# Film Financing and Television Programming: A Taxation Guide

Now in its seventh edition, KPMG LLP's ("KPMG") Film Financing and Television Programming: A Taxation Guide (the "Guide") is a fundamental resource for film and television producers, attorneys, tax executives, and finance executives involved with the commercial side of film and television production. The guide is recognized as a valued reference tool for motion picture and television industry professionals.

Doing business across borders can pose major challenges and may lead to potentially significant tax implications, and a detailed understanding of the full range of potential tax implications can be as essential as the actual financing of a project. The Guide helps producers and other industry executives assess the many issues surrounding cross-border business conditions, financing structures, and issues associated with them, including film and television development costs and rules around foreign investment. Recognizing the role that tax credits, subsidies, and other government incentives play in the financing of film and television productions, the Guide includes a robust discussion of relevant tax incentive programs in each country.

The primary focus of the Guide is on the tax and business needs of the film and television industry with information drawn from the knowledge of KPMG International's global network of member firm media and entertainment Tax professionals.

Each chapter focuses on a single country and provides a description of commonly used financing structures in film and television, as well as their potential commercial and tax implications for the parties involved. Key sections in each chapter include:

*Introduction*
A thumbnail description of the country's film and television industry contacts, regulatory bodies, and financing developments and trends.

*Key Tax Facts*
At-a-glance tables of corporate, personal, and VAT tax rates; normal non-treaty withholding tax rates; and tax year-end information for companies and individuals.

*Financing Structures*
Descriptions of commonly used financing structures in film and television production and distribution in the country and the potential commercial tax implications for the parties involved. The section covers rules surrounding co-productions, partnerships, equity tracking shares, sales and leaseback, subsidiaries, and other tax-efficient structures.

*Tax and Financial Incentives*
Details regarding the tax and financial incentives available from central and local governments as they apply to investors, producers, distributors, and actors, as well as other types of incentives offered.

*Corporate Tax*
Explanations of the corporate tax in the country, including definitions, rates, and how they are applied.

*Personal Tax*
Personal tax rules from the perspective of investors, producers, distributors, artists, and employees.

*Digital Media*
For the first time, we have included a discussion of digital media tax considerations recognizing its growing role in the distribution of film and television content.

*KPMG and Member Firm Contacts*
References to KPMG and other KPMG International member firms' contacts at the end of each chapter are provided as a resource for additional detailed information.

Please note: While every effort has been made to provide up-to-date information, tax laws around the world are constantly changing. Accordingly, the material contained in this publication should be viewed as a general guide only and should not be relied upon without consulting your KPMG or KPMG International member firm Tax advisor.

Production opportunities are not limited to the countries contained in this Guide. KPMG and the other KPMG International member firms are in the business of identifying early-stage emerging trends to assist clients in navigating new business opportunities. We encourage you to consult a KPMG or KPMG International member firm Tax professional to continue the conversation about potential approaches to critical tax and business issues facing the media and entertainment industry.

Thank you and we look forward to helping you with any questions you may have.

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# Hungary

## Introduction

Over the past few years, the Hungarian film industry has experienced dynamic development. There have been many Hungarian films in production, some of which were high budget co-production films. Hungary has also hosted a number of international productions, such as *The Rite, Bel Ami, The Eagle, - The Debt, Monte Carlo, The Raven,* and *47 Ronin*.

Due to favorable legislative changes in Hungary, significant investment in the infrastructure was made. For example, the Stern Studio at Pomáz and the Korda Studio at Etyek, organized by producer Andrew Vajna and the Hungarian entrepreneur, Sándor Demján. In addition to the financial incentives available, Hungary also offers a sophisticated film production workforce, including many talented and well-known production personnel, e.g., István Szabó, who was awarded an OscarTM, Lajos Koltai, Vilmos Zsigmond, Miklós Jancsó, and Béla Tarr.

Unfortunately, the financial crisis had its impact on the Hungarian film industry; however, as this segment is highly significant to the government, steps were taken to improve the financial situation of Hungarian film producers. In the spring of 2011, the government ordered that a new motion picture company would be established, and a national strategy would be created in order to rejuvenate the Hungarian film industry and to settle any outstanding debts. As a result, a new organization was established and called the Hungarian National Film Fund, which received almost HUF 6 billion from the budget to purchase existing debts and to renew the national film industry. Based on the number of domestic and international productions in progress, the Government's policy may be successful in achieving its plan.

