Investment in Hungary

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Investment in Hungary

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Preface

Investment in Hungary is one of a series of booklets published by KPMG member firms to provide information to those considering investing or doing business in various countries. This publication has been prepared by KPMG in Hungary to assist those contemplating investment or commencing operations in Hungary. KPMG in Hungary provides audit, tax and advisory services for Hungarian and multinational companies, government entities and inward investors.

The information in this booklet is of a general nature and should be used only as a guide for preliminary planning purposes. *Because of the continually changing legislative environment in Hungary, the complexity of Hungarian corporate, tax and social laws and regulations and the steadily evolving nature of the Hungarian economy, comprehensive professional advice and assistance should always be obtained before implementing any plan to invest in or immigrate to Hungary.* KPMG and its several hundred professionals in Hungary can render such assistance and would be pleased to provide more detailed information on matters discussed in this publication.

Every care has been taken to ensure that the information presented in this 12th edition is correct and accurate as of 1 January 2010.

Revised 12th edition
Budapest, January 2010

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Chapter 1

General Information

Geography and Climate

Hungary is located in the Carpathian Basin of Central Europe, within easy reach of Western Europe. It covers 93,000 square kilometers (36,000 square miles). About two-thirds of its territory is flat and lies less than 200 meters above sea level. The highest peak, Kékestető, rises to a height of 1,015 meters.

Hungary has two important rivers, which also serve as waterways – the Danube and the Tisza – and three major lakes – Balaton, Velence and Fertő. The greater part of the Fertő lake belongs to Austria. Lake Balaton, with a surface area of 598 square kilometers, and its surroundings are a popular destination for both Hungarian and foreign tourists.

In addition to rivers and lakes, the country is rich in thermal and medicinal waters and springs. The continental climate, the high annual proportion of sunshine and the quality of the soil ensures favorable conditions for agriculture.

A truly Central European country, Hungary has borders with Austria, Croatia, Romania, Serbia, Slovakia, Slovenia, and Ukraine.

Hungary joined the Schengen Agreement on 21 December 2007, taking full responsibility for EU borders.

Population and Language

Hungary has a population of approximately 10 million. Population density is about 100 persons per square kilometer. The population is expected to decline as a result of the country's low birth rate and the high death rate.

The capital, Budapest, has approximately 2 million inhabitants. The population of the other 10 major cities ranges from 100,000 to 200,000 people.

The official language is Hungarian, but English and German are also used frequently in business.

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Infrastructure

The transportation infrastructure is still undergoing major reconstruction. The highway network is currently being developed through use of EU funds while technical improvements are also being implemented in the railway system as well.

Hungary has an extensive road system, centered around Budapest, with highways extending in most directions. Public transport in Budapest is well developed and consists of a comprehensive network of trams, buses, an underground system and railways. Budapest Airport (BA) served a total of 8.1 million passengers in 2009.

The electronic communication sector is undergoing further rapid changes. While traditional voice market is shrinking, fixed and especially mobile broadband services markets are growing dynamically. Users are looking for more bandwidth and higher speed, which some technologies - including traditional ADSL in the long run – cannot cope with. Triple play cable is gaining market share and incumbent service providers are considering launching large scale optical network deployment projects. Preparations for the conversion from analogue to digital television are ongoing; digital broadcasting is being tested in most areas. The conversion will make new frequency ranges available for telecommunication purposes which is likely to give a further boost to market development.

Labor Force

The Hungarian labor force is highly skilled and highly educated, particularly in engineering, IT, pharmacy, economics, mathematics, physics and professional services. Around two-thirds of the work force has completed some form of secondary, technical or vocational schooling. Foreign investment has brought know-how and technology into the country, thus increasing the productivity of the labor force considerably.

The unemployment rate is slightly lower than the European Union average. The unemployment rate is higher in the eastern and southern regions and lower in the central and western areas.

Wages still lag behind those of Western Europe. The minimum wage is currently HUF 73,500 per month, approximately EUR 250 per month.

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The Political System

The President is the head of state, elected by Parliament and serves a largely figurehead function. Parliament is the dominant source of power in Hungary and is comprised of elected representatives in a single chamber. The Prime Minister is elected by a simple majority of the members of Parliament.

Hungary has been politically stable since the transformation process began in 1989. The political arena is bipolar, dominated by the center-right FIDESZ and the center-left Hungarian Socialist Party (MSZP), with some further minor parties also active in the political arena.

The Socialist Party (MSZP) won the 2006 general elections to lead a coalition government for the following four years. The next general election will take place in April 2010 and is expected to be won by the center-right FIDESZ, which had already led a coalition government between 1998 and 2002.

International Memberships

Hungary has been a member of the United Nations and some of its associated institutions (ILO, UNESCO, FAO, WHO, etc.) since 1955.

Hungary became a member of the IMF, the World Bank and the IFC (International Finance Corporation) in 1982. Additionally, Hungary is a signatory to GATT (the General Agreement on Tariffs and Trade), is a member of the WTO (World Trade Organization) and of the OECD, as well as of the International Bank for Reconstruction and Development (IBRD), the World Intellectual Property Organization (WIPO) and the Central European Free Trade Association (CEFTA).

Hungary became a member of NATO in 1999 and a member of the European Union in 2004.

Hungary and the EU

As of May 2004, Hungary is a full member of the European Union. In 1994, Hungary was the first of the Central and Eastern European countries to apply for EU membership. The negotiation process was launched in 1998, and since then, Hungary has met the economic requirements of the accession and brought its legal system in line with the acquis of the EU.

With the EU's financial assistance, Hungary aspires to close the gap between its level of development as a new member country and the EU average. The Hungarian government has been working hard to establish the physical and legal infrastructure, which enables the country to most effectively channel EU sources, as well as to complement these sources with domestic funds. As a result of these efforts, Hungary has been one of the few who successfully launched new programs for the 2007-2013 period, with EU subsidy of EUR 22.4 billion available to Hungary until 2013.

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The Economy

Hungary has seen successful transformation from a centrally planned economy to a fast-growing and robust market economy. Due to its open policy toward foreign investment and central geographical location, the country is a preferred location for foreign direct investment since then, with over USD 60 billion having been invested in the past 21 years.

The table below presents key indicators of the Hungarian economy from 2008 to 2010

	2008	2009 actual	2010 forecast
1. Volume of GDP (previous year=100)	100.6	93.5	100
2. Industrial production (constant prices, previous year=100)	98.9	84	103.5
3. Investment in the national economy (constant prices, previous year=100)	97.0	94	105
4. Construction (constant prices, previous year=100)	94.9	96.5	106
5. Retail trade (volume index, previous year=100)	98.2	95	100
6. Exports (current prices in euro, previous year=100)	105.6	87.0	104
7. Imports (current prices in euro, previous year=100)	105.6	80	106.5
8. Trade balance (EUR billion)	-0.2	4.8	3.3
9. Balance of the current and capital account (EUR billion)	-6.5	0.5	0
10. Average exchange rate of euro (forints)	251.2	280	265
11. Deficit of the general government (cash flow basis, without local governments; billion forints)	909	1000	870
12. Index of average gross earnings	107.5	101.0	101
13. Consumer price index (previous year=100)	106.1	104.2	103.5
14. Consumer price index at the end of the period (corresponding month of the previous year=100)	103.5	105.5	103
15. Rate of unemployment (at the end of the period, %)	8.0	11	10.5

Q1-Q3 2009
** First half of 2009
*** January-November 2009
**** August-October 2009
Sources of actual data: HCSO, NBH, MoF
Forecast of GKI Economic Research Co. on Developments in the Hungarian Economy in 2009-2010

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The privatization process has been completed in most sectors, bringing foreign strategic investors as well as know-how, technology and best international practice into the country. As a result, the private sector accounts for over 80% of the GDP today.

Between 1997-2006, Hungary made significant progress in achieving sustained economic growth – the growth rate was around 4% in each year in that period.. Inflation has declined continuously – from about 30% in the mid-90s.

In 2007, the economy lost momentum, and Hungary achieved GDP growth of only 1.1%, and 0.6% in 2008.

Being an export-driven, open economy, Hungary has been impacted severely by the global recession and the decreasing demand from its main export markets, especially in sectors such as the automobile and consumer electronics industries. Thus, in 2009, GDP has shrunk by 6.5 %, primarily due to slowing domestic consumption and a decline in investments.

However, analysts agree that beyond 2009, with bank financing returning and the M&A market recovering, the situation will start improving and the country will continue to be a favorite regional center for multinational firms, and an attractive location for shared service centers.

The country's traditional growth factors, including low cost of living, advanced infrastructure, an advantageous geographical position and a cost-efficient and well-trained workforce are likely to continue to attract more leading companies to Hungary.

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Chapter 2

Foreign Investment in Hungary

The Hungarian Act on Foreign Investment specifies that investments by non-residents enjoy full legal protection and security. Bilateral treaties in force guarantee additional protection for foreign investors.

Foundation of New Companies or Acquisition of Shares in Existing Companies by Foreign Investors

Foreign individuals and legal entities may found new companies or acquire shares in existing companies in Hungary. Companies that are wholly or partly foreign owned can, in practice, operate in all business areas. Where the chosen activity requires a permit (e.g., for banking activity) the same rules apply regardless of whether the owners of the entity are residents in Hungary or abroad.

Returns payable to Foreign Investors

There are no legal restrictions on the payment of returns on investments (e.g. dividends, interest, repayment of loans) to foreign shareholders. This provides important protection to foreign investors. However, dividends are subject to withholding taxes. The tax system and current tax rates are discussed in the taxation chapter.

Branches and Representative Offices

A foreign company may establish a registered company branch or a representative office in Hungary. Branch offices and representative offices are not separate legal entities but an organizational unit of a foreign company.

Representative offices are relatively easy to administer, and their activities may be stopped immediately without consequence or the requirement of deregistration.

Branches

Non-residents can conduct business in Hungary through branches registered with the Hungarian Court of Registration.

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After registration, branches can carry out most business activities in Hungary without limitation. In principle, the same business licenses must be obtained as are required for Hungarian legal entities.

The assets required for the operation of the branch must be provided by the founder of the branch office. The founder and the branch office have unlimited and joint liability for debts (liabilities) accrued in the course of operation of the Hungarian branch. The branch must keep its books in accordance with Hungarian accounting laws, and prepare annual financial statements. Branches of non-resident entities with a registered office in one of the member states of the European Union are exempt from auditing obligation. The same applies to non-resident entities having their registered office in the territory of the Grand Duchy of Liechtenstein and the Norwegian Kingdom.

The acquisition of real estate by a branch is subject to the provisions of the Act on Acquisition of Real Estate by Non-Residents, similarly to any other non-resident company. In all other respects, the same rules apply to branches as to resident legal entities (e.g. they are subject to Hungarian VAT, corporate income tax, local taxes, etc.), with the restriction that non-resident entities may not acquire ownership over arable lands.

Representative Offices

Certain activities of a non-resident entity may also be conducted through a representative office, which can be used to provide information concerning the non-resident's products and services and, to a limited extent, to assist the non-resident entity in the conclusion of contracts. The representative office is an unincorporated operational unit of the non-resident company. Tax consequences should be carefully considered.

Representative offices must be registered with the Hungarian Court of Registration. A representative office of a non-resident company is permitted to assist in the preparation of contracts and to supply advertising services on behalf of the entity it represents. They are not allowed to engage in any other kind of commercial activity. In particular, representative offices of foreign law firms may not provide legal services or legal consulting services.

