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HUNGARY IMPOSES WINDFALL TAXES ON LARGE CORPORATIONS

Implications of the new extra taxes for international businesses

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Issues & Sectors	**Banking, Insurance, Telecommunications, Aviation, Energy, Retail, Pharmaceuticals, Advertising**
Stakeholders	**Government of Hungary, Finance Ministry of Hungary**

Shortly after imposing a state of emergency over Russia's war against Ukraine last week, the Hungarian government announced special taxes on large companies in a number of different industries, officially with the aim of financing Prime Minister Viktor Orbán's flagship public utility cuts program and the development of the military.

The "extra profits taxes" are to be imposed for a period of two years (with possible extension not excluded) and will hit large corporations from a wide range of sectors. Combined with additional recently announced cuts in state expenditure, the government aims to use the extra state revenues to balance the budget and avoid a looming recession.

Below, Aretera provides further insight into the introduction of Hungary's new special tax regime, as well as its political, economic and business implications.

This memo will cover:

SPECIAL TAXES IN A NEW STATE OF EMERGENCY

On 25th May, Hungarian Prime Minister Viktor Orbán announced that his newly formed Government[1] will impose "special taxes" on large companies across various sectors. According to the Hungarian PM, Russia's war against Ukraine[2] and the EU's sanctions policy against Moscow has made "defending Hungarian families from price increases [in public utilities] more difficult", while "banks and big companies have made extra profits through higher interest rates and price hikes."

The announcement came after the Government – following the parliament's approval of a corresponding constitutional amendment – imposed a state of emergency over the Russia-Ukraine war, a special legal order allowing the PM to govern by decree in times of wars in neighbouring countries. Imposing extra taxes on large corporations was PM Orbán's first major decision during the state of emergency.

A MULTI-SECTORAL AUSTERITY PACKAGE

Minister of the Prime Minister's Office (PMO) Gergely Gulyás and Economic Development Minister Márton Nagy subsequently announced further details relating to the new special tax regime. Among the targeted industries are banking, energy, retail, insurance, telecommunications, aviation, pharmaceutics and media and advertising. The government is aiming to raise an annual HUF 800 billion this year and an additional HUF 815 billion in 2023, with the new tax regime imposed for a period of two years and the cabinet not excluding the possibility of extending it beyond 2023.

The newly imposed measures include increases in pre-existing sectoral taxes for large corporations, as well as new tax levies. Among them is the so-called advertisement tax. a controversial tax previously challenged by the industry and EU institutions, but later greenlighted by the EU's top court from 2023. According to the PMO Minister, the aim of the measure is to "protect" the government's previous public utility cuts for households, as well as to develop the capacities of the Hungarian military.

Minister Nagy said the government is targeting large corporations that have "excessively profited" from either the COVID-19 crisis or the rapidly rising inflation following the neighbouring war and the energy crisis. As to why the government chose the above eight sectors, Nagy notably added these sectors saw surprisingly high profits that were not anticipated by their business plans. Multiple government officials stressed that the cabinet is not "anti-profit", adding that the current measures are exceptional. In parallel, Foreign Affairs and Trade Minister Péter Szijjártó, who is also in charge of courting FDI, added that manufacturing companies would not fall under the new tax obligations.

The multi-sectoral tax regime is part of a broader budgetary adjustment policy, that will be followed by additional tax increases on cigarettes, alcoholic beverages and potentially other products. In addition, the government decided to halt a number of state investments and projects (those that have not yet been started) until 2024 and cut the expenses of the public administration.

Combined, the new measures are estimated to collect (a minimum of) HUF 2000 billion for the Hungarian state budget, representing one of the largest austerity packages in Hungarian economic history. Furthermore, the Finance Ministry will also restrict Hungary's most popular SME taxation scheme (KATA), used by an estimated 430,000 small businesses and business people.

[1] See here for our overview of the formation of Viktor Orbán's fifth Government on 25 May
[2] See here for our overview of Russia's war against Ukraine and its impact for Central & Eastern Europe

TARGETED INDUSTRIES & MAIN TAX AMENDMENTS

Sector/Industry	Amount (HUF billion)	Key Measures & Tax Amendments
Banking	300	• Sectoral tax based on interest margins to increase by an annual HUF 250 bn • Bank transaction tax to increase by an annual HUF 50 bn
Energy	300	• Sectoral mining fee to increase by an annual HUF 120 bn • Profits on refinery margins to be subject to extra tax • Increased taxes for bioethanol and biofuel producers
Retail	60	• Progressive tax rates to increase from 2.7% to 4.1% for companies with HUF 100+ bn in annual revenue • Companies with HUF 30-100 bn in annual revenue to pay under 1% tax rate instead of current 0.4% • Tax rate for companies with HUF 0.5-30 bn in annual revenue to remain unchanged
Insurance	50	• Annual sectoral tax to increase to HUF 170 bn
Telecoms	40	• Taxing turnover on roaming, internet and cable tv traffic
Aviation	30	• Departure and check-in fees to be levied on ground-handling service providers • Tax burden likely to be indirectly borne on passengers
Pharma	20	• Distributors to pay 24% tax after reimbursement from the National Healthcare Fund for subsidized products
Media/ Advertising	15*	• Re-introducing the advertisement tax from 2023 with no changes on the tax base and tax rate • Tax to be imposed on turnover derived from broadcasting/publication in several areas
Total	**815**	

*New taxes on advertising will be introduced only in 2023, unlike all other sectoral taxes. The government expects an annual HUF 800 billion in extra revenues in 2020 and HUF 815 billion in 2023.