## Key Tax Facts

| | |
|---|---|
| Corporate income tax rate | 10% CIT up to a CIT base of HUF 500 million and 19% above HUF 500 million. |
| Highest personal income tax rate | Flat rate of 16% |
| VAT rates | 0%, 5%, 18%, and 27% from 2012 |
| Normal nontreaty withholding tax rates: Dividends | 0% |
| Interest | 0% |
| Royalties | 0% |
| Certain services | 0% |
| Tax year-end: Individuals | December 31 |
| Tax year-end: Companies | December 31 or any chosen date of 12 months to comply with the international group's financial year |

## Film Financing

### Tax and Financial Incentives

The most significant developments in the Hungarian film industry are the Corporate Income Tax (CIT) legislative changes as of April 1, 2004 and the release of Act II of 2004 on Motion Pictures by the Ministry of Culture, which was amended in 2008 to be compliant with the regulations of the EU by implementing cultural test regulations.

The Hungarian Government's aim was to create the financial support system for the Hungarian film industry on two pillars: indirect state support (new tax incentives for films and related projects adopted in the CIT law) and direct state support (based on Act II of 2004 on Motion Pictures).

The cap approved by the European Commission for Hungary's film financing support is EUR 379 million for 2014-2019.

#### *Indirect State Support*

The indirect state support consists of the following corporate income tax regulations:

- Corporate tax allowance is a deduction from the tax base and also from the tax liability. The deduction from the tax base is up to a maximum of 20% of the direct production costs incurred in Hungary, and the decrease of the CIT liability is up to a maximum of 70% of the total tax liability. Besides the donation, supplementary donation should be provided in the amount of at least 75% of the tax advantage obtained by the donor;
- Corporate tax allowance relating to any investment for motion picture and video production of at least HUF100 million (approximately EUR 333,000) at its present value; and

- Accelerated depreciation allowed for equipment, machinery, and buildings used solely for motion picture production purposes.

The base of the indirect state support is 100% of the direct cost of the related film production if the direct cost of the related film production is at least 80% Hungarian. In the case where the production does not reach this ratio, the base of the indirect state support is the total amount of domestic direct cost of the related film multiplied by 1.25 (Subsection (9)-(10) of Section 12 of Motion Picture Law).

### Corporate Tax Allowance

As of April 1, 2004, the Hungarian CIT law implemented favorable rules applicable to such film products that are:

- Made under contract manufacturing (produced to order); and
- Made in co-production (not produced to order).

In both cases, the National Film Office would issue a so-called "sponsorship certificate" to the person who sponsors a motion picture production, indicating the amount that qualifies for the corporate tax allowance. The total certified amount contained in the sponsorship certificates cannot be greater than 20% of the total domestic direct cost of the related film production (Subsection (3) of Section 22).

As of November 23, 2004, the taxpayer supporting a motion picture is entitled to two types of favorable tax allowance:

- The taxpayer can obtain a corporate tax base allowance for support of the motion picture up to the amount indicated in the sponsorship certificate, provided that the film can be entitled to indirect support *(Point 15 of Annex 3/B)*; and
- The taxpayer can also reduce its corporate tax liability by the certified amount in the year of investment or in the subsequent six years *(Subsection (1) of Section 22)*. The amount of tax allowance allowed each year cannot exceed 70% of the corporate tax liability. (Subsection (3) of Section 23).

Besides the donation, supplementary donation should be provided in the amount of at least 75% of the tax advantage obtained, i.e., the effective rate of CIT savings is limited to 4.75% of the donation provided as of January 1, 2014.

### Corporate Tax Allowance Related to Any Investment for Motion Picture and Video Production (Section 22/B of CIT law)

Hungarian corporate taxpayers are entitled to enjoy a tax allowance for a maximum 10-year period for motion picture and video production investments of at least HUF100 million at their present value, which are executed within the framework of the development program published by the Government.

The taxpayer cannot use the tangible assets capitalized by the investment for making any motion picture films, which contain pornographic or violent scenes, in the first five years of operation.

