THE GLOBAL MINIMUM TAX AND ITS POTENTIAL IMPACT ON THE COMPETITIVENESS OF THE HUNGARIAN CORPORATE TAX SYSTEM

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ABSTRACT

In 2021, an agreement on the application of a global minimum tax was concluded, which was later adopted at the EU level in the binding form of a Directive. Such tax reforms entail significant changes in the operation of international and domestic tax rules. This study examines the expected effects of the global minimum tax on the tax incentives that function in the Hungarian corporate income tax system. This issue is approached by examining various types of tax incentives (general, entity-related, and economic activity-related) considering the features of global minimum tax rules. Furthermore, the study aims to identify the aspects and circumstances inherent in either the rules of the global minimum tax or the Hungarian tax system that can potentially mitigate the adverse effects of the global minimum tax on tax incentives. In the light of these findings, this study also provides tax policy considerations that can contribute to preserving the current corporate income tax system and its incentives in the most intact form.

KEYWORDS

global minimum tax
tax incentives
Hungarian tax system
tax competition
tax credits
local business tax
tax coordination

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1. Introduction

Recently, one can observe a plethora of reform proposals in the field of tax law at both international and EU levels. Developments under the auspices of the OECD/ Inclusive Framework (IF) bear particular relevance, as 137 participating countries succeeded in reaching an agreement regarding the Pillar One and Pillar Two Proposals[2] of the OECD. While Pillar One[3] entails, inter alia, the creation of a new nexus rule to allocate taxing rights to market jurisdiction under certain circumstances, Pillar Two[4] or the Global Anti-Base Erosion (GloBE) proposal is meant to introduce a global minimum corporate tax on large multinational enterprises (MNEs).

This study focuses on the second reform, that is, the implications of the global minimum profit tax for MNEs. More specifically, it analyses which parts of the Hungarian corporate income tax (CIT) system will be affected by the GloBE rules. The focal point of such an analysis is the tax incentives that are meant to maintain the competitiveness of the CIT system to attract foreign direct investment (FDI) into the country, which is crucial for an open and relatively small economy such as Hungary. This study does not intend to discuss each and every technical provision of the Hungarian CIT system. Rather, it considers the big picture and most remarkable features of this system.

The remainder of this paper is organised as follows. After the introduction, the development of international tax reforms, which has led to a long-awaited consensus on GloBE rules, is briefly presented (Section 2). This section discusses the evolution of GloBE materials at both the international and EU levels. Section 3 presents the main features and mechanisms of GloBE rules. It does not aim for comprehensive immersion in the detailed rules; rather, the rules are presented to the extent that it is necessary to understand their impact on domestic tax systems. Section 4 examines how GloBE rules would affect the current Hungarian CIT system. In this section, GloBE impacts are analysed with respect to the general characteristics of the tax system, special tax incentives, and entity-related features of tax incentives. Section 5 deals with how the identified impacts can be mitigated or resolved. Finally, concluding remarks are presented in Section 6.

2. Development of a global minimum tax system

Before the GloBE proposal, the OECD had already contemplated addressing the tax challenges that have arisen from the emergence of new digitalised business models of MNEs, to which the prevailing, traditional international tax architect could no longer be adequately applied. Within the framework of its BEPS (base erosion and profit shifting) Project, it addressed the problem of the digital economy

2 | OECD, 2021a.
3 | OECD, 2021b.
4 | OECD, 2021c (hereinafter: GloBE Model Rules).

in the Final Report on BEPS Action 1.[5] However, it left all pressing questions in this area unanswered.[6]

There was yet another attempt at the EU level that aimed to find a long-term and temporary solution to the challenges arising from the digital economy: significant digital presence and digital services tax (DST) directive proposals.[7] Regarding the latter, the DSTs targeted the taxation of revenue streams derived from the supply of certain digital services. The 2018 EU Commission Proposal – although it has never been adopted and was eventually abandoned – functioned as a model for DST legislation in EU Member States.[8] The DST Proposal determined three types of digital services, the proceeds of which would have been subject to the DST: 1. digital advertising (placing advertising targeted at the users of an interface on a digital interface); 2. digital intermediary services (making a multi-sided digital interface available to users which allows users to find other users and interact with them, which may also facilitate the provision of underlying supplies of goods or services directly between users); 3. monetisation of user data (transmission of data collected about users and generated from user activities on digital interfaces)[9]

The proposal aimed to align the taxation of income from the aforementioned economic activities with the place where the underlying value was created.[10] The DST Proposal identified the contribution of users' participation by providing their data as the core value-creation element in the supply of covered digital services. The proposal indicated that the revenues would otherwise go untaxed in the state where the users are located because the threshold for allocating taxing rights to the source state requires the existence of a permanent establishment based on the physical presence of the economic operator.[11] Although the DST Proposal failed to be adopted at the EU level, several Member States implemented a national DST.[12]

