



BEYOND THE TAX RATE

Industrial substance and the new
economics of automotive manufacturing



Hungary's automotive paradox: the first live test of whether industrial substance beats a tax rate

A STRUCTURAL QUESTION AT THE CENTRE OF HUNGARY'S INDUSTRIAL STORY

In late 2025, BMW began series production of the all-electric iX3 at its new plant in Debrecen. The facility runs entirely on renewable energy, houses first-generation Gen6 battery production, and was designed from the outset as the physical blueprint for the company's Neue Klasse vehicle architecture. It is one of the most technologically advanced automotive manufacturing facilities anywhere in Europe.

The location is Hungary, where a 9% corporate income tax rate now intersects directly with Pillar Two's 15% global minimum.

That juxtaposition sits at the heart of Hungary's

automotive competitiveness in 2026. Can genuine industrial substance protect a manufacturing location's economics when the global tax architecture is specifically designed to neutralise headline rate advantages? Hungary has become, inadvertently, the live test case for that question. The answer will shape how multinational groups think about Central European manufacturing investment for the next decade.

The honest answer, as this paper will argue, is that there is no single outcome. Hungary's automotive sector is bifurcating, and the forces pulling it in opposite directions are not temporary. Understanding which side of that divide any given operation sits on requires working through the mechanics, not just reading the headline. But the forces at work in Hungary are not unique to Hungary they define the CEE manufacturing investment



+€7bn → -€0.7bn

In five years, Europe's new mobility components trade balance shifted from a €7bn surplus to a €0.7bn deficit.

The global pressure system

CHINA HAS REDRAWN THE COMPETITIVE MAP BUT NOT WITHOUT RESISTANCE

To understand Hungary's position, start with the competitive force reshaping the industry's economics. Purely Chinese-branded vehicles doubled their total share of car registrations across Europe to approximately 6% in 2025, according to automotive consultancy Inovev, Chinese-owned brands with European marques are included, independent estimates place the figure closer to one in ten vehicles sold.

This advance happened despite the EU's countervailing duty regime. In October 2024, the European Commission confirmed definitive tariffs on Chinese-manufactured battery electric vehicles, ranging from 7.8% to 35.3% depending on the manufacturer, applied on top of the existing 10% standard import duty. SAIC faces the ceiling rate of 35.3%; BYD, 17%; Geely, 18.8%.

Yet a VoxEU analysis published by the Centre for Economic Policy Research in January 2026, approximately fifteen months after the duties took effect, concluded that they appeared to have had "little, if any, effect on prices, import volumes, or competitive dynamics." Chinese EV market share in Europe recovered to pre-tariff levels by mid-2025. The reason is partly strategic: Chinese manufacturers accelerated into plug-in hybrid vehicles, where EU tariffs do not yet apply, with Chinese PHEV volumes surging over 500% year-on-year in Europe by April 2025. The EU's response, published in January 2026, has been to move toward a minimum price mechanism to replace the tariff regime, under which Chinese OEMs would be exempt from duties if they commit to price floors per model. Whether this represents more sophisticated trade policy or an acknowledgment that tariffs alone have not resolved the structural competitive gap depends on how the mechanism is ultimately enforced. What it is not is a resolution of the underlying economics. The tariff regime has slowed the Chinese advance without reversing it.

THE EUROPEAN COMPONENTS INDUSTRY HAS PASSED A THRESHOLD

Employment data tells a story that production figures do not. The German automotive sector shed over 51,500 jobs in a single year, equivalent to 6.7% of its total workforce, according to data published by Deutsche Welle in August 2025. The VDA trade association puts total German automotive job losses at roughly 55,000 since 2023. Volkswagen, Bosch, ZF, Schaeffler, and Continental have all described these not as cyclical corrections but as structural adjustments to overcapacity and a cost base that no longer fits the competitive reality of electrification.