For the tax allowance for investments with a value above EUR 100 million, the Ministry for National Economy is required to grant authorization in a decree. The decision must be adopted within 60 days from the date when the application was submitted. If the Ministry for National Economy does not reject the application within the prescribed time limit, it shall be regarded as if it had been approved, in which case the taxpayer shall be entitled to the tax allowance. Investments below EUR 100 million are only required to be reported to the Ministry for National Economy.

As a result of Hungary's EU accession, a new tax incentive and subsidy system has been introduced, aimed at complying with the EU requirements. Based on the new rules, governmental subsidies and incentives (including cash subsidies, tax allowances, interest subsidies, etc.) have to be added up and their present value should be compared to the value of eligible investments made.

Based on the above mentioned, the total amount of tax incentives and other subsidies (almost all kinds of state aid including tax allowances) granted by the government shall not exceed, at current value, the amount computed by the "intensity ratios" stipulated in Government Decree No. 165/2014 on the investment amounts actually invested at current prices.

The intensity ratios vary (between 0% to 50% of the value of investment) depending on various factors, mainly the location of the invested assets, the number of new jobs created, and the line of business.

The amount of tax allowance allowed each year cannot exceed 80% of the corporate tax liability *(Subsection (2) of Section 23)*.

The concept of "de minimis" subsidies has also been introduced. Based on the current legislation, subsidies (allowances) qualify as de minimis if the amount of the subsidies (allowances) does not exceed EUR 200,000 for three years at current prices.

#### Accelerated Depreciation

Hungarian taxpayers owning equipment, machinery, or buildings used solely for motion picture production purposes are entitled to apply for accelerated depreciation rates, which are:

- 50% as opposed to the general 14.5% to 33% in case of equipment and machinery (Point 8/a of Annex 1 of CIT law); and
- 15% as opposed to the general 2% to 6% in case of buildings (Annex 2 of CIT law).

### *Direct State Support*

Direct support is set out in the Motion Picture Act and combines normative, selective, and structural subsidies. Normative subsidies aim to encourage producers of so-called "success films" to produce new films that are popular with the public. Selective subsidies are granted for productions that are viewed less by the public, but contain major artistic value. It is also possible to obtain individual structural subsidies to finance outstanding productions.

The National Media and Infocommunications Authority (http://english.nmhh.hu/) (The Film Office) has been established by the government and organizations of the motion picture industry to be responsible for allocating the resources defined in the state budget. The Film Office is entitled to grant refundable or nonrefundable subsidies on selective, normative, or structural bases, in line with the conditions and application procedures set for the allocation of funds published by February 28 of each year.

The above subsidies are available only for Hungarian film productions or co-production films with Hungarian participation based on the proportion of the Hungarian participation (the classification of activities related to film production is determined based on a scoring system that attaches certain weight to each of the film production activities). As of April 1, 2006, not only Hungarian resident individuals and corporations, but also those residents in one of the member states of the European Economic Community, can be registered by the Film Office to be entitled for direct or indirect subsidies.

The maximum degree of Hungarian support intensity is set at 50% or 100% if artistic and financing factors justify it. Individual support ratios may be defined at lower levels. The support percentages are to be based on the production budget of Hungarian films or on the Hungarian share of the production budget of a co-production film (Section 13 of Motion Picture Act).

However, in cases when a Hungarian film producer may only participate in a production by way of a financial contribution, thereby disqualifying it as a co-production, direct support may still be granted for such films if they can be qualified as co-productions within the given international treaties. (The European Convention on Cinematographic Co-Production permits such films to be recognized as financial co-productions).

*Eurimages*

Hungary became a member of Eurimages on January 1, 1990. Eurimages is a pan-European film funding agency that aims to promote the European film industry by encouraging the production and distribution of films and fostering co-operation between professionals. Eurimages funding is available for co-productions where there are at least three co-production partners from 47 member states. If the film is to be shot in English, an "English-speaking" partner is required.

Detailed rules of Eurimages support policy can be found at http://www.coe.int/t/dg4/eurimages/About/default_en.asp

## Corporate Taxation

### Corporate Income Tax (CIT)

The basic principles for taxing business profits are detailed in the Corporate Tax Act. The taxable income of Hungarian companies is subject to corporate tax. According to the current Corporate Tax Act, a favorable tax rate of 10% is applicable for all taxpayers without any specific requirements up to a tax base of HUF 500 million. Above this threshold, the tax rate is 19%.