The failure of the OECD and EU proposals highlighted above demonstrates that, in addition to the common interest in finding an answer to these tax challenges together and in consensus, there is a counterbalancing individual interest of states in preserving their fiscal sovereignty to devise their tax systems in a manner that best fits their economic and political aims. Against this backdrop, it

5 | OECD, 2015.
6 | Kofler, Mayr and Schlager, 2017, p. 524.
7 | Council Directive Proposal on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM (2018) 148 final. As the Member States could not reach an agreement on the Proposal, it was abandoned, see: Martin, 2019.
8 | Council Directive Proposal on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM (2018) 148 final.
9 | Council Directive Proposal on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM (2018) 148 final, Article 3.
10 | Council Directive Proposal on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM (2018) 148 final, Explanatory Memorandum, p. 2.
11 | Ibid., p. 2.
12 | Several Member States introduced (Austria, France, Italy, Spain) or postponed to introduce or apply (until an agreement to tax the digitalized economy was finalised internationally) some form of DSTs (the Czech Republic, Portugal, Poland, Hungary). See: Asen and Bunn, 2021.

is surprising that in October 2021, a bulk of the international community agreed to an international commitment to the Two-Pillar solution, including a commitment to implement the GloBE rules to achieve the taxation of multinational groups at an effective tax rate of minimum 15%. The consensus also ended the unilateral application of the DSTs, as it ensued with the abolishment/suspension of such temporary measures.[13]

After the global agreement, the OECD began to publish related materials on the GloBE rules. First, it released the GloBE Model Rules[14] in December 2021, followed by the publication of a related Commentary[15] and Illustrative Examples[16] in March 2022.

However, committed states did not rush to transpose model rules into their domestic legal systems. At the end of December 2022, the implementation of GloBE rules got an important impetus as they acquired a binding form at the EU level when, following a fierce and politicised bargaining process,[17] the Member States eventually unanimously reached an agreement on the GloBE Directive Proposal[18] with an implementation deadline set by the end of 2023.[19] After the groundbreaking consensus, several other countries followed suit and announced the introduction of GloBE rules or certain elements into their domestic legal systems.[20]

It is noteworthy that since the adoption of the EU GloBE Directive, new OECD documents, among others, two pieces of Administrative Guidance have been issued.[21] These documents intended to provide further clarification on the correct interpretation of the GloBE rules; however, in some instances, they go beyond mere clarification and provide new rules that would not stem from the original wording of the Model Rules. Such a situation can raise many problems at the EU level, where the adopted Directive is based on the Model Rules. Thus, new developments at the OECD level are not binding on the interpretation of EU law, that is, that of the GloBE Directive, which jeopardises the consistent application of GloBE rules worldwide.[22]

13 | OECD, 2021a. More recently: OECD, 2023d.
14 | OECD, 2021c, GloBE Model Rules.
15 | OECD, 2022c, (hereinafter: Commentary to the GloBE Model Rules).
16 | OECD, 2022a, (hereinafter: GloBE Examples).
17 | *EU Member States unanimously adopt Directive implementing Pillar Two Global Minimum Tax rules*, 2022.
18 | Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union, COM/2021/823 final.
19 | International taxation, 2022.
20 | For example Japan and South-Korea, see: PwC, 2023; Orbitax, 2023.
21 | OECD, 2023b (hereinafter: July Administrative Guidance). OECD, 2023a (hereinafter: February Administrative Guidance).
22 | For an analysis to what extent the Court of Justice of the European Union (CJEU) considers OECD developments prior and after the birth of the EU legislation, see: Geringer, 2023. Nevertheless, it must be submitted that it is problematic in the lack of clear reference by the EU legislation itself to the OECD material to pay any heed to the latter from a democratic perspective, as not all the Member States are members of the Council of the OECD.

3. The main features of the GloBE rules

3.1. The mechanisms to achieve a minimum level of taxation under the GloBE rules

The GloBE's scope affects MNEs that reach a certain size in terms of revenue. It covers the constituent entities (CE) of multinational groups that generate an aggregate annual revenue (in at least two of the four preceding years) of at least EUR 750 million, based on the consolidated financial statements of the ultimate parent entity (UPE).[23] The scope of the EU GloBE Directive covers purely domestic groups to which the same revenue threshold applies. This extension of the scope is meant to ensure the compliance of the GloBE rules with the fundamental freedoms.[24]

The GloBE rules entail three main sets of technical rules that serve the same purpose — to ensure that the in-scope MNEs are taxed at an effective rate (ETR) of at least 15% in each jurisdiction where they operate. These are the Income Inclusion Rules (IIR), the Undertaxed Payment (or, as recently referred to, Undertaxed Profits) Rules (UTPR), and the Subject-to-tax Rules (STTR). The first two are meant to be implemented in domestic legal systems, whereas the STTR, which has priority in the order of application of these rules, would ensue from the modification of double tax treaties. The STTR rule is not included in the Model Rules, nor in the EU GloBE Directive, consequently its date of implementation and its details remain uncertain.[25]

The IIR will function as a sort of Top-up Tax that the residence state of the UPE of the multinational group can primarily (preceding the intermediate parent companies) levy on the low taxed profits of a subsidiary that had not been subject to the minimum profit tax of 15 % in its home state.[26] It is specific to the GloBE rules, that the minimum effective tax rate (ETR) is calculated at a jurisdictional level.[27] Unlike a CFC (controlled foreign corporation) rule, the IIR does not apply the prevailing tax rate in the UPE country, rather the Top-up Tax is levied up to the extent that the ETR of the CEs concerned reaches the 15%.