Across the European components sector more broadly, closures and bankruptcies accounted for nearly half of all announced job cuts in the first half of 2025, close to double their historical share, according to CLEPA, the European automotive suppliers association. When the primary form of job loss transitions from restructuring to closure, it signals that the market is contracting rather than reorganising.

HUNGARY IS INSIDE THIS STORY IN TWO DIRECTIONS

Hungary is deeply embedded in German and Western European production chains. More than 40 of the world's 100 largest automotive suppliers operate there, producing predominantly for export, with Germany as the primary destination. When ZF announced thousands of job cuts across its German operations, the reverberations reached Hungarian facilities. When Bosch targets €2.5 billion in cost savings, its Central European operations are not insulated from the logic of that exercise.

But Hungary is also attracting investment from the very Chinese manufacturers whose European expansion is redefining the competitive pressure on European OEMs.

Mayor László Botka of Szeged announced the start of trial production at BYD's Hungarian facility in late

January 2026, with serial production targeted for the second quarter of the year. The plant, producing BYD's Dolphin Surf as its first model, is planned to reach an annual capacity of 200,000 vehicles over several years as employment expands in phases, per confirmed statements from both Mayor Botka and BYD Executive Vice President Stella Li. Reuters reported in mid-2025, citing sources familiar with the matter, that initial 2026 volumes would be "a few tens of thousands" of vehicles, with meaningful ramp-up not expected until 2027. The strategic logic is clear even if the immediate volumes are modest: producing within the EU removes the import tariff burden entirely as volumes scale.

The country that hosts BMW's most advanced EV production facility also hosts China's most ambitious European manufacturing foothold. Hungary is not simply Germany's industrial overflow zone. It is the place where the automotive industry's two competing futures are literally being built in parallel.

For years, low corporate tax rates have been a centrepiece of CEE investment propositions

9%

Hungary's corporate tax rate is the lowest rate in the EU.



The central paradox: when cost advantage meets minimum tax

For years, low corporate tax rates have been a centrepiece of CEE investment propositions — Hungary's 9% rate, the lowest in the EU, the most prominent example.

Under the OECD Pillar Two framework, every multinational group with consolidated revenues exceeding €750 million now faces a minimum 15% effective tax rate in every jurisdiction, making that rate a mechanical trigger for a top-up obligation. Hungary has responded by implementing the Qualified Domestic Minimum Top-up Tax, capturing the top-up revenue domestically rather than allowing it to flow to parent jurisdictions. The headline rate advantage has structurally narrowed for in-scope groups.

This is where most commentary stops. It should not.

Pillar Two was designed to prevent profit shifting: the allocation of income to low-tax jurisdictions that lack genuine economic activity. Hungary's automotive sector is the opposite of that profile. It has plant, equipment, payroll, engineering capability, and in Debrecen, a production facility setting the global standard for automotive manufacturing. It has substance in the most literal sense.

The mechanism designed to protect that substance is the Substance-Based Income Exclusion. Pillar Two's SBIE carve-out excludes from top-up calculations a percentage of the carrying value of tangible fixed assets and eligible payroll costs. The transitional rates for 2026 stand at 7.4% on tangible assets and 9.4% on payroll, both declining from their 2023 opening rates of 8% and 10% at 0.2 percentage points per year through 2028. From 2029, the pace of decline steepens materially: the payroll carve-out falls at 0.8 percentage points annually and the tangible asset carve-out at 0.4 percentage points annually, before both reach a permanent floor of 5% from 2033, per OECD GloBE Model Rules Article 9.2. For capital-intensive automotive manufacturers, the current exclusion is material. Whether it remains sufficient as the steeper phase of decline progresses from 2029 is the structural question the paper returns to below.

The SBIE in numbers: what protection looks like, and how it erodes

The argument that the SBIE makes Hungary's Pillar Two position manageable for manufacturing-intensive operations deserves to be illustrated. The scenarios below use 2026, 2029, and 2033 as three reference points: the current position, the steepening inflection, and the permanent floor.