Although accounting for Hungarian representative offices is not governed by Hungarian accounting legislation, most of the rules (e.g. double-entry bookkeeping, valuation rules, etc.) should be followed by these entities if they are subject to Hungarian corporate income taxes. For example, acting as an agent for a non-resident may subject a representative office to Hungarian corporate income taxes.

In other respects, the same rules apply to representative offices as do to other domestic business entities. For example, the employment of foreign or Hungarian employees results in the same administrative, personal tax and social security obligations as for Hungarian corporations or branches. The acquisition of real estate by a representative office is subject to the same rules as those applicable to the acquisition of real estate by branches.

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Chapter 3

Company Law

The primary legislation governing the form and regulation of companies is Act IV of 2006 on Business Associations (hereinafter the 'Companies' Act'), which came into effect on the 1 July 2006. This Act is the successor to Act VI of 1988 and Act CXLIV of 1997.

Most of the types of companies and the associated regulations in Hungary are similar to those used in other European Union countries.

As a result of the accession of Hungary to the European Union as of 1 May 2004, new forms of business associations have also been integrated into Hungarian company law. Such forms are the European Economic Interest Grouping and the Societas Europea.

Based on Act XLIX of 2003 on European Economic Interest Groupings ('EEIG'; in Hungarian: 'Európai Gazdasági Egyesülés' or 'EGE'; the 'EGE Act'), an EEIG having its seat in the Hungarian Republic is a legal entity, which shall be formed, organized and operated in accordance with the Council Regulation (EEC) No 2137/85 on EEIG, unless otherwise regulated by the EGE Act, when the provisions of the Companies' Act (e.g. to establishment, organization, conflict of interest of executive officers and exclusion of members) and the Act on registration and voluntary liquidation of companies (e.g. to registration) shall apply. The EGE differs from a firm or company principally in its purpose, which is only to facilitate or develop the economic activities of its members to enable them to improve their own results; it does not aim to make profits for itself. Its activity shall be related to the economic activities of its members and must not be more than ancillary to those activities. Its members are jointly and severally liable for any debts in excess of the EGE's assets.

Consequently, an EGE may not: (a) exercise, directly or indirectly, a power of management or supervision over its members' own activities or over the activities of another undertaking, in particular in the fields of personnel, finance and investment; (b) directly or indirectly, on any basis whatsoever, hold shares of any kind in a member undertaking; the holding of shares in another undertaking shall be possible only so far as it is necessary for the achievement of the EGE's objects and if it is done on its members' behalf; (c) employ more than 500 persons; (d) be used by a company to give a loan to a director of a company, or any person connected with such director, when such loans are restricted or controlled under Hungarian laws governing companies. Nor must the grouping be used for the transfer of any property between a company and a director, or any person connected with such director, except to the extent allowed by Hungarian laws governing companies.

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For the purposes of this provision, providing a loan includes entering into any transaction or arrangement of a similar effect, and property includes moveable and immoveable property; (e) be a member of another European Economic Interest Grouping.

Only the following may be members of an EGE: (a) companies or firms and other legal bodies governed by public or private law that have been formed in accordance with the laws of a Member State and that have their registered or statutory offices and places of central administration in the territory of the Community. Where, under the laws of a Member State, a company, firm or other legal body is not obliged to have a registered or statutory office, it shall be sufficient for such a company, firm or other legal body to have its central administration in the Community; (b) natural persons who carry out any industrial, commercial, craft or agricultural activity or who provide professional or other services within the Community.

An EGE must comprise at least: (a) two companies, firms or other legal bodies that have their places of central administration in different Member States, or (b) two natural persons, who carry on their principal activities in different Member States, or (c) a company, firm or other legal body and a natural person, of which the first has its place of central administration in one Member State and the second pursues its principal activity in another Member State.

The other new type of business association which may be established as of October 2004 in Hungary is the European public limited-liability company or Societas Europea ('SE'; in Hungarian: 'Európai Részvénytársaság'). Based on Act XLV of 2004 (the SE Act), the SE having its seat in the Hungarian Republic is a legal entity and shall be formed, organized and operated in accordance with the Council Regulation (EEC) No 2157/2001 on SE, unless otherwise regulated by the SE Act.

The capital of an SE is divided into shares, shall be expressed in euro, and must not be less than EUR 120,000. Employee involvement in an SE shall be governed by the provisions of Directive No. 2001/86/EC and Chapter II of the SE Act.

Act V of 2006 on company registration and voluntary liquidation is applicable for the registration and dissolution of business associations, branch offices, representative offices, EGE and SE.

Four types of business associations may be established under the Hungarian Companies Act:

- Unlimited Partnership (Közkereseti Társaság – Kkt.)
- Limited Partnership (Betéti Társaság – Bt.)
- Limited Liability Company (Korlátolt Felelősségű Társaság – Kft.)
- Company Limited by Shares (Részvénytársaság - Rt.); a Company Limited by Shares can operate as a 'Closed Company Limited by Shares' (Zártkörűen működő részvénytársaság, in short 'Zrt.') if its shares are not put into public circulation (i.e., through a stock exchange) or as a Public Company Limited by Shares (Nyilvánosan működő részvénytársaság, in short 'Nyrt.') if its shares are put into public circulation.

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The Kkt. and Bt. have elements which resemble partnerships in some ways but not to such an extent that they would be treated as such in all EU countries. The most important factor that separates the Kkt. and Bt. from the Kft. and Rt. is that the members of Kkt. and Bt. have unlimited liabilities for the obligations of the company while the members (shareholders) of Kft. and Rt. bear only limited liability. Another important difference is that the operation of Kkt. and Bt. is less formalised compared with Kft. and Rt. in respect of the decision making process, the increase or decrease of the registered capital, etc.

In practice, most foreign investors are likely to form or take a financial interest in either a limited liability company (Kft.) or a company limited by shares (Rt.). These legal entity forms correspond to the company forms most commonly used by businesses in the European Union.

Foreign parties may found or become shareholders in a Kft. or Rt. if they are either a company under their domestic law or if they are individuals.

Specific rules applicable to Kft. and Rt. are discussed below following a summary of the rules applicable to all types of business associations, including the Kkt. and Bt.

Rules applicable to all Types of Business Associations

Articles of Association

An initial step in founding a business venture is the preparation of a written Articles of Association (or 'Deed of Foundation/Statutes'), which must be signed by all members (or their authorized representatives bearing a power of attorney). The preparation of the Articles may be based on a model laid down in the Annex of Act V of 2006 (Act on the procedures of the Court of Registration). An attorney or notary public must countersign this document.

The Articles must contain:

- the name, the company form and the registered office of the company;
- the name, the company form, registered office (address) and company registration number of the founders;
- the main activity of the company (listing other activities in the Articles is optional but all actually carried out activities shall be registered at the competent tax authority within 15 days from the foundation of the company);
- the registered capital of the company, and the method (cash or in-kind) and date of contribution by the founder;
- authorities for signing on behalf of the company;
- name and address of executive officers;
- name and address of the auditor and supervisory board members, if auditor or supervisory board members were elected by the members;
- term of the company, if it was established for a definite period;
- other matters required by the Companies Act for the different forms of business associations.

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All members shall provide their contribution as assumed and until the date determined in the Articles of Association. In case a member fails to provide its contribution either within the period defined by the Articles or within another 30 days' deadline thereafter set by the management, the membership terminates the day after such deadline. A member providing in-kind contribution remains liable to the company for five years, for that the contribution did not worth less than the value stated in the Articles of Association.

Single-member Companies

Kft. and Zrt. may be established and operated by a single member (shareholder); however at least two persons are required for Kkt., Bt. and Nyrt. A company which is owned by one member is allowed to become sole member of another company (either can set up a single-member company or acquire all shares or quotas of a company).
In case of the establishment of a single-member Kft., the in kind contribution of a company founded by a single member must be paid up in full prior to submission of the application for registration. As for the contribution in cash, it is sufficient to pay in only HUF 100,000 if the Articles so provide. When a single-member Zrt. is established, the in kind contribution shall be paid up in full and 25% of the cash contribution shall be paid prior to the submission of the application for registration.

It is the single-member's (shareholder) right and duty to make decisions on all issues falling within the authority of the general meeting (Member's Meeting) and shall notify the executive officers thereof in writing.

Pre-company Status

A new business association may begin to operate (e.g., enter into contracts, etc.) from the date of the countersignature of the Articles of Association, and may begin to pursue its regular business activities from the date of filing the registration request with the Court of Registration. However, the business association will not be able to pursue any activities requiring a license until the Court of Registration has registered it, since licenses are only granted to registered companies. Until it is registered, the business association has a special interim legal status as a 'pre-company'. This status has to be indicated on all company documents.

The rules applicable for the business association to be registered apply to its pre-company, with the following exceptions:

- generally, no changes shall take place in the members of the pre-company;
- the articles of association shall not be altered, except to make corrections ordered by the court of registration;
- legal proceedings for the exclusion of a member shall not be initiated;
- no resolution may be made on termination of the entity without a legal successor, or transformation into any other business association or into a non-profit company;
- the pre-company shall not engage in any activity that is subject to prior official authorization (license);
- the pre-company shall not establish a business association, nor shall it join one as a member.

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If the application for registration of a new business association is refused, the business association may not acquire further rights or assume new obligations, and must terminate its operations. The members (shareholders) are liable for debts arising from the undertakings of the executive officers up to the proposed registered share capital. The executive officers are personally and unlimitedly liable for debts exceeding the proposed registered share capital.

Registration

The foundation of a business association has been made easier and faster through the use of samples and the submission of electronic applications. As of 1 July 2008, the electronic submission of registration applications is compulsory. The simplified company registration using models can be implemented within one working hour by using the sample contracts and forms.

Establishment of a company must be reported to the competent Court of Registration within 30 days of the countersignature of the Articles of Association. The Court must also be notified of any change in the registered data within 30 days of each change. If the court does not respond within a specific period of time, the registration is deemed to have occurred at the end of that period.

Business associations are deemed to be established as of the date of their entry into the register of companies. The pre-company status ends as of the date of registration.

The Management of a Company – Executive Officers

The duty of the executive officers is to manage the operation of the business associations, which means passing resolutions in all matters that do not fall into the exclusive competence of the Members' Meeting (General Meeting in case of Rt.) or the single member (shareholder) according to the Companies Act and the Articles of Association.

Individual persons can be appointed as executive officers (Managing Director, member of the Board of Directors, etc.) for a definite or indefinite period of time. If the appointment is for a definite period of time the term of the appointment cannot exceed five years. Executive officers may be re-elected, removed or recalled at any time without reasoning. The decision to appoint or recall executive officers and establish their remuneration falls within the exclusive powers of the members (shareholders); however the members may decide to transfer these rights to the supervisory board of the company, if elected.

Executive officers shall conduct the management of a business association with due care and diligence as generally expected from persons in such positions and give priority to the interests of the business association. However in the event of any imminent threat for the business association's insolvency, the executive officers shall conduct the management of the business association giving priority to the interest of the company's creditors.

Executive officers shall be liable to the business association in accordance with the general rules of civil law for damages caused by any infringement of the law or any breach of the Articles of Association, the resolutions of the members (shareholders) or their management obligations.

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Supervisory Board

For the purpose of supervision of the business association's management, the members (shareholders) may or, in certain cases, must appoint a supervisory board comprised of non-executive directors in their Articles of Association.

The Articles of Association of a Zrt. or a Kft. may assign authority to the supervisory board to appoint or remove the executive officers, establish their remuneration and approve particular transactions (e.g. contracts).