The second pillar of the charging provisions of the GloBE rules is the UTPR, which will be applied as a backstop rule if the IIR is not applicable. In such situations, when the IIR cannot be applied because the low-tax jurisdiction is the country of the UPE or no qualifying IIR rules are in force in the UPE country (or in any other lower-tier parent entity country), the UTPR comes to the fore. It would function by denying the deduction of certain otherwise deductible items or requiring them

23 | GloBE Model Rules, Article 1.1.
24 | Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union, COM/2021/823 final, Explanatory Memorandum, p. 6.
25 | As it stands now, it will entail an additional taxation of certain cross-border payments between connected companies where the recipient is subject to a nominal corporate tax rate below 9%. It will only apply to specific type of payments, such as interest, royalties, insurance premiums, guarantees, certain rental payments as well as payments for services. See: OECD, 2023c, pp. 1–2.
26 | GloBE Model Rules, Article 2.1.1.
27 | GloBE Model Rules, Article 5.1.1.

to make an equivalent adjustment under domestic law (in an amount that results in an additional tax expense for the affected CEs equal to the UTPR Top-up Tax).[28] The allocation of Top-up Tax under the UTPR is determined based on a formulaic apportionment calculated based on the number of employees and the total value of tangible assets in the given jurisdiction.[29]

As aforementioned, the ETR is calculated on a jurisdictional rather than a CE basis. This is the result of the division of Adjusted Covered Taxes and GloBE Income or Loss in the given jurisdiction. The Adjusted Covered Taxes category entails the current tax expense with respect to Covered Taxes and certain adjustments to it, such as total deferred tax adjustments.[30] Covered Taxes include taxes recorded in the financial accounts of the CE with respect to its income or profits, taxes on distributed profits, taxes imposed in lieu of a generally applicable CIT, and taxes levied with reference to retained earnings and corporate equity.[31]

GloBE Income or Loss can be found in the denominator of the formula. The starting point for calculating this amount is the financial accounting net income or loss of the CE in a given fiscal year.[32] This is subject to certain adjustments. One is the net tax expense[33] (such that taxes are not included both into the numerator and denominator of the fraction). The other adjustments are related to adjustments that are typically recognized by domestic tax systems in the calculation of the tax base. Accordingly, certain types of dividends, equity gains or losses, gains or losses from the disposition of assets or liabilities, and from the use of asymmetric foreign currencies are also excluded.[34] Furthermore, accrued pension expenses, policy-disallowed expenses, and prior-period errors are also excluded.[35]

When one has the amount of Adjusted Covered Taxes and the GloBE Income or Loss, the fraction shall be calculated. To the extent that the received jurisdictional ETR is lower than the minimum rate of 15%, the difference will be the Top-up Tax Percentage.[36]

GloBE rules also contain an exception related to substantive economic activities, labelled Substance-based Income Exclusion (SBIE). In the long term, it entails that an amount of the GloBE Income equal to 5% of the value of tangible assets and 5% of the payroll costs will be exempt from the Top-up Tax obligation.[37] At the beginning of the application of the GloBE rules, a higher rate will be at place that will constantly decrease to the aforementioned 5% in ten years.

Consequently, the Top-up Tax Percentage will be imposed only on Excess Profit, that is, on the part of the GloBE Income that is in excess of the SBIE amount.[38]

28 | GloBE Model Rules, Article 2.4.1-2.4.2.
29 | GloBE Model Rules, Article 2.6.1.
30 | GloBE Model Rules, Article 4.1.1.
31 | GloBE Model Rules, Article 4.2.1.
32 | GloBE Model Rules, Article 3.1.1.
33 | GloBE Model Rules, Article 3.2.1. a).
34 | GloBE Model Rules, Article 3.2.1. b)–c), e)–f).
35 | GloBE Model Rules, Article 3.2.1. g)–i).
36 | GloBE Model Rules, Article 5.2.1.
37 | GloBE Model Rules, Article 5.3.
38 | GloBE Model Rules, Article 5.2.2.

This Top-up Tax must be paid by the MNE. However, the mechanism by which it is collected is not necessarily IIR or UTPR. The jurisdiction where the Low-Taxed CEs are located may decide to introduce a Qualified Domestic Minimum Top-up Tax (QDMTT), in which case tax revenue will not be shifted to the budget of another jurisdiction. GloBE rules intend to ensure that the MNE is exposed to a minimum level of taxation everywhere it operates and do not intend to prescribe where this taxation should occur.[39] Thus, extra taxation under the IIR and UTPR occurs only when the low tax jurisdiction does not collect the Top-up Tax itself.

