APPLICATION FOR REFUND (ART. 1(15) AND 1(16))

3.4.1. General

No relevance in the context of Hungarian law.



3.4.2. Appeals

No relevance in the context of Hungarian law.

4. FRAUD AND ABUSE (Art. 5)

4.1. MEASURES UNDER ART. 5(1) OF THE DIRECTIVE

4.1.1. Domestic

In addition to the transfer pricing and thin capitalization rules (see Introduction, 1.2.1. a. *Thin capitalization* and 1.2.1. c. *Transfer pricing*), the Hungarian tax law operates general “substance over form” principle as the means to defeat abusive constructions. However, as the exemption from withholding tax of interest and royalty income of non-residents is unconditional and is not restricted to certain types of taxpayers or transactions, this anti-abuse provision has almost no practical application.

4.1.2. Agreement-based

For the reasons previously mentioned, the issue is not relevant in the context of Hungarian law.

4.2. MEASURES UNDER ART. 5(2) OF THE DIRECTIVE

For the reasons previously mentioned, the issue is not relevant in the context of Hungarian law.

4.3. COMPARISON WITH SIMILAR MEASURES UNDER PARENT-SUBSIDIARY AND MERGER DIRECTIVES

There are no specific anti-abuse provisions regarding interest and royalty and thus no need to compare with the Parent-Subsidiary Directive and the Merger Directive under Hungarian law.

5. SUMMARY

Hungary implemented the Directive by granting exemption from withholding tax on outbound interest and royalty in a much broader scope than that required by the Directive. It abolished Hungarian source taxation on interest and royalty income of non-resident legal entities in general.

Scope of the exemption

The general definition of interest used for domestic law purposes is sufficiently broad to encompass the income, which is to be exempted from withholding tax under the Directive. To the contrary, the definition of royalty used for Hungarian domestic law purposes is narrower than that of the Directive, in particular, it does not encompass payments for the use of, or the right to use, industrial, commercial or scientific equipment. The narrower definition does not, however, produce a result, which is contrary to the Directive, as payments from leasing in the previous sense are not subject to any withholding tax in Hungary either.

Hungary has exercised the option to apply withholding tax to interest and royalty payments re-characterized as dividends under the transfer pricing rules as expressly authorized by Art. 4(1) (a) and 4(2) of the Directive.

The cases when a payment exempt under the terms of the Directive may be exposed to a Hungarian withholding tax are when royalty or interest, in excess of the statutory limits, is paid from Hungary to a hybrid entity included in the Annex to the Directive and Hungary attributes the income to the entity's individual partner. The risk of taxing the income is further reduced by the fact that Hungary's right to tax this income may be excluded under a tax treaty.

Procedure

There are no procedural requirements for the general exemption to apply. The exemption is applied at source and there is no need to request a refund.

PART II. THE AGREEMENT

There have been no measures adopted to implement Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments (the "Agreement"). The Memorandum of Understanding to the Agreement has been ratified by Hungary by Act LIX of 2005.

The practical application of the Agreement by Hungary does not present any considerable issues with regard to interest or royalty payments, since companies resident in Switzerland receiving interest and royalties from Hungary benefit from the general exemption under Hungarian law.

The issue of imposition of withholding tax on interest and royalty payments to Switzerland may arise only in the case when a Hungarian company pays non-arm's length interest or royalty to its Swiss associated company, which is re-characterized as dividend. Please, note, however, that dividend withholding tax will be abolished as of 1 January 2006. Therefore, the following analysis describes the situation as between 1 July 2005 and 1 January 2006.

A payment from a Hungarian subsidiary to a Swiss parent company should benefit from an exemption by virtue of Art. 15 (1) of the Agreement, which corresponds to the provisions of the Parent-Subsidiary Directive (subject to all the conditions being met by the parent). The 2005 amendments to the Tao tv. (Art. 28 of Finance Amendment Act 2005) implemented the exemption under Art. 15 (1) of the Agreement, which will enter into force on 1 January 2006 with a retroactive effect to the date of entry into force of the Agreement.

The Agreement does not contain provisions corresponding to Art. 4 of the Directive and authorizing application of withholding tax in situation of reclassified income. The question arises whether the levy of withholding tax on interest or royalty re-characterized as dividends is in accordance with Art. 15 (2) of the Agreement. Such dividend withholding tax may be imposed by Hungary if:

- (i) a Hungarian subsidiary pays non-arm's length interest or royalty to its Swiss parent and the conditions for dividend exemption under Art. 15 (1) of the Agreement are not met; or
- (ii) a Hungarian parent company pays non-arm's length interest or royalty to its Swiss subsidiary or an "associated" sister company, when payment is outside the scope of Art. 15 (1) of the Agreement.

Article 15 (2) of the Agreement, however, contains a general "fraud and abuse" reservation, which might be arguably used to justify the imposition of withholding tax on constructive dividends.

ANNEX

Table of the maximum withholding tax rates on interest and royalty payments under the tax treaties between Hungary and the EU Member States.

EU Member State	Interest (%)	Royalties (%)
Austria	0	0
Belgium	15	0
Czech Republic	0	10
Cyprus	10	0
Denmark	0	0
Estonia	10	5/10 <1>
Finland	0	0/5 <2>
France	0	0
Germany	0	0
Greece	10	0/10 <2>
Ireland	0	0
Italy	0	0
Latvia	10	5/10 <1>
Lithuania	10	5/10 <1>
Luxembourg	0	0
Malta	10	10
Netherlands	0	0
Poland	10	10
Portugal	10	10
Slovak Republic	0	10
Slovenia	0	10
Spain	0	0
Sweden	0	0
United Kingdom	0	0

<1> The lower rate applies to (a) equipment rentals and (b) royalties for transmission by satellite, cable, optic fibre or similar technology.

<2> The lower rate applies to copyright royalties, including films.