Scenario A: Capital-Intensive OEM-Tier Manufacturer

	2026	2029	2033
SBIE rates (tangible / payroll)	7.4% / 9.4%	6.6% / 8.2%	5.0% / 5.0%
Tangible carve-out	€29.6m	€26.4m	€20.0m
Payroll carve-out	€7.5m	€6.6m	€4.0m
Total SBIE	€37.1m	€33.0m	€24.0m
Adjusted GloBE income	€17.9m	€22.0m	€31.0m
Post-SBIE ETR	48.9%	39.8%	28.2%
Top-up tax	Nil	Nil	Nil

One presentation note on the post-SBIE ETR figures: the SBIE does not reduce the taxes paid it reduces the GloBE income denominator against which those taxes are measured. An ETR of 48.9% does not mean the entity bears that tax burden; it means that the covered taxes of €8.75 million, when divided by the SBIE-reduced GloBE income of €17.9 million, produce a ratio well above the 15% minimum. The SBIE is a threshold mechanism, not a tax relief. For a capital-heavy manufacturer at this scale, protection holds through the full transitional period. The 2029 steepening reduces the absolute carve-out by approximately €4 million but does not threaten the ETR position.

Scenario B: Lighter-Asset Tier 2 Supplier

	2026	2029	2033
SBIE rates (tangible / payroll)	7.4% / 9.4%	6.6% / 8.2%	5.0% / 5.0%
Tangible carve-out	€4.4m	€4.0m	€3.0m
Payroll carve-out	€2.4m	€2.1m	€1.3m
Total SBIE	€6.8m	€6.1m	€4.3m
Adjusted GloBE income	€23.2m	€23.9m	€25.7m
Post-SBIE ETR	19.4%	18.8%	17.5%
Top-up tax	Nil	Nil	Nil

Protection holds here too, but the margin above 15% at the 2033 permanent floor is 2.5 percentage points. For an entity already at the threshold in its base position, a deterioration in profitability, a fall in the carrying value of tangible assets through accumulated depreciation without capital replacement, or a reduction in eligible payroll through restructuring would put the entity into top-up territory. These are not remote scenarios for components suppliers navigating cost pressure and demand uncertainty simultaneously.

The pattern across both scenarios points to a consistent structural truth about Hungary's automotive base. For genuinely capital-intensive operations, the SBIE provides durable protection across all three horizons. For lighter-asset operations, the 2029 steepening is the more meaningful risk inflection, not the final step in 2033. Groups with smaller asset bases should be modelling the 2029 position now.

The SBIE does not protect itself. It requires tangible assets to maintain their carrying value and eligible payroll to remain substantive. An entity that underinvests in its fixed asset base, or whose carrying value falls through depreciation without capital replacement, will find the carve-out shrinking not only through the scheduled rate decline but through a diminishing denominator as well.

Where tax design meets economic reality

HUNGARY'S SECOND PILLAR TWO ADVANTAGE

The 9% headline rate creates an obvious Pillar Two liability in any first-pass analysis. What is less visible, and materially underweighted in most modelling, is the breadth of taxes that count as covered taxes for effective rate purposes.

Hungary's Pillar Two implementation includes not just corporate income tax but the local business tax and the innovation contribution in its covered taxes definition. The local business tax is levied on a broad base that, for manufacturing entities, frequently exceeds the corporate income tax base. In Scenario A above, the covered taxes stack lifts the base ETR to 15.9% before the SBIE is even applied. For many automotive manufacturers in Hungary, when covered taxes are properly aggregated, the jurisdictional effective rate already approaches or exceeds the 15% minimum, reducing or eliminating top-up liability before any SBIE benefit is counted.

This outcome depends entirely on accurate profit allocation. Transfer pricing methodology determines how much GloBE income is allocated to Hungary. If the entity is characterised as more routine than its actual functions warrant, GloBE income is suppressed, the ETR denominator shrinks, and the covered taxes stack that appeared adequate suddenly is not. The regulatory and competitive threads run together.