3.2. The aim of the GloBE rules

It is worth examining the true objectives of the GloBE rules. Initially, it was to address the tax avoidance and profit-shifting strategies of MNEs, in particular, technology giant companies that engage in digital business segments.[40] Indeed, the GloBE rules were presented as part of the Two-Pillar solution to address the tax challenges arising from a digitalised economy.

Subsequently, the rhetoric changed, and the objective of establishing a floor for tax competition among countries began to be mentioned.[41] Nevertheless, the objective of limiting (even fair) tax competition did not acquire undisputed and universal approval among countries; consequently, in more recent documents, this objective remained more tacit.[42] However, formal or declared objectives are not decisive and require closer scrutiny — examining the provisions and their effects — whether these statements are mere slogans or indeed genuine objectives.

Furthermore, the GloBE proposal has been sold so that it is in the interest of all countries to participate; otherwise, they would lose their tax revenue. However, it is not straightforward that its implementation would bring about a fairer allocation of tax revenues between developing and developed countries,[43] and the economic rationale necessitates the participation of all countries.[44]

Although such an agreement may contribute to tackling certain BEPS issues and to curb or at least mitigate harmful tax competition among jurisdictions (that comes with the jeopardy of a race-to-the-bottom), the GloBE rules certainly go beyond what the previous proposals aspired to achieve. They not only affect situations involving non-taxation or BEPS strategies, but also aim to establish that large MNEs are subject to tax at a minimum rate in each jurisdiction in which they operate. Such an outcome is meant to be realised irrespective of what causes low taxation in a certain jurisdiction. Harmful tax avoidance through aggressive strategies and intended low taxation of real and genuine investments are equally targeted by these rules. Consequently, GloBE rules intersect with domestic tax policy considerations, most notably those that revolve around enhancing the competitiveness of the tax system.

39 | Csabai et al., 2022, p. 27.
40 | OECD, 2018.
41 | OECD, 2019. See also: Dourado, 2022, p. 283.
42 | Englisch, 2022, p. 861.
43 | Brauner, 2022, p. 2.
44 | Cui, 2022, p. 22.

3.3. The Hungarian standpoint regarding the adoption of GloBE

Initially, Hungary was one of the most reluctant states to join and commit to the GloBE agreement; however, this situation changed by October 2021. The Hungarian Secretary of State for Tax Matters underlined four important changes in the proposal that led the country to review its position.[45]

First, the expansion of substance-based carveouts has made the proposal more attractive. As the Secretary of State highlighted, although Hungary is interested in tackling artificial profit shifting and aggressive tax planning, it also insists on its sovereign right to tax real economic activity within its territory, as it deems fit. This aspect of fiscal sovereignty can be safeguarded through a substance-based carve-out.[46] As a dominant share of the Hungarian economy is based on car manufacturing, which is both labour- and tangible asset-intensive, this standpoint is understandable.

Second, Hungary, being a small economy, is a capital importing country. Therefore, it is crucial that the GloBE agreement ensures equal conditions for the countries of parent companies (capital exporting countries) and for the countries of subsidiaries. Under the October proposal of GloBE, this is realised through the inclusion of the UTPR that applies the minimum tax rules with respect to the UPE when it is not subject to sufficient tax in its state of residence. It is not only essential for aligning the rules in conformity with the EU fundamental freedom rules but also for maintaining the competitiveness of the EU market vis-á-vis third countries that potentially do not apply the IIR to their UPEs.[47]

Third, the updated agreement proposal created the possibility that the countries of subsidiaries where the tax burden of those subsidiaries does not reach the minimum level can collect the Top-up Tax on their own, rather than passing on this option to the parent company's country, and thereby, greater respect for the fiscal sovereignty of these countries is granted.[48]

Fourth, the October 2021 version of GloBE created the opportunity to include not only classical corporate income taxes but also other types of taxes on corporations where certain elements of costs (but not all related costs) are deductible. In the Hungarian context, this would mean that the energy supplier tax, local business tax, and innovation contribution are encompassed.[49]

45 | portfolio.hu, 2022.
46 | Ibid.
Similar consideration played a role in Ireland joining the GloBE. Paschal Donohoe (Minister of Finance) emphasised that in addition to the set of the minimum tax rate at 15% (instead of the provision of 'at least 15%'), the substance-based carve-out and thus the possibility of tax incentives for R&D activities resulted in changing Ireland's position. Available at: https://www.gov.ie/en/press-release/59812-ireland-joins-oecd-international-tax-agreement/ (Accessed: 19 February 2022).
47 | portfolio.hu, 2022.
48 | Ibid. This approach cannot be explicitly found in the OECD GloBE Proposal, however, the EU Directive Proposal on the GloBE expressly authorises the state of the undertaxed CE to apply the Top-up Tax domestically in respect of its own CEs. See: Article 10 of Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union, COM/2021/823 final.
49 | portfolio.hu, 2022.

