

# THE BENEFITS OF TAX FOR THE MOTION PICTURE INDUSTRY IN HUNGARY

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Since the reforms which have impacted the Hungarian Film Industry from the passing of Act II of 2004 on Motion Pictures (the "**Film Act**"), the legal framework has continuously developed with the view of making Hungary one of the most attractive and competitive locations for film production. In particular, in addition to the direct subsidies which the Film Act has made available, indirect subsidies, in the form of a tax incentive regime, provide tax relief through tax credits and allowances creating extremely favourable conditions for producers to make their films in Hungary.

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## THE TAX RELIEF SYSTEM

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The tax incentive regime currently in operation is a tax credit system which is broadly aimed at increasing production activities in Hungary, and in particular at making Hungarian production more attractive compared to productions in the neighbouring countries.

The tax incentive regime was initially introduced by the Film Act, which prescribed certain amendments to Act LXXXI of 1996 on Corporate Tax and Dividend Tax (the "**Corporate Tax Act**"). These amendments were designed to implement a two-model financing structure, a *production model* (for films on order) and a *co-production model* (for films not on-order), with each providing tax relief to Hungarian corporate investors involved in the financing of productions undertaken in Hungary. In addition to these models, development tax allowances, including accelerated depreciation provisions, were also made available.

The main differences between the structures introduced was that under the *production* model, a corporate investor could claim both a full tax credit and a tax base deduction when financing a maximum 20% of qualifying expenditures, whereas under the *co-production* model, the corporate investor was considered to be a co-producer retaining certain rights relating to the production and was entitled to a full tax credit but only a 50% tax base deduction by its deemed acquisition of rights.

The initial amendments were subsequently modified and replaced with effect from November 23, 2004, and apply for the first time in determining the 2005 tax base and tax liability. Under the current regime, the concept of the two-model system is retained, however both a tax credit as well as a full tax base deduction is available for both types of investments in Hungarian productions. It should be noted that the concept of tax benefits for developmental purposes was also retained, providing significant benefits for investment in infrastructure and equipment relating to motion picture and video production.

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## TAX INCENTIVES AVAILABLE

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There are *two* main types of tax incentives available which have been designed to address specific production models as well as certain perceived needs in developing and supporting the Hungarian audiovisual industry and Hungary's production capacity. The desired objectives are achieved by offering tax credits and favourable depreciation write-offs, thereby creating additional resources for film production and infrastructure development. The source of

credits is the pre-tax profits of Hungarian companies who wish to reduce their tax liability by sponsoring (investing) in the motion picture industry.

**(1) Production Service and Co-Production Incentives**

The Film Act and the Corporate Tax Act distinguish two types of productions in terms of tax relief:

(i) *Films produced on order (Production Services)*

This type of production involves the owner (typically a foreign entity) commissioning a film piece or parts of a film from a Hungarian film production company. In this production model, the film budget is typically fully guaranteed, but the objective is to reduce production costs by utilizing production services in Hungary for portions of the film.

(ii) *Films not produced on order (Co-Productions)*

These are co-productions involving a collaboration of a number of producers, including a Hungarian film producer. Productions falling into this category are Hungarian movies, co-production works with Hungarian participation and other films with Hungarian participation. This model supports films where the total budget of the film cannot be provided, therefore, a co-production which takes benefit of sources of international support is utilized.

In either production model, the incentive offered is a tax credit to a Hungarian corporate investor, who may deduct (i) from its tax base, as well as (ii) from its taxes payable, 100% of any amount of support (investment) it provides to a production. However, a Hungarian investor may write-off no more than 70% of its total taxes payable, and the amount of the support (and thereby the tax relief) is limited to 20% of direct film production costs incurred in Hungary.

In determining how 'direct film production costs' is defined, the legislators took the view of making the definition as broad as possible, so as not to exclude (without justified reason) certain types of costs. Generally, direct production costs in Hungary are the net amount of costs such as pre-production, shooting and post-production work to the first master print, and include all costs (with the exception of royalties), which are paid to Hungarian taxpayers.