THE COST OF SUBSTANCE IS RISING

There is one dimension of Hungary's competitive position that receives less attention in investment analysis than it deserves, and that is directly relevant to the substance argument at the centre of this paper. The labour cost advantage that underpins the payroll component of the SBIE is itself under pressure from within.

Hungary's labour market has tightened significantly. The working-age population has fallen by 142,000 since mid-2022, equivalent to the population of Hungary's fifth-largest city, according to ING Think analysis published in January 2026. Nominal wage growth reached approximately 9.0% in 2025, and ING

forecasts average wage growth of just over 10% for 2026 as a whole, driven by minimum wage increases of between 7% and 11% depending on skill category. Net real earnings grew 6.2% year-on-year in 2025, the fastest pace on record. The EU Commission's November 2025 economic forecast described the labour market as expected to remain tight, with nominal wage growth elevated through at least 2026.

For automotive manufacturers, this matters in two ways. The operational cost base is rising in real terms, compressing the labour cost differential relative to Western Europe that has historically been a core part of Hungary's investment case. And the payroll component of the SBIE grows in absolute value as wages rise, but so does the total cost burden that the exclusion only partially offsets.

The labour market tightening does not undermine Hungary's competitiveness in isolation. For facilities like Debrecen, where the argument for Hungary is anchored in manufacturing capability and technology rather than wage arbitrage alone, it is a manageable pressure. For commodity manufacturing operations where the cost differential with Western Europe is the primary justification for location, the trajectory is less comfortable. Hungary is becoming a more expensive place to employ people. Whether that reflects rising productivity and industrial sophistication, or a tight labour market hitting a structural ceiling in working-age population, will determine whether the trend is sustainable or constraining.

DECREE 45/2025: THE COMPLIANCE EVENT THAT REVEALS A STRUCTURAL TENSION

On 23 December 2025, Hungary published Decree 45/2025 (XII.23.) NGM, replacing its existing transfer pricing documentation framework with requirements that are more rigorous, more locally specific, and more precisely aligned with how NAV has been conducting audits for years. Much of the decree codifies practices NAV was already applying, converting long-standing administrative expectations into legal requirements. For groups

already aligned with OECD Transfer Pricing Guidelines and taking Hungarian audit practice seriously, it tightens the screws. For groups whose documentation has drifted from operational reality, the exposure is acute.

Several provisions matter beyond their compliance dimension. The statutory local benchmarking requirement means centrally prepared pan-European or global benchmark studies will only be accepted if they demonstrably comply with Hungarian comparability criteria. Mandatory DEMPE analysis for intangible transactions requires detailed documentation of where value in automotive development, engineering, and process design

is actually being created. The benefit test for intra-group services disallows management fees entirely, rather than merely adjusting them, when substantive evidence of genuine benefit cannot be produced.

Together, these requirements surface a structural tension that has been building in Hungary's automotive sector for years. The standard model for foreign-parented manufacturers, a limited-risk contract manufacturer on a cost-plus basis with

centrally prepared benchmarking, was designed for a simpler operating reality.

Many Hungarian automotive entities have evolved far beyond that characterisation. They now perform procurement, quality engineering, process development, and supplier management functions that were not contemplated in their original intercompany frameworks. Their documentation describes a company that existed twenty years ago. Their operations are something considerably more substantial.

That mismatch has consequences in two directions simultaneously. It creates audit exposure under Decree 45/2025 as NAV challenges characterisations that do not match operational reality. And it undermines the Pillar Two protections the entity should be entitled to, because an entity characterised as routine cannot credibly claim a substantial SBIE on the basis of assets and payroll that, according to its own documentation, do not drive value creation. The regulatory tightening is a forcing function toward documentation that accurately reflects what Hungary's automotive sector actually does.



Western Europe contracts, CEE absorbs but not uniformly

The migration of functions from Germany to Central Europe has accelerated sharply. As German automotive employment contracts, functions previously anchored to high-cost Western European operations, including engineering, quality management, procurement coordination, and supplier development, are being absorbed by Central European operations with the skills and infrastructure to handle them. Analysis of German automotive sector cuts consistently shows that firms are reducing headcount disproportionately in Germany itself, where management, administrative, and R&D positions are concentrated, rather than at overseas production sites.