4. The impact of the GloBE rules on the Hungarian tax system

4.1. Tax incentives and the GloBE rules in general

As discussed in previous sections, the GloBE rules contain a sophisticated set of mechanisms aimed at ensuring that the MNEs are subject to at least 15% ETR in each jurisdiction where they are present. It was also demonstrated that it has more far-reaching effects than merely addressing the challenges arising from the digitalised economy or BEPS or tax avoidance strategies. Instead, it generally sets the floor for tax competition. In the field of tackling abusive practices, Member States already have several obligations stemming from EU law to curb these practices. Most notably, the provisions of the ATAD 1(anti tax avoidance directive) and ATAD 2 Directives are already in force, requiring Member States to legislate general anti-abuse rules (GAARs), CFC rules, anti-hybrid rules, rules on the limitation on interest deduction, and exit taxation rules.[50] However, at the EU level, the primary rule was, from the perspective of taxpayers, that exercising their fundamental freedoms, even for tax-driven purposes, is acceptable to the extent that such an exercise of free-movement rights reflects genuine cross-border economic activity.[51] Placing this statement from the perspective of Member States meant that they were at liberty to establish a competitive tax system to attract FDI to the extent that they did not allow tax avoidance. This paradigm appears to have changed with the adoption of the GloBE Directive, because it constitutes a clear barrier to tax competition, irrespective of the form of competition. This study does not evaluate whether the ensuing positive effects would outnumber the negative ones, rather it analyses how the GloBE rules affect the Hungarian tax system and its tax incentive elements.

In order to evaluate this, OECD analysis regarding the interference of tax incentives with the GloBE rules. is worth being taken as a starting point.[52] This document highlights that tax incentives that target the amount of Covered Taxes (by reducing them) are most likely to be affected by GloBE rules. In this respect, reduced tax rates, exemption of part of the income for tax purposes) and tax allowances (depreciation in excess of the cost of the asset) are the most affected items. By contrast, the tax incentives that target GloBE Income (by way of increasing it), that is, the denominator of the fraction for the calculation of the ETR, have a lesser impact on the ETR and thus are less likely to bring about a Top-up Tax liability.[53] In that category, particularly the Qualifying Refundable Tax Credit (QRTC) should be mentioned. QRTC is defined by the GloBE rules as a refundable tax credit

50 | Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19.7.2016.
51 | CJEU, 12 September 2006 Case C-196/04, *Cadbury Schweppes*, ECLI:EU:C:2006:544, Paragraph 75.
52 | OECD, 2022b.
53 | OECD, 2022b, p. 39.

designed such that it must be paid as cash or available as cash equivalents within four years when a Constituent Entity satisfies the conditions for receiving credit under the laws of the jurisdiction granting credit.[54] Further, it is noteworthy that tax deductions (that reduce the taxable base) and tax credits (that reduce the tax liability) have different relevance in the context of the GloBE rules: to the extent a tax credit does not qualify as a QRTC, it is more strongly affected by the GloBE rules than an expenditure based tax deduction.[55] This outcome can be supported based on economic literature according to which expenditure-based tax incentives can be more targeted and more apt to achieve the objective of attracting real, genuine investments with less spillover effects.[56] Within the category of tax deductions, we can distinguish between permanent and temporary incentives. The latter encompasses tax incentives that provide a temporal benefit in the form of a deferral in taxation (for instance, accelerated depreciation or the immediate deduction of the cost of an asset for tax purposes). As ETR fluctuations owing to these timing differences are considered in the GloBE rules by providing for a deferred tax adjustment mechanism (to the extent that the recapture rules are not activated), these temporal benefits are not likely to be affected because the GloBE rules iron out such differences to the extent that the depreciation for tax purposes does not exceed the cost of the asset.[57]

4.2. Affected attributes of the Hungarian tax system

As the OECD analysis put forward, for a jurisdiction to evaluate the impact of the GloBE rules on its corporate tax system, several layers must be examined: jurisdiction, entity, and incentive levels.[58]

Under the jurisdictional level, the attributes of the standard CIT system are relevant: how the tax base and tax rate(s) are determined as a general rule. Bearing in mind that the GloBE Income or Loss calculation is based on some type of Financial Accounting Net Income, it is easy to see that if the national tax rules draw the boundaries of the tax base in a narrow manner–that is, excluding many items of income that form part of the financial accounting income–then it will result in permanent book-to-tax differences that are likely to increase the probability that the GloBE rules will have an impact on the national tax system.[59] The rules on the computation of GloBE Income or Loss also encompass adjustments to eliminate book-to-tax differences that are typical in most countries' CIT systems; for instance, it excludes certain dividend income, capital gains or losses, and asymmetric foreign currency gains or losses from the computation.[60] Therefore, the liberal Hungarian participation exemption regime does not appear to have caused problems under the GloBE. Similarly, exempted dividend income and income from capital gains are excluded as the primary rule from the computation of the ETR for GloBE