Generally, the CIT law follows the accounting law (the basis of assessment of CIT tax is the profit shown in the financial statements). However, the CIT law prescribes some adjusting (increasing and decreasing) items in relation to the tax base in order to protect the tax base; promote certain kinds of activities; and support the taxable entity for different social reasons. For these reasons, the CIT law provides special rules, amongst others, for the handling of:

- Development reserves, and provisions;
- Depreciation;
- Thin capitalization;
- Transfer pricing;
- Loss carry forward;
- Royalties; and
- Capital gains participation exemption.

*Development reserves, and provisions*

Taxpayers are permitted to deduct a development reserve, i.e., amounts expected to be spent on capital expenditure in the four years following the creation of the reserve. However, such a reserve can only reduce pre-tax profits by up to 50% (with an upper limit of HUF 500 million). In the tax return, development reserves may not be utilized for an investment or a purchased asset, which may not or should not be depreciated, e.g., land, based on accounting regulations. Development reserves reported in the taxpayer's financial statements of 2008 can be utilized over a six-year period (Point (f) of Subsection (1) of Section 7 of CIT law).

*Depreciation*

The Act on Accounting relates depreciation rates to the expected useful life of the assets, but the CIT law applies different rates for the reasons described above. Below are several of the current maximum rates for corporate tax purposes:

| | |
|---|---|
| Machinery and equipment | 14.5% |
| Computers | 33% |
| Vehicles | 20% |
| Buildings | 2%/3%/6% |
| Intangibles | Accounting life |
| Leased assets: | |
| Leased buildings | 5% |
| Leased tangible assets | 30% |

Some incentives were introduced into the CIT law as of January 1, 2003, which allow faster tax depreciation regarding the following assets:

- 50% depreciation rate can be claimed on general IT machinery and on equipment exclusively serving motion picture and video production (Point 8/a of Annex 1 of CIT law); and
- Taxpayers can claim 50% tax depreciation in connection with brand new tangible assets that are acquired or produced in 2003 or later and which would otherwise be subject to a 33% or 14.5% rate. The same rules apply to intangible properties purchased or produced in 2003 or later, and to the capitalized value of experimental development (Point 9 of Annex 1 of CIT law).

As of 2012, taxpayers are free to apply a tax depreciation rate lower than the rate specified directly by the tax law, nevertheless this cannot result in tax depreciation that is lower than the accounting depreciation (Point 5/a of Annex 1 of CIT law).

### *Thin Capitalization*

The debt-to-equity ratio for thin capitalization purposes is 3:1. Interest on loan instruments payable on all of the taxpayer's nontrade and nonfinancial institution creditors is included when calculating the ratio. Accordingly, the thin capitalization rules cover interest on loans granted by both related and unrelated parties, and also extend to bonds (but not for bonds issued to reimburse normal liabilities towards suppliers) and other loan securities issued exclusively to one party, i.e., closed securities. Moreover, all (nonfinancial institution) debts on which interest is paid should be taken into account during the calculation. This means that interest paid in respect of cash-pooling arrangements is also subject to the potential nondeductibility rules.

From 2012, the rules on thin capitalization have been extended to cover interest-free related party debts that are also subject to transfer pricing amendments. However, it is possible to offset the amount of debts by the daily average of claims from financial fixed assets, receivables, or securities. As of 2013, receivables and liabilities deriving from the sale of goods or the provision of services do not have to be considered for thin capitalization purposes.

The thin capitalization rules provide an exemption for loans made through certain financial institutions (Point (j) of Subsection (1) of Section 8 of CIT law).

### *Transfer Pricing*

Transfer pricing rules allow the tax authorities to adjust taxable profits where transactions between related parties are not at arm's length. The current legislation prescribes not only the methods applicable for determining a fair market price but also the way in which these should be applied. The taxpayer may calculate the fair market price using any alternative method, provided they can prove that the market price cannot be determined by the methods included in the Act, and the alternative method suits the purpose. OECD transfer pricing principles are generally accepted in Hungary.

To harmonize the Hungarian legislation with the Resolution of the Council of the European Union, taxpayers are now able to choose between preparing simplified documentation on intercompany services with low added value, or stand-alone documentation or EU transfer pricing documentation regarding intercompany transactions. The documentation can be prepared in languages other than Hungarian, and from 2012, the tax authority cannot oblige taxpayers to translate the transfer pricing documentation or other related documents (contacts, invoices) prepared in French, English, or German.