**(2) Development Driven Incentives**

In addition to production incentives, development-driven incentives have also been made available to promote and encourage investment in infrastructure and equipment relating to the motion picture industry. These incentives provide the following benefits:

(i) *Investment Tax Incentives*

Tax relief will be granted, within the framework of a development program, for projects aimed exclusively at motion picture and video production and valued at 100 million HUF or more (approximately 400,000 EUR).

Companies making such investment will be eligible for relief in the amount of 35-50% of their investment, depending on which region in Hungary they make their investment in (Budapest - 35%, Pest County - 40%, Western Trans-Danubia - 45%, Rest of Hungary - 50%).

This type of relief will only be granted if the taxpayer undertakes the commitment to refrain, in the first 5 years of operation, from using the assets installed by the project for making any motion picture that is classified as one which might seriously impair the physical, intellectual or moral development of minors, in particular those that involve pornography or extreme or explicit scenes of violence.

(2) *Favourable Depreciation Incentives*

Taxpayers are also provided with the ability to take benefit of favourable depreciation write-offs in connection with structures and equipment exclusively serving motion picture and video production. In case of equipment the applicable depreciation rate is 50%, while for structures the depreciation rate is 15%. Compared to the two per cent. depreciation rate available for industrial structures, this also provides significant tax savings.

It should be pointed out that as opposed to production incentives, a Hungarian taxpayer may write-off no more than 80% of its total taxes payable, when utilizing development driven incentives.

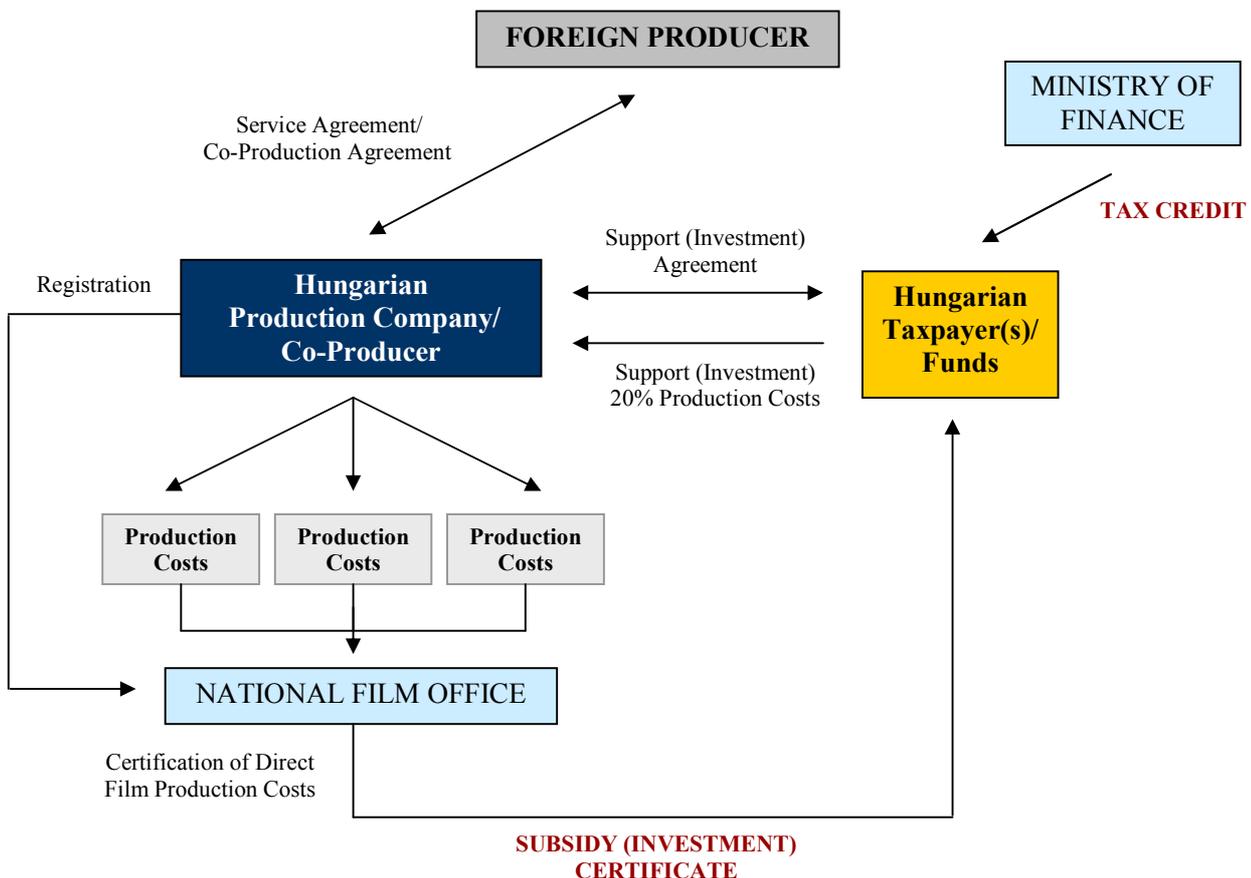
*In 2004, the Film Office issued 25 tax certificates on behalf of 19 Hungarian and 3 foreign producers in the value of 693 million HUF (approx. 2.7 million EUR).*

