The Insurance Tax Act shall come into force soon

The **insurance tax** introduced by Act CII of 2012 (the "Act"), and coming into effect on the 1st of January 2003 cannot be deemed to have not been foreshadowed as the Hungarian legislator had already introduced a direct tax on insurance services in the form of a so called **casualty tax** levied on MTPL premiums.

The ministerial preamble attached to the draft version of act on insurance tax pins down that although the insurance tax is a direct tax its nature reveals that it is rather a type of **turnover tax**. The underlying reason is that the introduction of the insurance tax closely follows a tax policy that propagates to modify the tax structure in order to decrease the proportion of public levies on labour, whilst increasing the proportion of turnover / consumption taxes.

Levies replaced by the insurance tax

With the coming into force of the Act, the following levies shall **cease**:

(i) the **special tax** borne by – amongst other financial carriers – insurers, reinsurers and the larger insurance associations, as well as

(ii) the **fire brigade contribution.**

The special tax borne by insurers amounted to 1.5% of the tax base not exceeding 1 billion HUF, 3% of the tax base in excess of this but not exceeding 8 billion HUF, and 6.4% on the excess thereafter.

The fire brigade contribution was to be paid to the state treasury by insurers on premium for certain non-life insurance classes of business as a contribution to professional and municipal fire brigades for the building, investment and renewal of barracks, to contribute to fire fighting and technical rescue operations, as well as the establishment, operation and development of fire detection and public monitoring and fire alarm systems under the supervision of the minister responsible for defence against catastrophes.

The insurers were required to pay 1.5% on premiums collected under the specified insurance classes as a fire brigade contribution.

The legislator originally intended to replace the **casualty tax** levied on MTPL premiums as well, however the draft wording finally adopted by parliament left these provisions unchanged.

The tax subject and the tax obligation

According to the Act

(i) the provision of insurance service is subject to tax if

(ii) the risk is situated within the territory of Hungary.

The Act therefore defines the **taxable activity** to be within the scope of insurance services, and therein the provision of **comprehensive motor vehicle insurance** and **property and accident insurance**. With regard to the definition of property and accident insurance the Act refers to the non-life insurance classes of insurance as defined under Section A of Enclosure No. 1 of the Insurance Act, excluding MTPL and sickness insurance contracts. All other business falling under non-life insurance classes such as the various liability insurances, credit and suretyship insurances, insurance covering miscellaneous financial loss and legal expenses, as well as burial insurance is therefore subject to the tax.

The scope of the Act **does not extend to life insurance** and **sickness insurance**. It does however extend to accident insurance provided as a supplementary cover to life insurance. The scope of the Act doesn't extend to **agricultural insurances** either. Within the meaning of the Act, and in accordance with the definition provided by Act CLXVIII of 2011 on the management of weather based and other natural risks affecting agricultural production, agricultural insurance shall mean property insurance concluded for uncut crops on a commercial basis.

Some may rightly point out that **suretyship insurance** is missing from the exceptions determined by the Act, as this type of insurance typically is exempt from insurance tax in other markets. The reason being that this type of insurance is deemed to be **in competition with bank guarantee products**, the two types of securities clearly being substitutable with each other. Therefore in those states where bank guarantees are exempt from tax it is necessary to exempt suretyship insurances from the scope of insurance tax as well, otherwise providers of such insurance products would experience a **competitive disadvantage** in respect of financial institutes providing bank guarantee products.

Pursuant to the Act insurers as defined by the Insurance Act are the subjects of the tax. The **tax subject** is therefore the **insurer seated in Hungary** (whether being a company limited by shares or a branch office), as well as **cross-border insurers**, provided they underwrite risks situated in Hungary.

In the case of non-life insurers typically the member state where the contracting party (policyholder) has its permanent domicile, or if the contracting party is a legal person, the member state where that business premises of the legal person is situated in, and which the insurance contract is applicable to, shall be deemed to be the member state where the **risk is situated.**

Therefore with regard to the tax obligation of the insurer it is irrelevant whether the contracting party (the policyholder) is a Hungarian company or not, what is of relevance however is whether the risk underwritten is applicable to any activity or property linked to a business premises of the contracting party situated in Hungary. It follows that a tax obligation may even arise from insurance contracts concluded by foreign insurers with foreign contractors.

The tax base and rate

Pursuant to the Act the tax base is the **gross written insurance premium** accounted for by the insurer in accordance with accounting rules. Shortly after publication of the Act the following not insignificant question on interpretation arose:

(i) in the case of insurance contracts concluded before the Act coming into force,

(ii) where the insurance premium (or several years of insurance premium) is paid before the Act coming into force, however

(iii) the insurance premium is earned by the insurer accepting the risk only after the Act coming into force,

is such insurance premium to be considered as part of the tax base?