ECONOMIC & BUSINESS IMPLICATIONS

The windfall taxes will have far-reaching consequences for Hungary's economic situation, as well as its business and investment climate. Below, we outline the key takeaways:

On the economy, the combined package is one of the largest in post-USSR Hungarian economic history and also a quasi-acknowledgement of the government's recent overspending. Budgetary cuts were widely expected well before Russia invaded Ukraine in late February, given the fourth Fidesz government's sweeping pre-election program that put huge burdens on the state budget. With the proposed measures, which account for 3% of Hungary's GDP, the government hopes to reduce the country's budget deficit to 4.9% of the GDP this year and to 3.5% in 2023.

Markets have reacted negatively to the announcement, with the Hungarian business media **estimating** that the country's stock market has taken a HUF 650 billion hit. The Hungarian Forint, which is among the most volatile currencies of the CEE region, has also seen a huge decline in its value over the announcement (although recovered below 390 to the the Euro after the details were clarified). In the short term, the value of the Forint is likely to fall further to 400 against the Euro, an historic low.

The move is poised to hit Hungary's investment potential in the short term. While state-owned energy giant MOL and OTP, the country's largest commercial bank, will suffer the biggest losses, several of the targeted industries are sectors with a considerable foreign market ownership share. At the same time, the government visibly chose to target sectors that are not prioritized areas of courting foreign investments. Foreign Affairs and Trade Minister Péter Szijjártó was quick to reassure the private sector that manufacturing companies, the main target sectors of attracting FDI, would not fall under the new extra tax scheme.

Inflation, which is already among the highest in the CEE region, is likely to increase further as certain companies in the impacted sectors could react by raising prices. While the government vowed to take action should corporations decide to do so, it remains unclear how this would be implemented. Low-cost airline carrier WizzAir has already announced price increases as a direct result of the government's package. Annual inflation in Hungary is expected to rise to at least 9% this year, with several forecasters also expecting a double-digit inflation for 2022.

The methodology behind calculating "extra profits" remains highly disputed. Furthermore, while the government claims to have targeted only sectors producing "extra profits", airline carriers operating flights from and to Budapest will also be taxed, despite their huge losses over COVD-19. Speaking out against the advertisement tax, The Hungarian Advertising Association said that re-imposing the tax would hurt the whole of the Hungarian economy, with other industry advocacy organizations still evaluating the impact of the special tax regime.

Consequences are also notable for food retail chains as the new government is dedicated to increase Hungarian ownership share (33% in 2020) on the market through – as told by Minister Nagy – "strengthening" domestic-owned chains against foreign ones. This hints at distant possibility of additional, potentially negative measures in the sector from the perspective of multinationals, while the increase in special taxes in the sector is likely to hit the largest (foreign) retain chains the most.

POLITICAL IMPACT

The new special tax regime comes after Viktor Orbán's right-wing Fidesz-KDNP alliance scored a landslide victory in the country's April parliamentary elections, leading to the formation of his fifth Government on 24th May. Below, we outline the main political implications.

On the political level, the new tax package is aimed at financing Orbán's flagship public utility cuts program, which has become virtually unsustainable in recent months. The previous, centre-left governments (2002-2010) notably failed in stopping energy household price hikes, bringing serious consequences in terms of popular support, which is why the PM is prioritizing the issue, particularly in the wake of the energy crisis. Although Fidesz scored a landslide electoral victory on 3 April, a mismanagement of the current economic situation could seriously impact popular support for the government and the ruling party.

The Orbán Government has a history of putting extra taxes on large corporations, particularly multinationals in certain sectors, with several of these extra taxes still in effect. While the new extra tax scheme is a sectoral package, with several Hungarian-owned companies impacted, a vast number of the targeted entities are foreign-owned large corporations, with a considerable stake on the Hungarian market. Critics also point out that by imposing extra taxes on large/foreign companies, the government is distracting attention from the consequences of its own overspending prior to the war.

The extra taxes will likely have huge public support, with most of the opposition also supporting the move and even demanding its extension to sectors dominated by close-to-government business elites. Aside from certain companies, the EU might also scrutinize the move as they did in 2010-2012 when the PM announced similar taxes to ease financial pressure from high state debt. For political reasons, the government has repeatedly ruled out imposing austerities directly on households, which is why large corporations could face further taxes if the economic situation continues to worsen.

The new corporate extra tax scheme comes at a time when Hungary has yet to secure billions of Euros in post-pandemic recovery funding from Brussels – an economic package seen by many as crucial to support the country's economic recovery and prevent a recession. Even more concerning, Hungary has remained the only EU country not yet granted the recovery funding: while the government aims to secure the funds by the end of the year, political differences with Brussels could overshadow the results of the talks.

LOOKING AHEAD

The Orbán Government's decision to impose extra taxes on large corporation across various sectors comes as Hungary faces an economic downturn and a severe challenge in balancing the state budget. Combined with other measures announced by the government, including austerities in the public sector, the multi-billion HUF budgetary adjustment package will likely be a discouraging factor for future investments, while it could also contribute to higher inflation.

At the same time, the government is visibly focusing on balancing the state budget and putting the country's fiscal situation back on track, while it was quick to highlight that prioritized investment sectors will not be taxed. While targeting such sectors seems unlikely at this point, a key risk for international investors going forward is looming taxes, further state intervention into economic processes and new measures against foreign companies operating on the Hungarian market.

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If you would like to schedule a discussion of this paper, please contact:
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