54 | GloBE Model Rules, Article 10.1.1.
55 | OECD, 2022b, p. 37.
56 | Perez-Navarro, 2023, p. 102.
57 | OECD, 2022b, p. 40.
58 | OECD, 2022b, p. 29.
59 | OECD, 2022b, p. 30.
60 | GloBE Model Rules, Article 3.2.1. Points b), c), f).

purposes. Therefore, it is particularly important that the taxpayer does register its newly acquired shareholding for the application of participation exemption (it is a formal requirement in Hungary); otherwise, not only will the gains upon later alienation be subject to the Hungarian CIT, but such tax payments will be ignored in the context of the GloBE rules, reducing the amount of Covered Taxes and thus the ETR. However, the exclusion of dividend income from the computation of GloBE ETR is not unrestricted; it only applies to dividends derived from a non-portfolio shareholding (10% or more), while the Hungarian rules do not contain such a limitation. Consequently, the GloBE rules affect the dividend exemption regime when applied to portfolio investments.[61]

Although the Hungarian CIT system does not contain any reduced rates, the one single standard rate of 9% can be considered as outstandingly low within the EU. As the 9% rate applies enerally, irrespective of the economic activity concerned or any characteristics of the taxpayer who earns income, it is certainly a strong indicator of a low ETR; therefore, it is strongly affected by the GloBE rules.

When entity-level factors are examined, it is important to compare the extent of a given tax incentive with that of the GloBE rules. For instance, the Hungarian CIT system contains a special tax credit for the implementation of debt-financed investments in tangible assets that is available only for small and medium-sized enterprises (SMEs).[62] SMEs are defined as enterprises in which the overall number of employees is less than 250 and their annual net revenues do not exceed EUR 50 million or their balance sheet total does not exceed EUR 43 million. Based on this definition, it is clear that although such a tax credit could significantly reduce an SME's Hungarian ETR, it does not interfere with the GloBE rules which target a different group of enterprises, that is, those whose annual net revenue exceeds EUR 750 million. Similarly, incentives that are only available to standalone companies are not relevant for GloBE purposes as a general rule; however, as the EU Globe Directive also applies to large-scale domestic enterprises to eliminate potential discrimination against cross-border situations (which is prohibited under the EU fundamental freedom rules), incentives targeting standalone companies can compromise the GloBE ETR. Nevertheless, the Hungarian CIT system does not encompass incentives directed solely at standalone companies.

The detailed design elements of tax incentives must be scrutinised when it comes to the tax incentive factor. The width of economic activity within the grip of tax incentives can strongly influence the extent to which it is affected by GloBE rules. For example, if it is connected to activities outside the scope of GloBE (such as international shipping), it will not be affected. On the other end of the spectrum, these incentives can be found that are applicable to a broad range of economic activities (e.g. export-related incentives that cover any economic activity that deals with the supply of goods directed abroad).[63] In the middle, one can find rather narrowly shaped tax incentives that encourage a specific income-generating activity, such as royalty income from R&D activities. Hungary also has an intellectual

61 | Liotti et al., 2022, p. 39.
62 | Section 22/A. of CITA.
63 | OECD, 2022b, p. 32.

property (IP) box regime in force, in accordance with the OECD requirements laid down in the BEPS Action Plans. Accordingly, half of qualifying royalty income earned by the taxpayer is exempt from CIT, and a 30% uplift is available for non-qualifying royalty income (i.e. for royalty income in relation to which the R&D costs were not incurred by the taxpayer).[64] Assuming that all royalty income qualifies for the benefit, such an incentive practically halves the applicable tax rate for royalty income and, consequently, is strongly affected by the GloBE rules. However, owing to its narrow scope, the ETR-reducing effect can be counterbalanced by other items of income of the taxpayer. This holds particularly true if the taxpayer is engaged in labour- or asset-intensive economic activity which also gives rise to SBIE under the ambit of the GloBE rules. It is important to highlight that not only are the taxpayer's other sources of income relevant in this respect, but also any income that is derived by another CE of the same group in the same jurisdiction because the ETR under the GloBE rules is calculated on a jurisdictional basis, blending all the GloBE Income and Loss as well as all the Covered Taxes.

One of the most important Hungarian tax incentives is development tax credit.[65] These rules enable the taxpayer, upon the fulfilment of certain conditions related to implementing a certain level of new investment, to reduce its calculated tax liability up to 80%.[66] As it can be seen, it can be an important and significant tax incentive for companies to invest in development. However, considering the GloBE rules, it does not qualify as a QRTC because the government does not repay any unused tax credit to the taxpayer in cash or cash equivalents.

The accounting treatment for the development tax credit is as follows: Pursuant to the IFRS, it can be accounted for either as a state grant under International Accounting Standard (IAS) 20 or as a deferred tax under IAS 12. In the first case, there is a profit and loss (P&L) effect, resulting in other revenues.[67] However, the Hungarian tax system neutralises the P&L effect by decreasing the tax base based on the aforementioned revenue.[68] In the second case, when the development tax credit is accounted for as a deferred tax, such a deferred tax cannot be shown because of the prohibition pursuant to IAS 12.33 and 12.22 c) thus, there is no revenue effect.