The Companies Act reworded the previous provisions regarding the compulsory supervisory board election:

- All Public Companies Limited by Shares are obliged to set up supervisory boards unless they are controlled by the one-tier system (by 'one-tier system' we mean that corporate structure when the directors perform the duties of the supervisory board).
- A Closed Company Limited by Shares is not obliged to set up a supervisory board, but a supervisory board must be set up if the shareholders, who represent at least 5% of the votes, require so.
- Establishment of a supervisory board shall be obligatory for companies whose annual average number of full-time employees exceeds 200 persons, with employee participation (one-third of the Supervisory Board members).
- Any company regardless of its form shall be obliged to set up a supervisory board if prescribed by law in the interest of the public property (e.g. at companies managing public property) or with attention to the company's activity.

Auditor

The auditor of a business association, appointed by the supreme body of the company, shall be responsible for carrying out the audit work in accordance with the Accounting Act and for determining as to whether the annual report of a business association provides a true and fair view of the business association's assets and liabilities, financial position and profit or loss and is prepared in full conformity with the effective legal regulations. These tasks assigned to the auditor are prescribed by law in order to protect the public interest, therefore an auditor of a company may only fulfill tasks of another nature if those do not risk proper fulfillment of auditing tasks.

In principal, the appointment of an auditor is optional even in case of Public Companies Limited by Shares as of 1 January 2008, save for when required by the Accounting Act or prescribed by law in the interest of protection of public property.

Appointment of an auditor is effective if, having been appointed by the supreme body of the company, the auditor accepts its appointment within 90 days and concludes an agreement with the management of the company on auditing services.

In order to be appointed as an auditor, the individual person or audit company must be registered in the list of registered accountants.

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A member (shareholder) of the company may not be appointed as auditor. Executive officers, supervisory board members, their close relatives and employees of the company may not be elected as the auditor of the company until after at least three years from the date of resigning from such position.

If appointed, the auditor must be named in the Articles of Association and may be appointed for a definite period not exceeding five years. The auditor may be re-appointed following the end of his term of office, unless such possibility is excluded by law.

The auditor is entitled to inspect all books and records of the company and to request information from all executive officers, supervisory board members and employees.

The auditor must safeguard the confidentiality of information obtained about the affairs of the company.

If appointed, the auditor must take part in meetings of the company's members/shareholders. If required, the auditor may be invited to attend meetings of the executive board or the supervisory board with a right of consultation, or the auditor himself may initiate his attendance at such meetings. In this latter case, the auditor's request may only be refused in exceptional cases.

If the auditor verifies or otherwise learns that a significant loss of the company's net equity is probable he must request that a members'/shareholders' meeting be convened.

If the company's members'/shareholders' meeting is not convened, or that meeting fails to take the decisions necessary to ensure that the situation will be rectified, the auditor must inform the Court of Registration.

Termination of Business Associations

The business association shall terminate:

- if the period of time set forth in the Articles of Association expires or any other condition of termination is realized;
- if it resolves its termination without a legal successor;
- if it resolves its termination with legal succession (transformation – merger, demerger);
- if the number of its members declines to one person, unless otherwise allowed by the provisions on the individual forms of business associations (Kft. and Rt. can operate with only one member);
- upon being declared terminated by the Court of Registration;
- on other conditions depending on the actual form of the company.

Business associations are deemed terminated upon cancellation from the company register.

If a company ceases to exist without a legal successor, a 'final account' must be prepared, except when a winding-up procedure has been initiated due to insolvency. In this case, a liquidation procedure is followed in accordance with Act XLIX of 1991 on Bankruptcy, Liquidation and Final Account.

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The closing balance is to be made by the liquidator(s), who can be appointed from the executive officers of the company, or can be any private individual. Members representing one-tenth of the votes or any creditor of the company may ask the court to appoint others as liquidators.

Transformation of Business Associations

Transformation can result from a change from one corporate form to another (e.g. a Kft. can re-register as an Rt., or vice versa), or from corporate reorganizations such as mergers and demergers. These can take a variety of different forms:

- Merger (consolidation, acquisition, merger)
- Demerger (division into two or more new companies, separation of part of the activities into a new company).

Compulsory Transformation

If a business association's equity shown in its annual report is less than the minimum capital required for its form of business association for two consecutive years, then the business association is required to reregister as a different form of business association unless the members/shareholders of the business association provide the necessary equity within a period of three months after the approval of the annual report for the second year.

The new form of business association chosen must be one for which the entity meets the minimum registered capital requirement or for which the Companies Act does not specify a minimum registered capital amount.

Liability of members of Business Associations

From 1 January 2004 Hungary has introduced a procedure whereby the 'corporate veil' (limited liability) can be lifted in certain circumstances. If the corporation cannot be found at its officially registered seat and its directors cannot be traced to their office addresses, the court can demand that the members/shareholders provide information on where the corporation can be found within 60 days. Failure to comply with this will result in the deregistration of the business association and may result in the loss of limited liability status. Loss of limited liability is only applicable for members (shareholders) having more than a 50% stake in a business association and in case the total unfulfilled debt after the deregistration exceeds half of the own equity of the business association.

This may be used as a mechanism to recover debts from customers that have failed to honor payment obligations and can no longer be traced.

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Limited Liability Company (Kft.)

The Limited Liability Company is a very popular form of company for small or medium-sized businesses in Europe. The Hungarian Kft. form is very close to the German and Austrian GmbH (Gesellschaft mit beschränkter Haftung) and similar to the British Ltd (private company limited by shares). It is possible to establish a single-owner Kft. The Kft. form is the most common company form for wholly-owned subsidiaries.

Formation of a Kft.

In addition to the items mentioned above as rules applicable for all types of business associations, a Kft.'s Articles of Association (or Deed of Foundation) must include the following:

- the stakes of each member
- calculation of voting rights.

Capital Structure

The capital of the company is comprised of the capital contributions of the individual members, which can be contributions in cash and in kind.

Contributions in kind constituting a part of the subscribed capital may be any marketable object or intellectual property with pecuniary value, any right representing pecuniary value or any claim that is acknowledged by the debtor or that has been established by a final and definitive court decision. Only those objects, intellectual properties or rights which can be subject to foreclosure and which can be transferred by the business association without the consent of a third party may be taken into account as contributions in kind. The amount of initial capital shall not be less than HUF 500,000. The Companies Act does not prescribe the ratio of cash-in kind contribution. The registered capital of a Kft. might comprise exclusively in cash or in kind contributions.

Each member has an identified percentage of the total capital ('quota') and a quota may be owned by more than one person. A quota cannot be less than HUF 100,000 and it has to be exactly divisible by 10,000.

The company may only be registered if, prior to the submission of the application for registration:

- contribution in kind has been made available to the company according to a Kft.'s Articles of Association; however if the value of the in kind contribution reaches or exceeds half of the registered capital the in kind contribution must be provided in full, and
- at least half of each contribution in cash has been deposited into the company's bank account.

The remaining part of the cash contribution must be made within one year of the registration and the remaining in kind contribution has to be provided within three years of registration. In case of a single-owner Kft., the value of the whole share must be made available at the foundation of the company unless the Articles of Association provides that for the contribution in cash, it is sufficient to pay in only HUF 100,000.

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Members' Meeting

The supreme body of a Kft. is the Members' Meeting. From 1 September 2007 the members of the Kft. may pass resolutions in writing with respect to any questions including the approving of the annual report; i.e. it is not necessary to hold a members' meeting. If the Articles of Association allows, the members' meeting can be held in such a way that the members participate by using electronic telecommunication equipment. It is the free choice of the members to decide that they will participate in the member's meeting personally or by using electronic telecommunication equipment. Electronic telecommunication equipment means a closed system which enables the holding of telephone- or videoconference and allows the identification of and the uninterrupted conversation between the members, dependent upon the constant state of the electronic system which provides the technical backbone.

The following fall, among others, within the exclusive authority of the members' meeting:

- approval of the annual financial statements of the company, including the decision on the appropriation of after-tax profits (dividend);
- decisions on the payment of additional capital contributions and the repayment of capital;
- decisions to pay interim dividends;
- consent for the division of business shares, and approval for the withdrawal of shares;
- resolutions initiating the exclusion of a member;
- decisions on the repurchase of shares by the company, and the sale of these to members;
- election and removal of the Managing Director, and the establishment of his or her remuneration, as well as the exercise of employer's rights if the managing director is an employee of the company;
- election and removal of supervisory board members, and the establishment of their remuneration;
- election and removal of the auditor and the establishment of their remuneration;
- approval to conclude contracts which take place between the company and one of its members, its Managing Director or their close relatives;
- enforcement of indemnification claims against members responsible for the foundation of the company, Managing Directors or supervisory board members;
- the decision on termination without legal successor or transformation of the company;
- decisions on increasing or decreasing the registered capital;
- amending the Articles of Association;
- all issues which are assigned to the members' meeting by law or by the Articles of Association.

A simple majority is required to approve members' resolutions at the meeting, unless the Companies Act or the Articles of Association provide otherwise.

The members' meeting has a quorum if at least half of the registered capital or the majority of the eligible votes are represented, unless the Articles of Association stipulate a higher rate of participation. Unless otherwise provided by the Articles of Association, if the members' meeting did not have a quorum, any reconvened members' meetings called as a result of this shall have a quorum for the issues of the original agenda regardless of the percentage of the capital or voting rights represented by those present.

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An extraordinary Members’ Meeting shall be convened by the Managing Director promptly to consider any necessary action if the annual or interim balance sheet of the company shows that due to losses the owner’s equity of the company has decreased to half of the registered capital or the company is threatened with insolvency or has suspended its payments and the assets of the Company do not cover its debts.

Managing Directors

The administration of the company's affairs and representation of the company is carried out by the Managing Director (or Directors).

From 1 September 2007 extracts issued by the Court of Registry in relation to the Kft. indicate if the quota is mortgaged.

Company Limited by Shares (Zrt. or Nyrt. – together Rt.)

A company limited by shares is the other popular corporate form for medium-sized or larger companies all over Europe. The Hungarian Rt. is very similar in form to the German and Austrian AG (Aktiengesellschaft) and similar to the British PLC (Public Limited Company).

An Rt. may be a private company or a public company. An Rt. is a private company (‘Zrt.’) if its shares are not issued publicly. An Rt. is a public company (‘Nyrt.’) if at least some of its shares are issued to the public.

The share capital of an Nyrt. must not be less than HUF 20 million. The share capital of a Zrt. must not be less than HUF 5 million. The Companies Act allows that the share capital of a Zrt. might comprise exclusively in kind contribution.

Shares and Shareholders' Rights

Shares are securities embodying membership rights and can only be registered shares (issuance of bearer shares are not allowed).

Different classes of shares can be issued, such as ordinary shares, preference shares, employees' shares, interest-bearing shares and convertible shares.

All shareholders are entitled to participate, to request information and to make comments at shareholders' meetings. Shareholders are entitled to make proposals and, if they hold shares with voting rights, to vote.

Shareholders are entitled to dividends voted by the members' meeting proportionately to the face value of their shares.

No dividends may be paid if, as a consequence, the equity of the company limited by shares will be less than the minimum required share capital of an Rt.

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General Meeting

The supreme body of a company limited by shares is the general meeting of shareholders.