Exemption is available if the value of the transaction does not exceed HUF 50 million, or if all costs recharged are originally invoiced by third parties (Section 18 of CIT law).

### *Loss Carry forward*

Under the legislation in force, losses arising in 2004 and thereafter can be carried forward without any time limitation. From January 1, 2009, taxpayers are no longer required to obtain permission from the tax authorities to carry tax losses forward in certain prescribed circumstances. From January 1, 2012, the provisions on loss carry-forwards changed significantly.

Losses carried forward will only be deductible for up to 50% of the tax base. In the case of corporate transformations or restructuring, previous losses can only be utilized if the new owner (or its affiliated company) of the legal successor previously exercised a significant influence over the legal predecessor, and if income is realized from the latter's activity for two consecutive tax years. However, should, the successor terminate its business within 2 years, or if the activity of the predecessor related only to asset management, the latter "revenue-condition" does not have to be met. Change in ownership restrictions may apply to loss carry-forwards in the case of acquisitions. If the new owner has not previously been an affiliated member, loss carry forwards can only be utilized if certain activity criteria and income criteria are met, or if the company is listed on a stock exchange.

Loss carry forwards were available for the first time to financial institutions in respect of their 2009 liabilities (Section 7 of CIT law).

### *Royalties*

Taxpayers can decrease their pretax profits by 50% of royalty income generated. This deduction is limited to no more than 50% of profit before tax.

### *Capital Gains Participation Exemption*

As an incentive for establishing holding companies in Hungary, domestic or foreign participations of at least 10% are considered an "announced participation," which is reported to the Tax Authority within 75 days of the acquisition. The capital gain on such participations held for at least one year is exempt from corporate taxation. Any loss on write-offs, foreign exchange, or losses incurred when cancelling from the books (except during transformations) should be added back to the corporate income tax base.

An investment cannot be treated as an announced participation nor can the special rules be applied if it is in a controlled foreign company (CFC). A foreign organization is considered to be a CFC if a Hungarian resident individual owns at least 10% of the shares or the foreign company derives most of its revenue from Hungarian sources; further stipulations are that the foreign organization does not pay corporate tax because of its zero or negative tax base, despite its positive pretax profit, or its effective income tax rate does not exceed 10%. Foreign entities resident in EU member states, OECD member states, or jurisdictions with a Hungarian tax treaty may be excluded from the CFC provisions if it is proven that real business activity is undertaken in the jurisdiction according to its residence *(Section 7 of CIT law)*.

*Withholding Tax*

As of January 1, 2011, no withholding tax is levied in Hungary.

*Local Business Tax*

Enterprises pay local business tax on all business performed on a permanent or temporary basis in municipal areas. In general, the basis of this tax is the enterprise's gross sales revenue less cost of goods acquired for resale, material costs, and the value of mediated services and subcontractors' fees. Direct costs of R&D are fully deductible. Accordingly, service providers get very limited relief and are required to compute their local tax based almost on gross revenue.

As of 2013, a restriction on the amount of allowed cost of goods sold and mediated services has been introduced. As per the new rule, for an amount over HUF 500 million net sales revenue, the tax base is reducible only with a limited value of cost of goods sold and mediated services, depending on the value of the revenue and considering certain thresholds. As a result, the restriction adversely affects those who realize less than a 30% gain on the items mentioned above.

In addition, a consolidated local business tax base establishing method has been introduced concerning taxpayers qualified as related parties for corporate income tax purposes, whose aggregated amount of cost of goods sold and mediated services exceeds 50% of their net sales revenue.

The maximum rate of tax is 2% of the tax base, which can be lower depending on the particular municipality where the company carries out its business. Enterprises have to pay local business tax for all the municipalities where they perform a business activity. The tax base should also be allocated to foreign locations, but such cases are not subject to local business tax.

As the national law provides no minimum levy, it is up to each municipality to determine whether it will impose local business tax; and if so, the rate it will charge. There are still some municipalities that do not charge this tax at all. The law sets special allocation rules on certain activities, e.g., telecommunication services, energy providers.