Hungary sits within this dynamic in a differentiated way. ZF's Hungarian operations face the same rationalisation logic as its German plants. BMW's Debrecen facility represents the opposite: Hungary as the location for the group's most advanced, most strategically important manufacturing investment, not as a fallback but as a deliberate platform for the Neue Klasse architecture. And BYD's Szeged plant, as it ramps toward meaningful volume in 2027, adds a third dimension: Chinese-owned, EU-based production serving European demand from within the tariff boundary.

The divergence between contraction among legacy Tier 1 suppliers and strategic expansion by leading OEMs, and by the Chinese challengers to European market share, is the defining feature of Hungary's automotive landscape in 2026.



The European automotive sector is splitting between legacy supplier contraction and strategic expansion by global OEMs.

Which side wins

Hungary's automotive sector in 2026 is not simply strong fundamentals meeting external headwinds. It is two genuinely competing forces whose resolution is not yet determined.

The case that the industrial model holds is supported by the quality and strategic intent of recent investment. BMW, BYD, Audi, and Mercedes-Benz are not withdrawing from Hungary. They are expanding their presence with facilities that represent their most forward-looking production capabilities. The Pillar Two mechanics, for genuinely capital-intensive operations with properly documented substance, are manageable at current SBIE rates, with the covered taxes stack providing a first line of protection before the SBIE is even required. GDP growth, while modest at the 1.7% to 2.0% range forecast by the EBRD and ING for 2026, is on a recovering trajectory.

The case that structural pressure prevails is equally serious. The European components sector is contracting in a form, closures rather than restructuring, that is qualitatively different from previous downturns. Hungary's motor vehicle manufacturing sector contracted at roughly 3% annually over five years. Automotive output fell 3.9% year-on-year in late 2024. The EU tariff regime on Chinese EVs, while nominally in place, has demonstrably not reversed the competitive dynamics it was designed to address. The SBIE declines in value every year, with the pace of reduction steepening from 2029, and Hungary's labour cost advantage is under sustained upward pressure, with nominal wage growth forecast above 10% for 2026 alone.

The outcome will differ by segment. For the OEM and advanced manufacturing tier, Hungary's fundamentals are durable and the regulatory environment is navigable for well-documented operations. For the commodity components tier, the structural headwinds are not a problem that cost competitiveness alone can resolve. It is not one story. It is two, running simultaneously, in the same country.

WHAT THE REGULATORY SHIFT ACTUALLY SIGNALS

The convergence of Decree 45/2025 and Pillar Two reflects something deliberate about how Hungary is positioning itself within the European industrial and tax landscape. By implementing the QDMTT, Hungary is choosing to collect its own minimum tax revenue rather than allow it to flow to parent jurisdictions. The breadth of its covered taxes definition is a design choice that reduces effective top-up liability for manufacturing-intensive entities while keeping the revenue in Hungary. The local benchmarking requirements of Decree 45/2025 assert that profit allocation decisions for companies operating in Hungary will be evaluated against Hungarian standards, not the convenience of globally centralised documentation.

The message to multinational groups is consistent across both developments: Hungary will compete for investment on genuine merits, and it intends to ensure that profits generated by activity in Hungary are taxed there. That is a more demanding environment than existed a decade ago. It is also, for operations with genuine substance, a more coherent and defensible one.