Under Hungarian accounting rules (HU GAAP), the development tax credit is shown as a reduction in current corporate income tax expenses, and there is no P&L impact.[69] GloBE rules have specific provisions[70] that ensure that QRTCs are treated as income for GloBE purposes, irrespective of their financial accounting treatment. However, the non-qualified tax credits leave GloBE Income or Loss untouched (i.e. not added to it) but decrease the Covered Taxes.[71] It is easy to see

64 | Section 7 (1) s), (14), (22)–(24) of CITA.
65 | Section 22/B of CITA.
66 | Section 23 (2) of CITA.
67 | IAS 20.12, IAS 20.24–27.
68 | Section 18/B. (1) c) of the CITA.
69 | Tormáné dr. Boris, 2022, p. 9.
70 | For the elimination from the Covered Tax element: Article 4.1.2. d), while for the inclusion in the GloBE Income or Loss: Article 3.2.4. of the GloBE Model Rules.
71 | GloBE Model Rules, Article 4.1.3. b).

that in the case of a tax credit that does not qualify as QRTC and that is capable of contributing to an 80% reduction in the taxpayer's tax liability is particularly susceptible to be affected by the GloBE rules, as it can significantly reduce the ETR which may result in a corresponding Top-up Tax liability.[72]

5. Aspects with mitigating impact of GloBE rules on the domestic tax system

5.1. Preliminary remarks

The previous section examined some focal points of the competitive features of the Hungarian CIT system considering GloBE rules. It is clear that some of them will be strongly affected by the GloBE rules that is capable of compromising their underlying tax policy objective, that is, attracting FDI by means of creating a beneficial tax environment for them.

This section scrutinises these aspects that could be able to mitigate the identified impacts. Considering the outcome, it identifies the tax incentives that can 'get away' with their ETR reducing effect even in the post-GloBE era and those that should be modified to prevent them from being devoid of their very purpose.

5.2. Scope of the GloBE rules and the QDMTT

The scope of the GloBE rules covers only large MNEs whose annual revenues exceed EUR 750 million. Consequently, even strongly affected tax incentives can remain effective for any taxpayer that does not qualify as a CE of such a large MNE. Therefore, it is reasonable to maintain tax incentives if they are otherwise apt to pursue their intended tax policy objectives. This standpoint can be further supported by the fact that the states have the possibility to introduce a QDMTT. It entails that while their tax incentive system remains intact vis-á-vis out of the scope taxpayers, the additional budgetary consequences for the in-scope taxpayers can be collected by the incentivising country itself.[73] Furthermore, the QDMTT applies after the calculation of the Top-up Tax, meaning that it will not be levied on routine profits, as calculated in a formulaic way under the SBIE.[74] This further mitigates the impact of the GloBE rules. Clearly, this is not ideal, because there was a reason (in the form of other benefits for the country) for not collecting those taxes before the GloBE; however, it is better than losing both competitiveness and tax revenue.

72 | It is noteworthy that the transitional rules (Article 9.1.1.) of the GloBE Model Rules allow to consider the deferred tax assets that has been created in previous years with respect to a development tax credit. Thus, the development tax credits that have already been granted prior to the GloBE rules entering into force and whereby deferred tax assets have been created, will be capable of reducing the tax liability without causing Top-up Tax liability. In more detail, see: Tormáné dr. Boris, 2022, pp. 12–13.
73 | Liotti et al., 2022, p. 27.
74 | Bammens and Bettens, 2023, pp. 162–163.

Therefore, the combination of the scope of GloBE rules and the option to introduce a QDMTT indicates that the application of GloBE rules will not require a complete overhaul of a tax incentive system that is deemed well-functioning.

5.3. Covered taxes under the GloBE rules

As mentioned earlier, Hungarian reception of the Two-Pillar solution was not delightful. However, as the Secretary of State pointed out, one reason Hungary eventually committed to the GloBE Agreement, was that in the Covered Taxes category, not only CIT but other corporate non-income taxes such as energy suppliers' tax, the local business tax, and innovation contribution have been encompassed as well. This standpoint also played an important role in Hungary surrendering its veto at the EU level during the course of the GloBE negotiations, providing a green light to the unanimous adoption of the GloBE Directive. However, the only proof of this understanding is a letter[75] written by the Legal Service Director of the General Secretariat of the Council of the European Union, which nevertheless does not have a binding effect.

Therefore, it is worth examining whether such an understanding can be deduced from the wording of the GloBE Model Rules or the EU GloBE Directive.