Actions which fall within the exclusive competence of the general meeting, among other things, include:

- establishment and alteration of the Statutes (Articles of Association);
- decisions to change the form of the company;
- decisions on transformation or termination without legal successor;
- the election and removal of members of the Board of Directors or the General Director (only in case of a Zrt.), members of the supervisory board and the auditor, and the establishment of their remuneration (the Statutes of a Zrt. might delegate these decisions to the competence of the Supervisory Board);
- approval of the Annual Report, including the decision on the appropriation of after-tax profits;
- decisions to pay interim dividends;
- decisions on the acquisition of own shares;
- decisions to change the type of the shares;
- decisions to convert the printed shares to non-certificated shares;
- decisions to modify the rights attached to different series of shares, and the share types and share classes;
- decision to issue convertible bonds;
- decision to increase or reduce the share capital;
- decision to exclude the execution of preferential prescription right;
- all issues which are assigned to the general meeting by law or by the Statutes.

The general meeting must be convened as frequently as required in the Statutes, but at least once every year. If so required, extraordinary general meetings may be held at any time.

The general meeting is generally convened by the Board of Directors.

The general meeting has a quorum if shareholders representing more than half of the votes are present, unless the Statutes stipulates a higher rate of participation.

If the general meeting does not have a quorum, any reconvened general meetings will have a quorum in the issues on the original agenda irrespectively of the number of those present, unless otherwise specified in the Statutes.

If the Statutes allows, the general meeting can be held in such a way that the shareholders participate by using electronic telecommunication equipment. It is the free choice of the shareholders to decide that they will participate in the general meeting personally or by using electronic telecommunication equipment, unless otherwise provided by the Statutes. Electronic telecommunication equipment means a closed system which enables the holding of telephone- or videoconference and allows the identification of, and the uninterrupted conversation between, the Shareholders, dependent upon the constant state of the electronic system which provides the technical backbone.

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Board of Directors

The Board of Directors is responsible for the management of the Rt. (except that the Statutes of a Zrt. may provide that there will be no Board of Directors and that the rights of the Board of Directors are to be exercised by a General Director.)

The Board of Directors must consist of at least three and at most 11 members who must be natural persons. The Board of Directors elects its chairman from among its members.

The Board of Directors must exercise its rights and perform its duties as an independent body. The rules of procedure approved by the Board of Directors will provide for the allocation of tasks and responsibilities among the members of the Board of Directors.

The Board of Directors must ensure that the books of the company are kept according to the accounting law.

The Board of Directors must prepare reports on the management, the financial situation and the business policy of the company at regular intervals (at least once every year for the general meeting, and at least once every three months for the supervisory board).

The Board of Directors is responsible for preparing the Annual Report presented to the general meeting and for presenting a proposal on the appropriation of after-tax profits.

The members of the Board of Directors participate in the general meeting of the company with a right of consultation.

Supervisory Board

An Rt. must have a Supervisory Board unless otherwise provided by law, i.e.:

a) for public limited companies, except for any public limited company that is controlled by the integrated management system;

b) for private limited companies if requested by the founders or members (shareholders) controlling at least 5% of the total number of votes;

c) irrespective of the form and operational structure of the company, where prescribed by law to ensure the protection of public assets or due to the activities in which the company is engaged;

d) where so prescribed in the Companies Act in order to ensure the exercise of the control rights of employees The Statutes of a Nyrt. may provide that instead of the Supervisory Board and Board of Directors a Management Board shall operate at the company implementing the integrated management system).

The Supervisory Board supervises the management of the company. The supervisory board may request information from the executive directors and officers, and may inspect the books of the company.

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Increase of Share Capital

The share capital may be increased:

- by the issue of new shares;
- to the extent that assets exceed share capital;
- by the issue of employees' shares;
- by the conversion of convertible bonds (as a conditional capital increase).

New shares or bonds may be issued publicly or privately.

The General Meeting of the company may authorize the Board of Directors to increase the share capital up to a defined maximum limit, unless otherwise provided by the Statutes. Such authorization may be valid for a period of up to five years and is renewable.

Reduction of Share Capital

The general meeting may decide to reduce the share capital and, in certain cases, is obliged to reduce the share capital. The share capital may not be reduced below the minimum registered capital (HUF 5 or 20 million), except in cases when the registered capital is increased at the same time and by the increase the minimum amount of the registered capital is reached.

If the reduction of share capital is not possible because the share capital of the company would fall below the minimum registered capital required and the shareholders do not ensure the replenishment of the share capital within three months, the general meeting must pass a resolution to transform the company into another form of business association to merge into another company or to terminate the company.

In any share capital decrease, any own shares held by the company must first be withdrawn.

In respect of printed share certificates, the share capital reduction may be implemented:

- by exchanging the shares;
- by stamping the shares;
- by reducing the number of shares according to the procedure set forth in the deed of foundation.

Termination of Companies Limited by Shares

The general meeting of an Rt. may decide to terminate the company by a majority of three-quarters of the votes.

The assets of an Rt. undergoing voluntary dissolution may not be distributed until its deregistration.

In the event of termination of an Rt. without legal successor, the assets remaining after the satisfaction of creditors must be distributed among shareholders on the basis of payments and contributions in kind actually provided, and in proportion to the face value of their shares. If the company has issued shares with preferred rights on liquidation, the rights granted by such shares must be taken into account when distributing the assets of the company.

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Acquisition of an Influencing Interest in Business Associations

The Companies Act simplified the provision regarding the acquisition of interest.

These provisions are only applicable for the members (shareholders) of Kft. and Rt. and are not applicable for Kkt. or Bt. The Companies Act regulates only one interest ratio that is the 'qualified interest' if a member (shareholder) holds three-quarters or more of the votes in a Kft. or Rt.

The existence of 'qualified interests' must be reported to the Court of Registration by the member (shareholder) holding the interest within 15 days from the acquisition of such interests.

Please note that in case of a public company limited by shares the Hungarian law specifies further obligations to comply with if a party acquires interests.

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Chapter 4

Working in Hungary

Working Permission

As a general rule foreign persons cannot usually be employed in Hungary unless they hold a valid work permit and stay visa or residence permit.

Stay visas: Foreign persons who want to enter Hungary to work must apply for a stay visa unless there is an agreement between Hungary and the relevant country. The stay visa is issued for one year. A stay visa is granted by any Hungarian embassy in the home country of the applicant. Stay visa can be applied for after obtaining the work permit.

Residence permits: If the foreigner intends to work in Hungary and the stay visa has expired, a residence permit is required. The person must register and apply for a residence permit at the relevant police station for the place of residence. The registration procedure is subject to a fee.

Work permit: An application must be submitted by the employer to the relevant local Labor Centre prior to applying for a stay visa (a so called 'Workforce demand'). Chief executives (including managing directors, general managers, board members of an Rt., members of the supervisory board, head of the Hungarian representation office and of the Hungarian branch office) appearing in the Company's documents filed with the Registration Court are not subject to work permit requirements. The required data and documents have to be included in the application. The work permit is granted for a maximum period of two years but may be extended with further two years.

An employee may begin to work in Hungary only after having received all the necessary permits.

The amendment of the government decree no. 355/2007. (XII. 13) introduced basic changes to the rules of working in Hungary. From 1 January 2009 the EU/EEA citizens and the citizens of Switzerland do not need a work permit, not even for jobs requiring qualification under law. (Working in the framework of posting, designation or temporary employment relationship is not subject to this advantage.) Employers shall be obliged to notify the competent employment office the latest on the beginning date of employment. The employment center registers every notification; however, the notification is not a pre-condition to the employment. Also the termination of the employment relationship shall be reported to the competent office.

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In some specific cases work permits are granted without examining the conditions of the labor market. Such easier procedure applies for employees holding 'key positions,' or in case of a company owned by foreigners, up to 5% of the total number of its employees.

Beyond the above, no work permit is required in the following cases: spouses of Hungarian citizens living in Hungary do not need work permits, nor do the head of a branch or representation office of a company having its seat abroad.

Employment Law

The basic elements of employment agreements are regulated by the Hungarian Labor Code (Act XXII of 1992), which is broadly similar to the employment laws in other European Union countries.

The Labor Code provides a basis for organized labor negotiations with trade unions or other representative bodies of employees (e.g., works councils). An employer may enter into only one collective bargaining agreement at a time. Notwithstanding this, more than one collective agreement may have effect on the employer (e.g. collective agreements of industrial branches or regions, if any).

By means of the collective bargaining agreement it is possible to depart from a number of otherwise mandatory provisions in the Labor Code (especially in terms of working time and work scheduling). The Labor Code and the collective bargaining agreement will prevail over any contradictory provision of the employment agreement, with the exception that any provision more beneficial to the employee than the corresponding provision of the Labor Code will find application.

The employment agreement can only be concluded after having obtained all necessary permits, if any are needed. The employment relationship is created by the employment contract, wherein the first day at work – which basically is the effective date of the agreement – can also be set to a later date.

An employment agreement – which must be in written form – can only be deemed such, if it includes the mandatory minimum contents:

1) 1The basic salary, the place of work and the position (title) must be stated in the employment contract. The scope of work to be performed has to be specified by the employer, whose obligation is usually discharged by issuing a written job description. The employer also must specify the qualifications required to hold the position in question (information which is primarily relevant for the purposes of the applicable minimum salary).

Upon conclusion of the employment contract the employer is obliged to notify the employee of:

a) the basic work hours;
b) other components of the remuneration (e.g. bonus, cafeteria, etc.);

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c) the date of payment of salaries;
d) the commencement date of the employment (first day at work);
e) the amount of paid leave and the procedures for allocating and determining such leave;
f) the rules governing the notice periods to be observed by the employer and the employee should their contract or employment relationship be terminated;
g) whether a collective agreement applies to the employee; and
h) the name of the trade union that represents the employee, and that work council, central work council, where elected or not.

(The employer is obliged to provide the above information to the employee in written form within 30 days after concluding the employment agreement).

2) There is a national Minimum Salary that must be paid to employees when they are employed full time (40 hours per week). As of 1 January 2010 the minimum monthly salary is HUF 73,500; however, depending on the qualification and past experience required, the amount can be as high as one and a half times this amount; furthermore different amounts are set, if the calculation basis is shorter than a month (the hourly minimum salary is HUF 423).

Taxation

For taxes on dependent/independent personal services please refer to Chapter 6.

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Chapter 5

Accounting and Auditing

Introduction

Hungarian accounting regulations and the annual reporting requirements for companies are set out in Act C of 2000 on Accounting ('the Act'). The Act also establishes rules for independent auditing. There are additional acts and government decrees which affect accounting in specific industries such as banking and insurance.

The Act draws on the Fourth, Seventh and Eighth Directives of the Council of the European Union. These Directives regulate, respectively: the financial statements of limited liability corporations; the basic rules pertaining to the preparation of consolidated financial statements; and the appointment and qualification of persons responsible for statutory audits. The acts and decrees dealing with banking and insurance companies are based upon the European Union Bank Accounting Directive and Insurance Accounting Directive, respectively.

The requirements of the Act extend to all entities, including branches of foreign organizations but not representative offices.

Accounting Principles

The Act incorporates accounting assumptions and principles, which are predominantly the same as those approved by the International Accounting Standards Board ('IASB'). However, while some companies find it possible to report the same profits under the Act and International Financial Reporting Standards ('IFRSs'), there can still be significant differences between financial statements prepared in accordance with the Act and IFRSs. Some of these differences arise due to different recognition and measurement principles but most result from different presentation and disclosure requirements.