# Indirect Taxation

## Value Added Tax (VAT)

Hungary charges VAT on the supply of goods and services, as well as on the import and intracommunity acquisition of goods in the course or furtherance of business under the harmonized system of VAT found in the EU. In Hungary, no input VAT credits are available with respect to food and drink, entertainment, the purchase and operation of cars, gasoline, and other goods and services not purchased for business purposes.

### *Supply of a Completed Film*

In Hungary, the supply of cinematographic and video films to final customers is treated as a supply of goods subject to VAT at a standard rate of 27%. The transfer of the right to project or utilize films qualifies as provision of services subject to 27% VAT, if taxable in Hungary. Projection of film, video, and DVD is also subject to a 27% VAT rate. In general, VAT is due at the time of the supply of goods or upon completion of the service. However, if a payment is received in advance of delivery of a completed film, VAT becomes due at the time of the prepayment. A VAT-registered person must submit his or her VAT return and account for any VAT payable to the tax authorities monthly, quarterly, or annually by the 20th of the month following the end of the accounting period in which the VAT became due. The annual return, however, is due on February 25 of the following year.

When a company established in Hungary delivers a completed film to a company not established in Hungary, but established in another EU member state, the transaction would be exempt from VAT, provided the customer is not registered for VAT in Hungary. If the transaction qualifies as a supply of goods, the customer is deemed to be performing an intracommunity acquisition of goods and is required to account for local VAT in the EU member state to which the goods are delivered. If the transaction qualifies as a supply of services, it will be subject to VAT in the country where the customer has its seat or fixed establishment. The Hungarian supplier of the film would, of course, be entitled to full recovery with respect to VAT, which was incurred in relation to the supply of the film.

When a Hungarian company delivers completed films to EU VAT-registered companies and the transaction is treated as a supply of goods, it is required to include this transaction on a quarterly EC Sales List which discloses the value of sales per quarter to each VAT-registered customer. In addition, where the value of sales to other EU countries exceeds at least HUF 100 million (approximately EUR 333,000), the Hungarian company will be required to prepare the monthly INTRASTAT declaration.

The VAT exemption will apply for a company established in Hungary that delivers a completed film to a company outside of the EU. Again, the supplier of the film would be able to recover all the VAT incurred while making the film. There are no special reporting requirements other than the requirement to complete a Customs export declaration on a Single Administrative Document if the transaction qualifies as supply of goods.

### *PreSale of Distribution Rights*

VAT is charged at the standard rate of 27% on a presale of distribution rights to a person established in Hungary. A presale of distribution rights to a business established in another EU member state, or to any purchaser outside of the EU, is exempt from Hungarian VAT. However, any VAT incurred by the supplier on expenses incurred in relation to making the film and selling the rights is fully recoverable.

*Royalties*

When a company established in Hungary pays a royalty to another company established in Hungary, VAT is chargeable at the rate of 27%.

When a company established in Hungary pays a royalty to a company that is established outside of Hungary, VAT at the rate of 27% must be accounted for by the Hungarian company on the so-called reverse charge basis. When the Hungarian company is fully VAT taxable, it is entitled to recover the VAT in full, which it must account for under the reverse charge rules.

When a company established in Hungary receives a royalty from a business established in another EU member state or from any person outside the EU, no Hungarian VAT is chargeable. However, if the payer is located in the EU, the payer will be required to account for VAT in its own member state under the reverse charge rules. Royalty charged by a Hungarian established company to a non-VAT registered person in the EU would be liable to Hungarian VAT at 27%.

*Peripheral Goods and Merchandising*

The sale of peripheral goods connected to the distribution of a film (such as books, magazines, published music, and clothing) will be chargeable to VAT at the rate applicable to the goods in question. For example, printed books, magazines, periodicals, daily newspapers, and sheet music are subject to VAT at the 5% VAT rate, while audio cassettes are subject to VAT at the 27% rate (except audio books). If the peripheral goods qualify as auxiliary goods, the VAT treatment would follow that of the distribution of the film.

*Promotional Goods or Services*

The supply of promotional goods or services does not qualify as a supply of goods or services if the value of those goods does not exceed HUF 5,000 or if the goods qualify as a product sample, as specified in the Act on VAT.

### Catering Services to Film Crew and Artists

In general, the supply of goods as part of catering services is chargeable to VAT at 27% and reduced 18% in the case of dairy and bakery products as from July 1, 2009 irrespective of whether or not the meals are paid for by the crew and artists. Drinks are also chargeable to VAT at the 27% standard rate. However, VAT on meals, drinks, and catering services are not recoverable.