2 Forces
Strong industrial
investment vs
rising structural
pressure.

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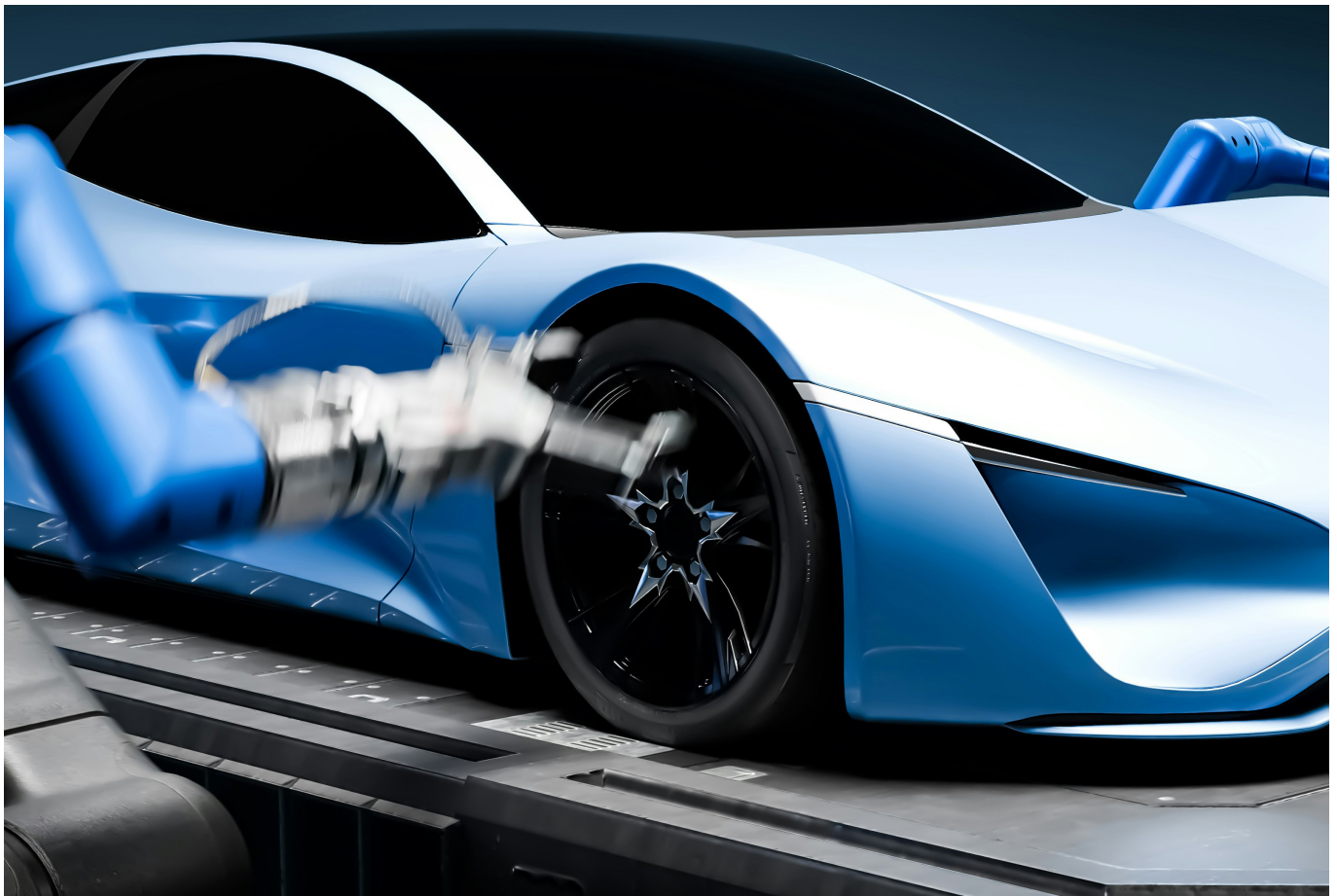
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TRANSFER PRICING STRATEGY DOCUMENTATION

Post-separation framework rebuilds, DEMPE analysis, local file preparation aligned with Decree 45/2025, NAV audit.

PILLAR TWO MODELLING

SBIE optimisation, covered taxes stacking, QDMTT assessment, multi-year exposure modelling through the 2029 and 2033 inflection points.

ENTITY FUNCTION ASSESSMENT

Functional characterisation reviews where operational reality has evolved beyond original intercompany frameworks.

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