The Act adopts basic principles such as going concern, accruals, consistency and prudence. It requires annual financial statements to be prepared on the assumption that

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the entity will be a going concern. The principles of substance over form and materiality were first introduced in 1997 and have been increasingly invoked by preparers of accounts and auditors as these concepts have become more familiar. Departure from the provisions of the Act is allowed when it is necessary to achieve a fair presentation.

There are differences in presentation from IFRSs since the Act sets out detailed rules governing the recording and reporting of different categories of income, expenditure, assets and liabilities. Amongst other requirements, the Act requires transactions and balances to be evaluated individually and presented in gross form (to ensure completeness of reporting). This means that certain items presented net under IFRSs are grossed up in the Hungarian balance sheet and income statement. Also, the Act defines in detail the conditions which give rise to a requirement to restate prior year financial statements and mandates that any such prior year adjustments are presented in a separate third column supplementing the current and previously reported prior year financial statements. The net result is that some figures presented in Hungarian financial statements can look different from those most IFRS literate readers would expect.

The Ministry of Finance, which is responsible for accounting and auditing regulation, is also responsible for taxation and fiscal matters, and corporate liability to taxation is still closely dependent on the recording of financial transactions in accordance with the detailed accounting rules set out in the Act.

Company bookkeepers are usually focused on booking accounting transactions in the way expected by the tax authority and on being provided with the supporting documentation which a tax authority auditor may be expected to request.

Accounting and Bookkeeping

It is important to appreciate that the Act regulates day-to-day bookkeeping as well as annual accounting. It requires, amongst other matters, the following:

- The accounting records of entities must be kept in accordance with the principles and rules laid down in the Act.
- This requirement does not preclude the use of accounting and reporting systems developed and/or held outside Hungary (e.g. in shared service centers). However, such systems must be capable of presenting accounting information in accordance with the Act and prime ledgers and accounting documents must be made available promptly in Hungary if requested for Tax Authority audits.
- The accounting records are generally closed out on 31 December each year. However, subsidiaries and branches of foreign entities except for banks, other financial institutions and insurance companies, can account to another balance sheet date if the foreign entity's balance sheet date is not 31 December.
- The accounting records must be kept in the Hungarian language. Generally, the accounting records are kept and the financial statements are presented in Hungarian forints.

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From 1 January 2010, it is possible for any company to prepare its financial statements and keep its accounting records in euros, provided that it has specified euro as its functional currency in its Deed of Foundation and in its detailed accounting policy rules, before the beginning of the relevant financial year. In addition, under limited circumstances, companies with a functional currency other than forint or euro may keep their books and present their financial statements in their functional currency. To be able to use the company's functional currency instead of the forint in financial statements for periods beginning on or after 1 January 2010, more than 25% of the total of the absolute amounts of the financial assets and financial liabilities as at the balance sheet date, and more than 25% of the total of the absolute amounts of the income and expense items for the year, must be denominated in the functional currency in the previous and in the current year.

- Single-entry bookkeeping is allowed only for a limited group of not-for-profit organizations.
- The Hungarian accounting regulations define a compulsory fixed numbering of account classes from 0 to 9:
  - The asset accounts are in classes 1–3 and class 4 includes the equity, provisions and liabilities accounts.
  - Costs are recorded in accounts classes 5 and 8 based on their nature, and revenues are recorded in the class 9 accounts.
  - Classes 6 and 7 may be used to account for direct and indirect costs based on their function. Their use is not mandatory. Each entity is free to decide whether and how to use these classes of account.

  There is flexibility to choose specific account headings to suit the business' needs within each class of the accounts.
- Descriptions of the accounting policies and the chart of accounts must be prepared. (These documents are usually among the first documents tax auditors look for to understand the entity's accounting policies and procedures.)
- Transactions should only be recorded in the books if they can be verified. In practice this means that bookkeepers expect to receive authorized supporting documentation before booking entries. It also means that they are sometimes reluctant to book accruals, estimates or provisions unless there is strong supporting evidence to substantiate these.

This last feature has implications for timely recording, for the preparation of reliable interim and management accounts, and for the ability to prepare annual statutory accounts reporting the same results as are shown in accounts prepared in accordance with IFRS or parent company reporting rules. Many subsidiaries of multinational companies find it possible to book accruals at each month end and to report the same figures to their parent company as they do for local statutory purposes at year end, but some incoming investors may be surprised by incomplete accruals and provisions, particularly in interim financial statements and management accounts.

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Financial Reporting

All entities must issue a financial report following the end of each business year. The report is the responsibility of the entity and its authorized representatives. The form of report required is determined by the size of the organization and, in some cases, its method of bookkeeping. There are four different kinds of report:

- Annual Report
- Two types of simplified Annual Report (normal or prepared using specific rules)
- Consolidated Annual Report.

A company whose deed of association has been signed but which has not yet been registered by the Court of Registration may be required to prepare and publish a separate financial report covering the period from its date of formation until incorporation (in which case, the date of incorporation becomes the period end date, the "pre-company" period). A new company does not need to prepare a separate financial report for the pre-company period if it has not performed business activities during the pre-company period and its date of incorporation is earlier than its first annual balance sheet date.

Annual Report

Companies are generally required to prepare an Annual Report. The Annual Report consists of a balance sheet, an income statement and supplementary notes (including a summary of accounting policies applied, notes to the accounts and a cash flow statement). In addition to the Annual Report, a Business Report must also be prepared. The balance sheet and the income statement must each be prepared according to a prescribed structure and detail, in the Hungarian language and in HUF thousands (see *Accounting and Bookkeeping* for exceptions from using the forint as a presentation currency).

The balance sheet and income statement must be based on, and supported by, book-keeping records. Comparative figures for the preceding reporting period must be shown.

The prescribed format for the balance sheet follows the format of the Fourth Directive of the European Union. Companies have a choice of income statement format between a total cost model and a cost of sales model. The Act permits companies to adopt the model which the company considers to be most appropriate to the nature of its business.

The supplementary notes include additional information necessary to give a true and fair view of the financial position and results of the business. This includes explanations of the accounting policies applied in the accounts and the cash flow statement.

The Business Report provides a commentary by management on the financial position presented in the accounts.

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Simplified Annual Report

Companies which meet two of the three criteria detailed below in the preceding two years are permitted to prepare a Simplified Annual Report:

- total assets at year-end do not exceed HUF 500 million;
- annual net sales do not exceed HUF 1 billion;
- the yearly average number of employees does not exceed 50.

A Simplified Annual Report consists of a balance sheet and an income statement simplified to show only certain headings and simplified supplementary notes (for example, this need not include a cash flow statement or a movement schedule of the tangible and intangible assets).

As of 1 January 2009 general partnerships ("Kkt.") and limited partnerships ("Bt.") that are not obliged to have an auditor are entitled to prepare the simplified annual report using special rules. In this case, they are exempted from some recognition and measurement requirements relating to goodwill, revaluations, impairment losses, provisions and fair value measurements. Additionally, they are not required to attach supplementary notes to the balance sheet and income statement. If a company chooses to prepare this special form of simplified annual report, the company will not be entitled to change back to the normal method unless it no longer meets the conditions for exemption.

Consolidated Annual Report

In addition to their separate stand-alone company accounts, companies having a majority holding in or exercising control over subsidiaries must prepare a consolidated annual report unless they have met two of the following criteria during the preceding two years:

- Total unconsolidated assets do not exceed HUF 2.7 billion;
- Total unconsolidated sales revenue does not exceed HUF 4 billion;
- Total number of employees of the group does not exceed 250

The above exemption does not apply to banks, other financial institutions, insurance companies, and companies whose debt or equity securities are publicly traded.

A parent company which has one or more subsidiaries is not obliged to prepare a consolidated annual report, if it is itself a subsidiary of a company which prepares a consolidated annual report under the Act, EU requirements or any equivalent financial reporting framework (and has included the parent company and its subsidiaries in its own consolidated annual report). This exemption does not apply to the issuers of publicly traded debt or equity securities. A Hungarian parent that is exempted from the preparation of its own consolidated financial statements shall publish the official Hungarian translation of the consolidated financial statements of its parent company within 180 days of the balance sheet date of its parent company.

Consolidated accounts should present a true and fair view of the group's transactions with third parties. To this end, all intra-group transactions and balances are eliminated.

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The consolidated annual report consists of a consolidated balance sheet, income statement and supplementary notes. A consolidated business report must also be prepared.

Listed companies must, while other companies may, prepare and present their consolidated financial statements in accordance with IFRS as adopted for use by the EU.

A company exempted from the preparation of consolidated accounts and having control, significant influence or joint control over another company must record its investments at cost less impairment and account for dividends received as income. In the balance sheet, such investments are valued at the lower of cost and market value. Any write down on the value of the investment is shown under financial expenses in the income statement.

Accounting Rules

Accounting Convention

Transactions are normally recorded at historical cost. Inflation accounting is not permitted. General revaluations of assets are only permitted in exceptional circumstances (such as on merger or the transformation of a company from a Kft. to an Rt.). Contributions in kind are recorded at the value recorded in the Deed of Association.

Foreign Currency Translation

Transactions denominated in foreign currency must usually be recorded at the exchange rate applicable on the day of the transaction. Differences between these amounts and the subsequent cash settlement must be recorded as financial expense or financial income.

Any monetary asset or liability (including equity securities) denominated in foreign currency at year end are valued at the year-end rate. The unrealized foreign exchange gains and losses deriving from the year-end valuations are netted. The net foreign exchange gain or loss is generally recognized in the income statement.

There are special rules for unrealized losses on foreign currency loans taken out for the purpose of acquiring fixed assets. The loan amount is reported in the balance sheet at the current year-end rate but the unrealized loss can be deferred and amortized to the income statement in annual installments over the repayment period of the loan. On partial or full repayment of the loan previously deferred unrealized losses corresponding to repayment amounts become realized and must be charged to the income statement immediately. Any unrealized foreign currency gain arising on the loan should be netted against the deferral.

Fixed Assets

Tangible and some intangible fixed assets may be recorded at cost, less depreciation and impairment, or at a revalued amount. Borrowing costs (including exchange differences)

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that are directly attributable to the acquisition or construction of a tangible fixed asset or a right are capitalized as part of the cost of that asset. If a revaluation is recorded, it is not necessary to revalue all the assets within the same class. Assets under construction, bonds and other securities held as income earning investments, goodwill, capitalized foundation, restructuring and development costs may not be revalued upwards. The revalued amount of assets must be reviewed annually.

If assets are revalued upwards, the revaluation surplus must be recognized directly in equity and presented separately as a revaluation reserve. Subsequent adjustments in the revaluation surplus are charged directly against the revaluation reserve; the depreciation charge recognized in the income statement is based on the historical cost less residual value, if any.

If assets are revalued downwards below their carrying amount, the revaluation deficit must be recorded in the income statement as extra depreciation.

The depreciable amount of most assets (other than land and works of art; and those assets, including goodwill, whose value does not diminish through use) must be depreciated or amortized over their expected useful lives, as determined by management. If there has been a permanent decline in the value of a fixed asset (including securities and shares) as at the Closing Date for the preparation of the balance sheet, additional depreciation should be charged to reflect the revaluation of the asset to its market value. If the market value is considered to be permanently and significantly less than the book value, then a write down must be made. Impairment losses must be reversed if no longer appropriate due to a subsequent increase in market value.

Assets purchased under finance leases must be capitalized. However the definition of a finance lease is much more restrictive under the Act than under IFRSs and most lease agreements in Hungary are structured as operating leases for the Act’s purposes.