*With recent amendments in law, the anticipation of 2005 is a growth in production to an estimated 2 billion HUF (approx. 8 million EUR).*



## UTILIZING PRODUCTION INCENTIVES

The following diagram sets out a general overview of the structure behind production incentives for both Production Services and Co-Productions:



- The Foreign Producer and Hungarian Production Company (in case of the Production Services Model), or Hungarian Co-Producer (in case of the Co-Production Model) enter into a Service Agreement or Co-Production Agreement respectively, requiring certain production services to be provided in Hungary.
- The Producers seek out Hungarian Taxpayer(s) (or Funds) to support the production, and obtain their agreement to support up to 20% of the *direct film production costs in Hungary* (following obtaining the certificate issued by the National Film Office).
- The Hungarian Producer registers the production with the National Film Office and provides the contracted services thereby incurring *direct film production costs in Hungary*.
- Following the completion of production (or a phase thereof), the Hungarian producer requests the National Film Office to review costs and to certify the *direct film production costs in Hungary*.
- Following the examination of accounts (approximately 30 days), the National Film Office will establish the *direct film production costs in Hungary* and will issue a Subsidy (Investment) Certificate amounting to 20% of such costs.
- The Hungarian Taxpayer(s) (or Funds) will provide support in an amount corresponding to the Subsidy Certificate and will then seek a tax credit (tax base and tax payable) from the Ministry of Finance of up to no more than 70% of its total taxes payable.

## BENEFITS OF PRODUCTION INCENTIVES

As noted above, the benefits in production incentives for the Hungarian corporate taxpayer are (i) reductions in the tax base as well as (ii) reductions in the amount of tax payable. The advantage for the producer is the ability to reduce its production budget with respect to services rendered in Hungary.

Consider the following:

TAXPAYER BENEFIT			PRODUCTION BENEFIT		
	<i>No Support (Investment)</i>	<i>Support (Investment)</i>		<i>No Production in Hungary</i>	<i>Production in Hungary</i>
<b>Total Taxable Profit</b>	3,600,000	3,600,000	<b>Production Cost</b>	4,000,000	4,000,000
<b>Support (Investment)</b>	-	400,000	<b>Foreign Production Cost</b>	4,000,000	2,000,000
<b>Tax Base</b>	3,600,000	3,200,000	<b>Hungarian Production Cost</b>	-	2,000,000
<b>Tax Payable</b>	576,000 <i>(3,600,000 x 16%)</i>	112,000 <i>((3,200,000 x 16%) - 400,000)</i>	<b>Maximum Support</b>	-	400,000 <i>(20% of direct film production costs)</i>
<b>Total Paid</b>	576,000	512,000	<b>Total Cost</b>	4,000,000	3,600,000
<b>TAX SAVINGS</b>	-	<b>64,000</b>	<b>PRODUCTION SAVINGS</b>	-	<b>400,000</b>

By making an investment of 400,000 in supporting Hungarian film production, the Hungarian corporate taxpayer is able to reduce its taxes (tax base and tax payable) by 64,000, or 16% of its investment. Consequently, by bringing a portion of the production to Hungary, a foreign producer is able to reduce Hungarian production costs by 20% and thereby its total production costs.