*Import of Goods*

Goods imported into Hungary from outside the EU will be subject to VAT on importation (VAT rate depends on the type of goods). The VAT on import is payable and deductible in the same VAT return. However, a film company established outside the EU generally would be entitled to import professional equipment for use in the making of a film under the customs procedure of temporary importation without paying import duties and VAT.

*Customs Duties*

Depending on the nature of the goods imported, customs and/or excise duty may be payable on importation. The customs/excise duty paid is not recoverable. However, a film company established outside the EU generally would be entitled to import professional equipment for use in the making of a film under the Customs procedure of temporary importation without paying import duties and VAT. Equipment is normally imported under the cover of an ATA Carnet.

## Personal Taxation

The individual Hungarian income tax liability is largely governed by whether the individual is regarded as a resident in Hungary for tax purposes. Under Hungarian domestic law, individuals with Hungarian citizenship (apart from dual citizens without a permanent or habitual residence in Hungary), individuals having an EEA residence permit who stay more than 183 days in Hungary, foreign nationals with a valid settlement permit, and stateless persons are treated as residents for income tax purposes. For other natural persons, the residence status can be determined firstly by permanent residence, secondly by determining their center of vital interests, and thirdly by their habitual abode *(Point 2 of Section 3 of Personal Income Tax (PIT) law)*. Individuals are considered to have a habitual abode in Hungary if they stay in the country for more than 183 days (including the date of arrival and the date of departure) during a calendar year. There is no codified test for applying the 183-day rule, but in practice, it is understood to be a physical presence test. In the event of any doubt, an individual is responsible for proving that his/her stay did not exceed 183 days.

Hungarian resident individuals are subject to personal income tax on their worldwide income. Nonresident individuals are subject to income tax on their Hungarian-source income or income taxable in Hungary based on double taxation treaties or reciprocity. The same taxation rules are applicable as for residents, i.e., the same tax rates. For tax purposes, Hungary means the territory of the country (Subsection (4) of Section 2 of PIT law).

According to most double tax treaties concluded with Hungary, income from the activities of artists (theatre, motion pictures, radio, or television artists who are residents of the Contracting State) exercised in Hungary may be taxed in Hungary.

## Digital Media

Digital media has seen rapid growth in the Hungarian market. Currently, not only individuals but business entities also use social media platforms on a regular basis. Digital media and electronic service provision are liberalized. There are no restrictions for foreign investments in this industry.

Electronic services are taxable in Hungary based on the general rules. The main tax types to be fulfilled in Hungary for business entities are 27% VAT based on the turnover, 10%/19% CIT based on the net profit generated, and 2% local business tax based on the gross profit. However, there are countries in the EU where special beneficial rules are introduced for electronic services and digital media services, e.g., Luxembourg, where 3% VAT rate is applicable for electronic services.

The reason for the rapid growth of this industry in Europe and also in Hungary is that companies carrying on business in this industry could avoid any eventual high tax burden due to a common European rule effective until December 31, 2014. Based on this rule, electronic services provided to private individuals were taxable in the country where the seat of the service provider was located. Consequently, a big part of the income generated in this industry in Hungary was not taxable in Hungary provided that the seat of the service provider was not in Hungary. Accordingly, Google, Yahoo, T-Home and other similar electronic service providers took their European seats into a country (mainly into Luxembourg) where tax burden was the lowest. This rule caused a huge tax shortage for countries, e.g., for Hungary, maintaining higher tax or general rates, and it was disadvantageous for companies carrying out activities exclusively in the Hungarian market and having their seat in Hungary.

As the current tax regime is unfair for several countries, the EU decided to change this tax regime by introducing separate rules for the taxation of electronic service provision as of January 1, 2015. Based on this rule, electronic service provision will be taxable in the country where the address of private individuals is located. Consequently, all electronic services provided to Hungarian individuals by European companies will be taxable in Hungary independently from the location of the service provider.

This new regime will be unfavorable for some global service providers when considering a 20% advertisement tax levied for advertisement activities provided in Hungary or mainly in Hungary as of July 1, 2014. This advertisement tax will also be applicable for the advertisements published by electronic service providers.

We hope that this new regime will not reduce the stable growth level of Hungarian digital media business significantly.

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