Development expenses and foundation or reorganization expenses are permitted, but not required, to be capitalized and written off over a period of up to five years. Recognition criteria for capitalization of development costs are less restrictive than under IFRSs.

Goodwill might not be recognized under certain types of business reorganizations.

Inventory

Inventory is valued at the lower of cost or realizable value. Cost can be calculated on a first in, first out or average cost basis. Inventories must be written down to market value in the case of loss in value but provisions, as distinct from write-downs (e.g., for slow moving goods) are not permitted. Write-offs must be reversed if no longer appropriate due to a subsequent increase in market value.

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Securities

Long-term securities (held for investment or trading purposes) should be valued at cost unless the market value has permanently and significantly decreased below cost. Securities with a maturity of not more than one year (short-term securities) should be valued at cost unless it is not expected that the face value will be repaid by the issuer. (See Fair valuation for an alternative measurement of securities at fair value).

Unlike under IFRSs, treasury shares are presented as assets in the balance sheet.

Export Subsidies

Any export subsidies due may only be recorded as income when financially settled by the date of preparation of the balance sheet, not when receivable.

Capital

A special reserve must be established within equity for certain capitalized costs and future liabilities. Dividends can be paid only if the total equity, excluding this non-distributable reserve, after the dividend payment, exceeds or equals the registered capital.

Liabilities

Liabilities may only be recorded if they are supported by invoices, contracts or other appropriate documentation.

Provisions

As noted earlier, formally, provisions cannot be made against inventory (although write downs are permitted).

Provisions are required to be made against specified kinds of liabilities: legally enforceable guarantees (such as warranties), early retirement pensions and severance payments.
It is also possible to record provisions against other losses that are likely or probable to occur and can be estimated with reasonable certainty.

Deferred taxation

Deferred taxes are not recognized in a company's separate financial statements.

Deferred tax provided in consolidated financial statements represents the difference between the total tax charge in the individual companies' financial statements and the tax charge in the group financial statements after eliminating the effect of inter-company transactions (this is a different concept from deferred tax under IFRSs).

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Income Statement Presentation

The principle of completeness (grossing up) means that some related items are presented separately in the income statement. For example, the proceeds of fixed asset disposals and the write back of the prior year impairment of assets are reported under *Other Income*, whereas the book value of fixed assets disposed of and the full amount of the write down required at the current year end are reported under *Other Expenses*.

Dividends approved after the balance sheet date (at the annual general meeting or members' meeting) should be recognized as liabilities on the balance sheet date and presented on the face of the income statement as a deduction from profit for the year.

Extraordinary Items

Whereas IFRSs prohibit, the Act requires certain income or expense items to be categorized as extraordinary. Even immaterial and recurring amounts should be reported as extraordinary, if they are outside the normal course of business.

Extraordinary items include development grants, the value attributable to assets received as gifts and redemption of treasury shares. Further, the grossing up principle means that elements of a single transaction are sometimes reported separately under extraordinary profits and extraordinary losses. For example, the redemption of treasury shares will result in the presentation of an extraordinary loss (the book value of the treasury shares redeemed) and an extraordinary profit (the nominal value of the treasury shares redeemed), rather than simply the net profit or loss.

Prior Year Material Errors

Significant errors detected from prior years must be adjusted directly against the retained earnings and presented in a separate column of the financial statements. The amount which is considered significant can be decided by the company but cannot exceed the lower of 2% of the total assets for the year in question and HUF 500 million. This amount could be below what is considered material under IFRSs. There are detailed rules defining what a significant error is and how the calculation of the total of significant errors is to be made. Errors increasing and decreasing profits cannot be netted in arriving at this total.

Financial Instruments

Entities can opt to present financial instruments at fair value and to apply hedge accounting. If fair valuation is applied, the classification of financial instruments and the recognition requirements are similar to those of IAS 32 and IAS 39. However, there are significant differences from IFRS in terms of measurement.

Disclosure

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The disclosure requirements in financial statements prepared in compliance with Hungarian accounting rules are less extensive than under IFRSs. For example, there is no requirement to disclose earnings per share or segment information in Hungarian financial statements.

Filing Requirements

All legal entities which are registered in the Trade Register and maintain double or single entry books must file their Annual Report within 150 days after the balance sheet date. The managing director of the entity must sign the Annual Report. The Annual Report should be accompanied by the auditor's report, where an audit is required, as well as the resolution pertaining to the appropriation of the after-tax profit. The business report need not be filed but must be available for inspection at the registrant's own registered office.

Consolidated Annual Reports must be filed within 180 days of the balance sheet date. Many Hungarian companies still tend to regard their separate company financial statements as their primary financial reports and treat the preparation and issuance of their consolidated accounts as less important.

Under Budapest Stock Exchange rules, listed companies must issue their audited separate and consolidated financial statements within four months of the year-end.

Publication

All entities keeping double-entry books are required to publish their annual report and the related auditor's report (if any). The business report is not required to be published. The filing and publication requirement must be satisfied by filing the information electronically at the Company Information Office of the Ministry of Justice.

Companies with securities traded publicly within the European Union must also publish their Annual Report, Consolidated Annual Report and Business Report on their own web site.

Branch offices of foreign companies are not required to appoint an independent auditor and are not required to publish their annual report if the foreign company is established in the European Union or in a state outside the European Union where the national legal requirements on the preparation, audit, deposit and publication of the annual accounts are in conformity with the relevant regulations of the European Union. The annual reports of such foreign companies must be available in Hungarian.

A branch office of a financial institution that satisfies the above conditions is required to ensure that the annual report on its own activities and statements for tax purposes prepared according to the Accounting Act and the relevant Decree is available to all concerned parties for review and for making copies.

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Auditing

The general rule is that all companies required to keep double entry books, including branch offices of foreign companies, must appoint independent auditors. Auditors are normally appointed at formation and subsequently at the general meeting at which the previous year's accounts are approved.

There are exemptions for small companies. Companies do not have to appoint an auditor if they meet both of the following criteria in the preceding two years:

- their average annual net sales over the past two years do not exceed HUF 100 million; and
- the yearly average number of employees over the past two years does not exceed 50.

There is no audit exemption for branches of foreign companies, subsidiary companies, banks and insurance companies; these must always be audited.

The independent auditor must be an individual or an accounting firm registered at the Chamber of Hungarian Auditors (‘Registered Auditor’). If an accounting firm has been appointed as auditor, an individual Registered Auditor from the firm must be nominated as the responsible auditor and the audit report must be signed by this individual.

Only specifically certified individuals and firms are authorized to sign audit reports on banks, investment funds, brokerage companies and insurance companies. KPMG Hungária Kft. is one such firm.

Under the Act, the purpose of an audit is to establish that the annual report (or simplified report) has been drawn up in accordance with the Act and provides a true and fair view of the financial position and results of operations of the entity in accordance with the Act.

An auditor is entitled to request the company to provide facts and information in the course of an audit. Auditors have a duty of confidentiality with respect to the facts and information that they become aware of in the course of their duties. The auditor is required to draw attention to any breaches of the law or other matters detrimental to the company's present situation or prospects (including losses of share capital, for which special rules apply) and may initiate the convening of meetings of management or shareholders if the circumstances justify this. The auditor must attend the general meeting of the company approving the financial statements audited by the auditor.

Registered Auditors and the Chamber of Auditors are regulated under Act LXXV of 2007. The Act gives certain responsibilities to the Chamber of Auditors. These include the registration and regulation of auditors, quality reviews and the development of national auditing standards. The Chamber of Auditors has adopted International Standards on Auditing (‘ISA’). All auditors are expected to comply fully with ISA (adapted as necessary to deal with particular local issues).

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Other Matters

Specific rules and legislation apply to certain types of entities.

Banking and other financial institutions are legislated for under Act CXII of 1996 on Financial Institutions and Financial Institutional Activities and associated rules and regulations. Special accounting rules require banks to establish a risk reserve to cover the risks associated with off balance sheet commitments and contingencies. Other risks such as credit risk, country risk and investment risk should be considered in the valuation of the related assets at the balance sheet date (i.e., any specific provisions should be reflected in the reported value of the asset).

Insurance companies are legislated for under Act LX of 2003 on Insurance Companies and Insurance Activities.

Brokerage firms are regulated by Act CXX of 2001 on Capital Markets. Brokerage firms must also comply with the rules and regulations established by the BSE.

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Chapter 6

Taxation

Introduction

Personal income tax and VAT were introduced into the Hungarian tax system in 1988.

This was the first step in a long process of tax reform. The next major step, undertaken in 1991, was the modernization of the corporate income tax system.

In 1993 and in 2004, the VAT legislation was further modified to conform, at least in principle, to the VAT systems used in the European Union. From 2008, a new redrafted VAT law is in force.

In 1995 a two-tier corporate tax system was introduced, comprised of a standard rate and a supplementary tax. New legislation, which came into force in 1997, left the standard rate untouched while replacing the supplementary tax with a withholding tax, which was totally ceased from 2006.

With Hungary's accession into the European Union, several changes were implemented into the Hungarian tax legislation to comply with the EU tax directives (e.g. Parent-Subsidiary Directive, Mergers Directive, VAT Directive).

The current, significant taxes and levies imposed in Hungary are:

- Corporate Tax
- Personal Income Tax
- Social Security Contributions
- Simplified Tax and Contributions
- Gift and Inheritance Taxes
- Value Added Tax
- Customs Duties
- Excise Duties
- Motor and Vehicle Tax
- Company Car Tax
- Registration Fees and Stamp Duties
- Property Transfer Tax
- Local Taxes

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- Contribution to the Rehabilitation Fund
- Contribution to the Vocational Training Fund
- Environmental Protection Charge
- Environmental Pollution Charge
- Innovation Contribution
- Energy Tax
- Surtax on energy suppliers and traders
- Registration Tax
- Wealth Tax

Corporate Tax

The basic principles for the taxation of business profits are detailed in the Corporate Tax Act. The taxable income of Hungarian companies is subject to corporate tax at a rate of 19 % as of 2010. Certain taxpayers which do not obtain tax incentives provided for in the Corporate Tax Act are taxed at a rate of 10%. As of 1 January 2008, the upper limit of the base for this preferential tax was increased from HUF 5 million to HUF 50 million. The reduced rate is only applicable if requirements are met in respect of number of employees, connection with the labor authority and the amount paid on pension and health insurance contributions.

Since July 2007, if the higher of the taxpayer's profit before tax or tax base does not reach the so-called income- (profit-) minimum they should, depending on their decision:

1. make a declaration on an additional sheet of their tax return presenting their cost structure. Based on these reports, the Hungarian Tax Authority may select the taxpayers for investigation. By means of risk analysis software, the Authority selects companies for tax audit, where it can be assumed that the low or negative profit of the business activity could result from the hiding of revenues or accounting for fictitious costs. In the course of an investigation, the taxpayer should support the transactions challenged by the tax authority and show that the costs (expenditure) have been incurred in the interests of the business activity. The tax authority is also granted the possibility of estimating the tax liability; or

2. the revenue- (profit-) minimum should be regarded as the tax base, and the corporate income tax should be calculated and paid by reference to this base.

According to the Act, the income- (profit-) minimum is 2% of the total revenue modified by the decreasing and increasing items described by the law.

There has been no dividend withholding tax in Hungary since 1 January 2006.
As a result of this amendment, the EU Parent-Subsidiary Directive has become irrelevant in the context of dividend payments made from Hungary to an EU-based parent company.

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The following table sets out as an example the rates of tax applicable in 2010 to corporate profits.