Article 4.2.1. of the GloBE Model Rules defines the scope of the Covered Taxes such that it includes:

(a) Taxes recorded in the financial accounts of a Constituent Entity with respect to its income or profits or its share of the income or profits of a Constituent Entity in which it owns an Ownership Interest;

(b) Taxes on distributed profits, deemed profit distributions, and non-business expenses imposed under an Eligible Distribution Tax System;

(c) Taxes imposed in lieu of a generally applicable corporate income tax; and

(d) Taxes levied by reference to retained earnings and corporate equity, including a Tax on multiple components based on income and equity.[76]

The EU GloBE Directive Proposal defines the scope of the Covered Taxes in an identical manner.[77]

However, this catalogue does not support the optimism of the Hungarian Secretary of State for Tax Matters that the Covered Taxes of the GloBE would include the local business tax and other business taxes with similar features. These taxes can be classified as hybrid taxes because their basis of assessment is a hybrid between revenue-based and income-based taxes. It allows deduction of various costs from the net sales revenues; however, the tax base is wider than that of a CIT.

The list from (b)-(d) relates to specific situations that do not appear relevant in the context of hybrid business taxes. Hybrid taxes have no effect on profit distribution, retained earnings, or equity. Furthermore, they are not levied in lieu of

75 | vg.hu, 2022.

76 | GloBE Model Rules, Article 4.2.1.

77 | Article 19 of the Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union, COM/2021/823 final.

corporate income taxes but rather in parallel with them, and they are typically not expected to be considered when it comes to the elimination of economic or juridical double taxation.[78]

Regarding point (a), the question is how the terms income or profits are interpreted and whether they can be perceived as widely as including hybrid taxes, such as the Hungarian local business tax that stands close to a classic corporate income tax base. However, certain cost elements are not allowed to be deducted or they are added back for the purposes of these special taxes.

In the context of double tax treaties, the concept of income typically keeps these taxes out of scope[79], unless the contracting parties explicitly add the given tax to the list of covered taxes. This solution could also enhance legal certainty regarding the covered taxes in the context of the GloBE; therefore, it would be desirable to have a country-by-country list of covered taxes. Based on the current wording of the list, it is ambiguous whether the GloBE covers the hybrid taxes mentioned by the Secretary of State. However, legal analyses and political realities are often not aligned. As the inclusion of Hungarian hybrid taxes was a crucial point in the adoption of the GloBE Directive as a political deal, it is likely that these taxes will indeed be included in the Covered Tax category.

Such an outcome is of particular importance because companies with substantial economic operations in Hungary can be subject to high local business tax liabilities that often exceed their CIT liabilities, which, as their tax base is wider, may result in a high ETR in the GloBE system. These CEs may avail themselves of various ETR-reducing tax incentives because of the counterbalancing effect of local business tax liabilities. The local business tax base excludes interest and royalty revenue. Thus, CEs engaged merely in intragroup financing or licencing activities are likely to have a low ETR for GloBE purposes. However, owing to jurisdictional blending, such a low ETR can be reversed by other operating CEs, incurring a high local business tax liability.

6. Conclusion

Although with several transitional rules and without the UTPR, the GloBE rules will become effective by 2024 within the EU and many other countries. This fundamental tax reform will bring about tremendous changes and affect CIT systems worldwide, in particular, the tax incentives provided for taxpayers by the states to create an attractive investment environment.

From a Hungarian perspective — being a country known for its beneficial CIT system — it can be concluded that beneficial features of the tax system that apply generally, such as the 9% nominal CIT rate, will interfere with the GloBE rules. Other narrower incentives, such as the IP box regime, can also be compromised;

78 | Pistone, 2021, p. 407.
79 | For a detailed analysis of the scope of income taxes in the context of double tax treaties, see: Pistone and Ullmann, 2021, pp. 167–200; Kotha, 2021, pp. 25–43.

nevertheless, it is possible that the taxpayer can avail of the ensuing benefit owing to its other income, which is taxed heavier. Furthermore, the jurisdictional blending under the GloBE rules enables that the heavier taxed income of other CEs of the same MNE group be considered as well to counterbalance the ETR effect of the low-taxed income.

The most problematic element of the Hungarian tax incentive system through the lens of the GloBE is the development tax credit because it can significantly reduce the ETR and, classified as a non-qualifying tax credit, it will have a direct impact on the Covered Tax element of the GloBE's ETR calculation. This entails a significant disadvantage compared with QRTCs, which only affect GloBE Income or Loss rather than the Covered Tax calculation, resulting in milder implications. Restructuring the development tax credit to include QRTC attributes could be a desirable policy option.

The most important factor in mitigating the GloBE effects on tax incentives appears to be outside the scope of the Hungarian CIT system, and the current opinion that some hybrid business taxes – most importantly, the local business tax liability – will also be included in the ETR calculation will result in a significantly higher ETR for GloBE purposes for operating Hungarian CEs. Moreover, it may enable groups to exploit this benefit at the group level and balance out low-taxed entities (e.g. licencing or financing entities) with the high ETR of operating CEs.

In the light of the specific scope of the GloBE rules (only applicable to large MNEs), the mitigating effect of other hybrid business taxes, and the possibility of introducing a QDMTT, a complete overhaul of the tax incentive system does not appear to be necessary.

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