*The Hungarian Corporate Taxpayer is able to realize a 16% return on its investment.*

*The Producer is able to reduce Hungarian production costs by 20%.*

It should be noted that this tax saving may be carried forward for three years, and no Subsidy (Investment) Certificate will be issued for any motion picture that is classified as one which might seriously impair the physical, intellectual or moral development of minors, in particular those that involve pornography or extreme or unjustified scenes of violence.

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## THE NATIONAL FILM OFFICE

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The National Film Office (the "**Film Office**") was established by the Minister for National Cultural Heritage and performs public administration tasks relating to the functioning of the motion picture industry, in the course of which it performs statutory, control and service provision activities.

The tasks of the Film Office are, among others, to:

- classify films in accordance with the Film Act, including into categories entitled Hungarian film, co-production film with Hungarian participation, or film with other Hungarian participation;
- register professional motion picture organizations and natural persons applying for state subsidies and Hungarian enterprises participating in the production of motion pictures;
- keep a register of motion picture productions requiring direct or indirect subsidies and all motion picture productions to be distributed;
- keep records of the number of viewers and ticket revenues reached as a result of the distribution of a motion picture in Hungarian cinemas, the number of screenings of the motion picture by breakdown per cinema operators and the number of copies sold in the distribution of the motion picture on various data carriers and the sales revenue realized; and
- register motion picture productions requiring indirect subsidies, examine and certify Hungarian production costs, and issue Subsidy (Investment) Certificates.

## Steps to Receiving a Subsidy (Investment) Certificate

To be eligible to receive a Subsidy (Investment) Certificate and thereby the support from the Hungarian Taxpayer(s) (or Funds), the production must:

(1) *Register the Producer*

The resolution of the Film Office to register a production (as set out below) will only be issued if the Film Office has previously registered the Hungarian Production Company or the Hungarian Co-Producer, as the case may be. Registration of the Producer will take approximately 30 - 50 days.

(2) *Register the Production*

To successfully register the production with the Film Office, the producer or the company participating in the production must, among others, file the following documents 45 days prior to production:

- a) the script of the motion picture to be produced;
- b) documents containing the consent to the making of the motion picture by the authors;
- c) the list of artists participating in the production, the artistic and technical staff and production locations, indicating the technical and artistic contributions of foreign countries participating in the production;
- d) the budget and detailed financial plan of the production, including the budget on the direct costs of motion picture production to be incurred in Hungary (counter-

- signed by all co-producers, sponsors and investors);
- e) the scheduling of the production, including the Hungarian production plan;
  - f) in case of the *Production Services*, the service agreement concluded between the Hungarian Production Company and the Foreign Producer (the ordering party);
  - g) in case of *Co-Productions*, the co-production agreement (which must include the agreement of the parties on the sharing of revenues and the geographic allocation of distribution) and documents certifying the cover of the direct motion picture production costs arising in Hungary;
  - h) an extract from the Company Registry not older than 30 days of the Hungarian Production Company or the Hungarian Co-Producer, as the case may be;
  - i) an extract of the general ledger assigned to the motion picture production and part of the exclusive ledger account, closed on the last day of the month preceding the current month; and
  - j) the request of the producer or the company participating in the production regarding the scheduling option to be used in the issuance of the Subsidy (Investment) Certificate(s).

Following the review of the budget and the documents submitted, the Film Office will issue a resolution which registers the production (outlining the respective registration fees to be paid) and which also sets out which costs will

qualify as direct eligible motion picture production costs to be incurred in Hungary.

- (3) *Provide a declaration regarding completion and request the issuance of the Subsidy (Investment) Certificate(s)*

On the basis of (a) the declaration of the producer or the company participating in the production indicating the completion of Hungarian production (or a phase thereof) and (b) the request for the issuance of the Subsidy (Investment) Certificate(s), the Film Office will audit the production and the costs established in its resolution registering the production.

The audit, which will take approximately 30 days, will be performed on the basis of the general ledger extract filed, and in justified cases, the Film Office may also request accounting documents in relation to the production and may also review the accounts of the motion picture producer.