Based upon the definitions provided in the Act, the unanimous opinion of the insurers is that given that gross written insurance premium accounted for in accordance with accounting rules forms part of the tax base, insurance premiums **invoiced**, **paid** by the clients and **accounted for** as income by the insurers before the Act coming into force shall undoubtedly **not be considered to be part of the tax base** after the Act comes into force, independently of the fact whether any part of the accounted insurance premium is earned by the insurer after the Act coming into force.

It follows from the above also that for insurance premiums invoiced, paid and accounted for after the Act comes into force the insurer shall be required to pay tax by the 20th day of the month following the accounting month for the full amount accounted for, even though a large proportion of the insurance premium accounted for shall only be earned by the insurer on a continuous basis and over a course of time (even years).

The Act exempts premiums arising out of **active reinsurance activity** the result of which these premiums **do not form part of the tax basis**. The objective of the legislator was to avoid double taxation of the same premium on the direct insurance and reinsurance side. It follows therefore that the direct insurer is obliged to pay tax even if the whole risk is ceded to the reinsurer. The Act therefore **doesn't levy the tax on premium in proportion to retention**, but rather on the gross written insurance premium realised by the direct insurer, irrespective of the proportion ceded.

Given that the tax base is the gross written insurance premium, it follows for example that **commission** paid by the insurers **is also part of the tax base**. In other countries where a similar insurance tax regime has been introduced this has in the case of business insurance led to **fee based broker remuneration becoming the norm**, such fees not forming a part of the insurance premium and thus being exempt from insurance tax. As long as insurance broker services remain exempt from VAT in Hungary, including any fee charged by the broker, a restructuring of intermediary remuneration and the referral of net premiums can lead to significant savings for clients.

The **tax rate** in the case of comprehensive motor insurance is **15%** of the tax base, whereas for property and accident insurance it is **10%** of the tax base.

Calculating and paying the tax

The tax is to be **reported and paid voluntarily**. The Act provides that the insurer shall calculate the tax, file the standardised report provided by the tax authority and pay the tax to the account of the tax authority on a monthly basis, that is **by the 20th day following the month the insurance premium or instalment is accounted for**.

In the case of **insurers providing cross-border services** the issue arises as to how they can comply with the monthly obligation to calculate, file and pay the tax even though physically they are not present on the Hungarian market.

The act on tax procedures provides that foreign companies that are in connection with their economical activities carried out in Hungary not obliged to be established in Hungary **may appoint a tax representative** for the performance of its internal tax obligations.

The accession to the European Union saw the introduction of a new type of representation in the field of taxation. Aligning with the principle of the free movement of capital it became necessary to provide the possibility for foreign companies that are not obliged to be established in Hungary to be able to carry out economic activities in Hungary in a manner that facilitates the performance of the ensuing tax obligations, and at the same time allows the tax authority to perform the necessary tasks in the most effective way.

This new type of proxy is the tax representative, which can be undertaken by any entity meeting the requirements stipulated by law. However **it is not mandatory to assign a tax representative**.

The requirements stipulated by law ensure that the assigning of a tax representative does not lead to a non-performance of tax obligations. For this very reason it is necessary that the tax representative, when reporting its right to represent the tax subject, certifies that it meets the following conditions:

(i) it has **subscribed capital** of at least **50 million HUF**, or (**ii**) it has a **bank guarantee** made out for the same amount, and

(**iii**) it has **no tax arrears** recorded at the tax authority.

The tax representative has to meet these conditions throughout the time that it represents the tax subject. The tax representative may accept assignments from several foreign companies; however it is not necessary to meet the conditions for representation on a client by client basis.

The tax representative performs the national tax obligations of the foreign company in its name, and exercises the rights available to the tax subject. During the term of representation by the tax representative the foreign company may not appear before the tax authority in person or through any other representative.

The foreign company's and the tax representative's **liability for the tax obligations** of the foreign company is **joint and several**. Termination of the representation does not affect the tax obligations of the foreign company.

As the **assignment of a tax representative is not mandatory**, cross-border insurers may choose to apply directly to the Hungarian tax authority and request a tax number, and may **directly perform** the obligations of calculating, filing the tax return and paying the tax pursuant to the Act. This may be hindered however by the fact that the accounting departments of foreign insurers shall have to file the tax returns based on forms issued in the Hungarian language.

For more information on the issues discussed above please address your queries to us.

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