From 1 January 2010, the corporate income tax rate is increased to 19% from 16%; however, at the same time the solidarity tax (4%) on corporations was abolished.

	Tax rate	**Tax (HUF)**	**Income (HUF)**
Taxable income			100,000
Corporate tax	19%	19,000	
Balance of undistributed income available for distribution as gross dividend			81,000
Tax charged on dividend payable to the company	0%	0	
Total tax charged on distributed income		19,000	
Net distributed profits			81,000

Determination of Taxable Income

The basis of assessment is the profit shown in the financial statements of the taxable entity, as adjusted by various additions and deductions required under the Corporate Tax Act.

The Act provides special rules, among others, for the treatment of:

- Non-business expenses
- Development reserves, provisions
- Depreciation
- Loss in value
- Receivables forgiven
- Thin capitalization
- Own research and development expenses
- Transfer pricing
- Loss carry forwards
- Royalties
- Capital gain participation exemption
- Foreign sourced interest

Non-Business Expenses

In general, expenses considered incurred for non-business reasons are not deductible for tax purposes. The tax legislation provides a list of various costs and expenditure that are not seen as incurred in the interests of the business, and hence, not deductible.

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All services exceeding HUF 200,000 must be documented in writing, the nature of the service must be determined and the business purpose proven. As noted, the expense must be incurred in the usual business activities of the company in order to be deductible.

Since 1 January 2007, write-offs on participations arising from investments made to address negative equity problems through an increase in share capital are not subsequently allowed for corporate income tax purposes.

From 2010, the cost of entertainment and business gifts defined in the personal income tax law is considered as not incurred in the interest of business activity.

Goods, services, financial assets etc. provided without receipt of consideration qualify as expenses incurred for business purposes unless granted to foreign companies resident for tax purposes in a state with which Hungary has no double tax treaty, or granted to a CFC, or the taxpayer does not have a declaration stating that the pre-tax profit of the beneficiary would be positive even without the receipt.[1]

Development reserves, provisions

The taxpayer is permitted to deduct a development reserve, i.e. amounts expected to be spent on capital expenditure in the four years following the creation of the reserve. However such a reserve can only reduce the pre-tax profits by up to 50% (with an upper limit of HUF 500 million). In the tax return, development reserves may not be utilized for an investment or an asset purchased, which may not or should not be depreciated (e.g. land) based on the accounting regulations. The development reserve reported in the 31 December 2008 financial statements can be utilized over a 6-year period.

Subsequent to the capitalization of the invested assets, the tax book value of the assets must be decreased by the amount of the development reserve (to avoid giving rise to a double deduction).

The amount of development reserve limits the dividend payment potential of the taxpayer, as it is accounted for as a transfer from profit reserves to tied-up reserves.

Any tax relating to that part of the development reserve which is not utilized by the relevant deadline should be paid together with default penalties.

Depreciation

No depreciation is allowed on assets that have not been put into use or are still considered to be part of constructions-in-progress.

The Act on Accounting specifies depreciation rates according to the expected useful life of the asset. The exact text is as follows: "the absolute amount of depreciation shall be planned with regard to the expected use of the individual asset, its duration arising therefrom, its physical deterioration through use and obsolescence, as well as to the circumstances typical of the entrepreneurial activity concerned." It can be seen that the criteria include not only physical life but also useful economic life.

1 *This rule might be subject to mid-year amendment.*

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The corporate tax depreciation rates must be used to determine the allowable deduction for tax purposes. The following table sets out most of the current maximum rates for corporate tax purposes:

Machinery and equipment, breeding stock	14.5%
Computers	33%
Vehicles	20%
Buildings	2% / 3% / 6% (Depending on type)
Intangibles	Accounting Life
Leased assets:	
Leased Buildings	5%
Equipment in leased buildings and other leased tangible assets	30%

There are some incentives in the CIT law which allow faster tax depreciation regarding the following assets:

- 50% depreciation can be claimed on general IT machinery and on equipment exclusively serving motion picture and video production.
- Taxpayers can claim 50% depreciation in connection with brand new tangible assets that are acquired or produced in or after 2003 and which would otherwise be subject to a 33 or 14.5% rate; the same rules apply to intangible properties purchased or produced, and to the capitalized value of experimental development.

Receivables Forgiven

Expenditure accounted for as a consequence of written off receivables is not deductible for tax purposes, unless regarded as irrecoverable debts for accounting purposes.

From 2010, 20% of the amount of outstanding receivables not settled within 365 days is also considered as irrecoverable.

Thin Capitalization

The debt to equity ratio for thin capitalization calculation purposes is 3:1. Interest on loan instruments payable on all of the taxpayer's non-trade and non-financial institution creditors is included when calculating the ratio. Accordingly, the thin capitalization rules cover interest on loans granted by both related and unrelated parties and also extend to bonds (but not for bonds issued to reimburse normal liabilities towards suppliers) and other loan securities issued exclusively to one party (i.e. closed securities). The thin capitalization rules provide an exemption for loans made through certain financial institutions.

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Since 1 January 2006, all (non-financial institution) liabilities on which interest is paid should be taken into account during the calculation. This means that interest paid in respect of cash pooling arrangements will also be subject to the potential non-deductibility rules.

R&D expenses

From 1 January 2010 only the direct costs of own research and development activity are allowed as a tax base-decreasing item. Potentially, a triple deduction can be claimed for R&D expenses with an upper limit of HUF 50 million, if the research and development activity is carried out according to an agreement with an institute of higher education, the Hungarian Academy of Science, or with a commonly funded research institute. Nevertheless, there is only deduction from an accounting point of view for R&D activities supported by governmental subsidies (to the extent of the subsidies). The law specifies that R&D definitions should be interpreted in line with the Frascati Handbook.

Transfer Pricing

Transfer pricing rules allow the tax authorities to adjust taxable profits where transactions between related parties are not at arm's length. The current legislation prescribes not only the methods applicable for determining a fair market price but also the way in which these should be applied. The taxpayer may calculate the fair market price using any alternative method, provided they can prove that the market price cannot be determined by the methods included in the Act, and the alternative method suits the purpose.
OECD transfer pricing principles are generally accepted in Hungary.

These rules should also be applied to transactions where capital is provided in the form of non-cash contribution, the decreasing of registered capital and in-kind withdrawal in case of termination without successor and non-cash dividends, if this is provided by or provided to a shareholder that has majority ownership in the company.

Taxpayers other than corporations owned directly or indirectly by the government are obliged to produce detailed transfer pricing documentation. This documentation should be prepared by the deadline for submission of the annual corporate income tax return of the company. Nevertheless, these records do not have to be filed with the tax return itself but must be available at the time of subsequent tax authority investigations.

Since 1 January 2007, advance-pricing agreements (APA), a legal framework similar to binding ruling requests, can be obtained concerning the process of determining regular market prices. In this process, the Tax Authority will resolve the following with respect to a future transaction between related parties: the method to be applied for determining market prices, the facts and conditions underlying the transaction, and – if possible – the market price or range of prices.

To harmonize the Hungarian legislation with the Resolution of the Council of the European Union, taxpayers received the possibility to choose between preparing stand-alone documentation or EU transfer pricing documentation regarding inter-company transactions. The documentation can be prepared in languages other than Hungarian,

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however, the Tax Authority could oblige the Taxpayer to translate and present the documentation in Hungarian.

Loss Carry forwards

Under the effective legislation, those from 2004 and subsequent losses can be carried forward without a time limitation. From 1 January 2009, taxpayers are not required to obtain permission from the tax authorities to carry forward tax losses in certain circumstances.

Companies formed with no predecessors may carry forward losses incurred in the year of establishment and in the three subsequent tax years thereafter for an unlimited period of time.

In the event of transformation, a legal successor is permitted to use the losses of a predecessor; the rules last changed significantly in 2000 in this respect. There are anomalies in the law which mandate special attention to this area.

Loss carry forward is available for the first time to financial institutions in respect of their 2009 liabilities.

Royalties

Taxpayers can decrease their pre-tax profits by 50% of the royalty income arising. This deduction is limited to a maximum 50% of profit before tax.

Capital Gains Participation Exemption

As an incentive for the establishment of holding companies in Hungary, domestic or foreign participations of at least 30% acquired would be considered as an "announced participation," where this is reported to the Tax Authority within 30 days following acquisition. Any loss on write off, foreign exchange or loss suffered during cancellation from the books (except during transformations) should be added back to the corporate income tax base. The capital gain on such participations held for at least one year is exempt from corporate taxation.

An investment cannot be treated as an announced participation and the special rules applied if it is in a controlled foreign company (CFC). From 1 January 2010 a foreign organization is considered a CFC, if a Hungarian resident individual owns at least 10% of the shares or the foreign company has its revenues mainly from Hungarian sources; further requirements are that the foreign organization does not pay corporate tax because of its zero or negative tax base, despite its positive pre-tax profit, or its effective income tax rate does not exceed 12.67%. Foreign entities resident in EU Member States, OECD Member States or jurisdictions with a Hungarian tax treaty may be excluded from the CFC provision if real business activity is proved to be undertaken in the jurisdiction of residence.

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Non-resident Companies

Withholding tax

From 2010, new rules are introduced regarding a withholding tax of 30% related to certain foreign corporations on income connected to interest, royalties and certain service fees such as activities of head offices, management consultancy activity, market research and public opinion collation, business agency activity or other professional, scientific and technical activities.

Exemption from the 30% withholding tax is available for foreign companies resident for tax purposes in a state with which Hungary has an operative double tax treaty.

Interest paid by special organizations owned by the Hungarian State is not subject to withholding tax. Furthermore, interest derived from bonds listed on the recognized stock exchange of any EU-, EEA or OECD countries is exempted from withholding tax.

Branches and Permanent Establishments

Non-residents are in most cases able to conduct business in Hungary through branches registered with the Hungarian Court of registration, if they do not want to establish a Hungarian registered company. Hungarian branches are treated the same as any other corporate income taxpayer.

Tax Incentives

As a result of Hungary's EU accession, the intervention of the state in the private sector has had to be limited.

Tax Allowance for Small and Medium-sized Enterprises

(effective as of 1 January 2001)

Small and medium-sized companies, as defined, may apply for a tax incentive with regard to the interest payable on loans borrowed from a financial institution for the purpose of purchasing or manufacturing tangible assets (including a second loan obtained to refinance an existing one). The company must qualify as a small or medium-sized company on the last day of the tax year when a loan contract was entered into.

The available tax incentive equals 40% of the interest paid on the loan in a tax year, and the amount of the tax allowance received cannot exceed HUF 6 million per tax year.

Development allowance

The Ministry of Finance grants tax incentives for a maximum 10-year period for investments executed within the framework of the development program published by the Government. The Corporate Income Tax law prescribes the following investments, which can provide entitlement to a development tax allowance:

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1) For investments of at least HUF 3 billion at present value or in case of investments in certain special investments of at least HUF 1 billion (present value), which meet either of the following requirements during the four years following the first year in which the tax allowance is utilized:

    - the average number of persons employed should exceed by at least 150 (75 in certain special regions) the average number of persons employed in the year or in the average of the three years prior to the commencement of the investment, based on the option of the taxpayer; or
    - the taxpayer's annual wage costs should exceed by at least 600 times (or by 300 times in the case of certain special regions) the minimum wage calculated for the tax year compared to the wage costs of the year or in the average of the three years prior to the commencement of the investment, based on the option of the taxpayer.