- (4) *Advise the Film Office of the details of the sponsors (investors)*

The Film Office will only issue the Subsidy (Investment) Certificate(s) if the producer or the company participating in the production has advised it of the names, seats and tax numbers of the sponsors (investors), and the producer has attached documents verifying the eligibility for the certificate (agreements certifying the existence of the subsidy (investment)).

- (5) *Receipt of resolution and Subsidy (Investment) Certificate(s)*

Following its review, the Film Office will establish the total amount of direct

eligible production costs incurred in Hungary (or the amount with respect to the phase of production concerned) and will issue the Subsidy (Investment) Certificate(s) for 20% of this amount.

The beneficiary of the Subsidy (Investment) Certificate(s) is the sponsor (investor) of the production and a copy of the certificate is also provided to the producer or the company participating in the production.

### **Phases of Production (Scheduling Options)**

The Film Office will generally issue the Subsidy (Investment) Certificate(s) in respect of the costs of direct Hungarian motion picture production following the completion of the entire phase of Hungarian production, unless requested in a *different schedule* and in *several phases* by the producer or the company participating in the production.

The request for a different issuance schedule may be based on the following options:

- if production is not completed by 31 December of the year in which the request is filed, the producer or the company participating in the production shall have the right to request the issuance of the Subsidy (Investment) Certificate on the direct Hungarian motion picture production costs incurred until *31 December (the first phase of production)*; and
- if production is not completed within 9 months from the filing of the request, or if the direct production costs incurred in Hungary exceed HUF 150 million (600,000 EUR), the producer or the company participating in the production shall have the right to request the issuance of the Subsidy (Investment) Certificate *quarterly*.

In case of applying the above issuance schedule, the amount indicated in the certificate (or the total amount in case of certificates issued to several sponsors (investors) for the same motion picture) will be 20 per cent. of the production costs incurred in Hungary in the relevant period.

### **Registration Fees**

The fees payable to the Film Office for the registration of a production (the issuing of Subsidy Certificates) in case of *Production Services* is:

- (1) 0.2 per cent., maximum HUF 500,000 (2,000 EUR) of the direct motion picture production cost incurred in Hungary in case of the issuance of Subsidy (Investment) Certificate(s) at the end of production or 31 December; the fee for secondary proceeding is 0.1 per cent., maximum HUF 250,000;
- (2) 0.3 per cent., maximum HUF 500,000 of the direct motion picture production cost incurred in Hungary in case of the issuance of Subsidy (Investment) Certificate(s) quarterly; the fee for secondary proceeding is 0.15 per cent., maximum HUF 250,000.

The fees payable for the registration of a production (the issuing of Subsidy Certificates) in case of *Co-Productions* is:

- (1) 0.1 per cent., maximum HUF 250,000 (1,000 EUR) of the direct motion picture production cost incurred in Hungary in case of the issuance of Subsidy (Investment) Certificate(s) at the end of production or 31 December; the fee for secondary proceeding is 0.05 per cent., maximum HUF 125,000;
- (2) 0.15 per cent., maximum HUF 250,000 of the direct motion picture production

cost incurred in Hungary in case of the issuance of Subsidy (Investment) Certificate(s) quarterly; the fee of the secondary proceeding is 0.07 per cent., maximum HUF 125,000.

Fees for secondary proceedings are those which are payable in case of appealing a decision of the Film Office to the Minister for National Cultural Heritage.

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## LOOKING AHEAD

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Hungary is comparatively well placed in providing incentives for local production, and

thus for making up shortfalls which have occurred in the past. Subsidies and development driven incentives directly contribute to increasing investment in the motion picture industry and the technical ability of Hungarian production companies.

In 2004, the Film Office issued 25 tax certificates on behalf of 19 Hungarian and 3 foreign producers in the value of 693 million HUF (approximately 2.7 million EUR). With recent amendments in law, the anticipation of 2005 is a growth in production to an estimated 2 billion HUF (approximately 8 million EUR).

*The contents of this article are intended to provide only a general overview of the subject matter. Specialist advice should be sought for specific matters. Queries relating to this article should be addressed to the authors at:*

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