2) For investments of at least HUF 100 million at present value for:

    - projects bringing an existing food facility producing foodstuffs of animal origin into compliance with the requirements laid down in legal regulations concerning food hygiene (permission of the European Council is needed as of 1 June 2007);
    - independent environmental protection or rehabilitation projects:
    - broadband Internet service projects (permission of the European Council is needed since 1 June 2007);
    - motion picture and video production;
    - investments serving basic research, applied research or experimental development;
    - investment begun within three years following the date when shares issued in the course of an equity increase receive listings on the Hungarian or another EU stock exchange.

3) For investments creating new jobs, an investor could be eligible for tax allowance by creating any new job.

4) For investment of at least HUF 500 million at present value by a small or medium-sized company, which meets either of the following requirements during the four years following the first year in which the tax allowance is utilized:

    - the average number of persons employed should exceed by at least 20 (small-sized enterprises), or at least 50 (medium-sized enterprises) the average number of persons employed in the year or on average for the three years prior to the commencement of the investment, based on the option of the taxpayer; or
    - the average number of persons employed should exceed by at least 20 (small-sized enterprises), or at least 50 (medium-sized enterprises) the average number of persons employed in the year or on average for the three years prior to the commencement of the investment, based on the option of the taxpayer; or

The tax allowance can be utilized if the project is for the creation of a new facility, the expansion of an existing one, or involving a significant improvement in a product that is manufactured, or in production technology.

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To receive eligibility for the tax allowance, requests should be submitted to the appointed minister who shall grant an authorization through decree where the present value of the investment, costs and expenditure exceed EUR 100 million. If this value is lower than EUR 100 million, only notification is required prior to commencement of the investment.

The decision must be adopted within 60 days from the date when the application was submitted or when re-submitted. This deadline may be extended once, by a maximum of 60 days. The taxpayer should present the required data to the appointed minister before the investments starts.

The incentive allows tax relief of up to 80% of the corporation tax liability, but in total no more than a fixed percentage (intensity ratio) of the capital invested, defined, or staff costs (depending on the particular industry).

Tax Benefit on R&D and Software Development Wage Costs

Ten percent (in case of small and medium-sized enterprises, 15%) of the payroll costs accounted for as direct R&D costs of basic research, applied research or experimental development and payroll costs of software developers may be deducted from the corporate income tax liability in the tax year and in the next three years in equal installments, provided that the taxpayer has payable corporate income tax in that period. If there is no tax liability in that tax year, any remaining amount can be carried forward to be utilized in the following year. The maximum amount of tax benefits is capped at 70% of the calculated tax liability.

Motion Picture and Video Production

The Hungarian Government creates indirect state support for the film industry through tax incentives for films and related projects adopted in the CIT law.

The taxpayer can reduce its corporate tax liability by the certified amount, in the year of investment or in the subsequent three years, by not more than 20% of the eligible costs approved by the Hungarian Film Office.

The tax incentive system is beneficial for all taxpayers, and is secured by continuous Film Office control.

Relief from tax

Foreign Tax Credit

A domestic tax credit system is available for corporations in order to avoid double taxation on foreign-source income other than dividends (which are usually exempt). Hungarian tax treaties apply either the exemption or the credit method to prevent double taxation.

Interest box regime

From 1 January 2010 a favorable new rule was introduced into the CIT law regarding foreign sourced interest income.

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The new rule allows 75% of foreign interest income to be exempted from the tax base. The interest income is determined as the difference between interest income and the costs and expenses directly related to that income. This means an effective tax rate of 4.75% for international financing, regardless of whether or not a double tax treaty exists.

Real estate owing company

The concept of a so-called *real estate company* is introduced from 2010.
A real estate company exists if the following requirements are met:

- more than 75% of its consolidated total assets are real estate located in Hungary; and
- at least one of their shareholders is resident in a state with which Hungary has not concluded a double tax treaty, or in a state where the double tax treaty allows gains from the sale of shares in property owning companies to be taxed in Hungary.

A tax liability arises when the shareholder sells, gifts or contributes the shares of such a company. The tax base is the difference between the income from the sale of the shares and the acquisition costs, including expenses related to the shares during the shareholding period. The tax rate is 19%.

Taxation of Individuals

Personal Income Tax

Residence

Under Hungarian domestic law, individuals with Hungarian citizenship (with the exception of dual citizens without a permanent or habitual residence in Hungary), EEA citizens who stay more than 183 days in Hungary, foreign nationals with a valid permanent residency permit (or settlement permit) and stateless persons are treated as residents for income tax purposes. In case of other natural persons, the residence status can be determined firstly by permanent residence, secondly by determining their center of vital interests and thirdly by their habitual abode. Individuals are considered to have a habitual abode in Hungary if they stay in the country for more than 183 days (including the date of arrival and the date of departure) during a calendar year.

There is no codified test for the application of the 183 days but in practice it is understood to be a physical presence test. In the case of any doubt, an individual is responsible for proving that his/her stay did not exceed 183 days.

Non-resident individuals are subject to income tax on their Hungarian source income or income taxable in Hungary based on Double Tax Treaties or reciprocity. The same taxation rules are applicable as for residents (i.e. same tax rates). For tax purposes Hungary means the territory of the country. Hungarian resident individuals are subject to personal income tax on their worldwide income.

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Income derived from Hungarian sources is in particular:

- Income derived from employment with a Hungarian employer;
- Income from activities exercised in Hungary; and
- Income from assets situated in Hungary.

The provisions of double taxation treaties are relevant in determining tax residence for certain purposes and deciding which country has the taxing rights over different forms of income.

Income

Individuals are subject to tax on a progressive basis on the aggregate amount derived from different types of income unless the income is specified as non-aggregated income (e.g. dividends), which is taxed separately at flat rates (see applicable flat rates below). Income is defined as "any increase in wealth or value obtained in any manner and form."

The income of directors, regardless of whether or not they carry out their function as employees, is taxed similarly as employment income. The term "director" is not defined under the income tax law.

Rates

From 1 January 2010, the base of personal income tax is determined as the so-called "super gross income" which contains all dependent, non-dependent, other sources of income and a tax base increasing element. The individual income tax is levied on the aggregate taxable base according to a progressive scale. There is a two-level tax table for 2010, as illustrated below.

Annual taxable income in HUF	Tax payable
0 – 5,000,000	17%
Over 5,000,001	850,000 + 32% on excess over 5,000,000

The tax base increasing element is calculated as the total employer's social security contributions (the total rate is 27% in 2010), or in the absence of Hungarian social security coverage it would be the mandatory health care charge (EHO, whose rate is also 27%), therefore the income tax should be calculated on 127% of the tax base in 2010.

When calculating the tax base-increasing element, non-taxable income should not be taken into consideration.

Flat rates applicable to certain types of income are as follows

- 30% on the interest income paid by a Hungarian entity to an individual resident in a non-Treaty country
- 20% on capital related income realized on controlled capital market transactions
- 25% on income from the lending of securities
- 10% on dividends from securities on an EEA country's exchange market (in other cases 25%)
- 20% on certain capital gains from trading options and futures
- 25% on gains from the alienation of immovable property and valuable rights and interests.

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If the taxpayer did not take into account the acquisition value or the related costs when determining income from interest/capital gain, they will be able to amend this in their tax return.

Taxation of Certain Specific Benefits

- Housing provided by a Hungarian entity both in cash and in kind is taxed as a part of employment income if supported by an employment contract or as benefit-in-kind under certain circumstances. In the case of foreign employees who are assigned to Hungary and do not have a direct employment contract with a Hungarian entity, housing may be treated as a non-taxable benefit-in-kind.
- Relocation services provided in kind by the employer are taxed as benefits.
- Reimbursement of home leave expenses of family members is taxed as a benefit.
- In certain circumstances, training of employees may be treated as a benefit in kind at a preferential tax rate
- Should the interest charged on an employee loan be less than the Hungarian National Bank prime rate plus five percentage points - or the standard market rate if the payer is able to prove that the standard market rate is lower - the difference is taxable as income from dependent activities (salary income). Salary advances not exceeding five times the minimum wage (currently HUF 73,500/month) are not treated as below market rate loans, if the loan is repaid within six months.
- Business travel and accommodation expenses are business expenses where supported by proper documentation. If the invoices are not issued in the employer's name (i.e. the actual payer of the expense), or if invoices are not provided to the employer, the costs reimbursed by the company are treated as employment income of the individual or a benefit in kind.
- The cafeteria benefits system has been changed significantly.
  The new package would determine a favorable tax rate on a specific group of fringe benefits with a discount tax rate of 25% up to limits as described below:
  - National holiday voucher or holidays in a company's resort (paid by the company) up to the value of the monthly minimum wage (HUF 73,500/head);
  - Warm food vouchers up to HUF 18 000/month;
  - Reimbursement of training and education fees (tuition allowances in the school system) up to 250% of the annual minimum wage;
  - school starting subsidy provided to parents up to 30% of the annual minimum wage (per child);
  - monthly travel pass.
- Special Employer's pension or health fund contributions for employees listed below:
  - voluntary mutual health insurance payment up to 30 of the minimum wage:
  - voluntary mutual pension insurance payments together up to 50% of the minimum wage;
  - contribution of employer's pension funds up to 50% of the minimum wage;
  - employer's contribution to the employee's private pension fund payments with regard to the Act on Private Pension and Private Pension Funds.

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These items exceeding the specified limits would be taxed as ordinary benefits in kind:

- Certain life assurance premiums and accident insurance premiums paid by the employer for the benefit of an employee may be tax-exempt.
- Business gifts and entertainment costs would be tax-exempt in kind benefits if these costs should be treated as non tax deductible for the provider company.
- Those tax allowances that could be deducted from the calculated income tax are abolished, except family tax allowance and those allowances which provide long-term savings for individuals, such as voluntary insurance and pension funds.

Exemptions

Some types of income are exempt or not taxed under Hungarian tax legislation. The most significant types are the following: house, flat, real estate for residential purposes, including:

- income from the disposal of real estate if the real estate was purchased five years prior to the sale;
- certain housing subsidies provided by the employer are regarded as non taxable up to HUF 5 million.

Deductions and tax allowances

In general, expenses incurred for the purpose of pursuing business activity are deductible in order to determine the taxable base of income from independent activities. Tax legislation provides individuals with two options for the deduction of such expenses: either the deduction of actual expenses or a deduction of an allowance of 10% of gross revenues. Increased allowances are available for small entrepreneurs.

No expense deductions from employment income are allowed. Foreign mortgage and other interest are not deductible, nor are contributions to foreign pension or insurance schemes.

Since 2008, family allowance is also applicable for children of EEA citizens. That means that a fixed sum of HUF 4,000/month/child allowance is deductible from the consolidated tax base if there are at least three children in the family, but an income limit should be considered for the tax allowance.

This allowance is applicable if the individual's annual gross income does not exceed HUF 7,620,000, in case of three children. If the individual has more than three children, the limit increases by an additional HUF 625,000/child up to HUF 10,160,000.

Tax assessment

In certain cases, individuals can request tax assessment by the Tax Authority that is equivalent to their annual income tax return (simplified income tax return). More details are provided under the Rules of Taxation section.

Relief from tax – elimination of double taxation

Under its double tax treaties, Hungary mainly gives relief by way of exemption with progression. This means that income taxed abroad does not form part of Hungarian

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taxable income, though it is included in the taxable base in order to determine the tax rate applicable to the taxpayer's other income. The wording of each double tax treaty should be considered on its own merits.

Social Security Contributions

If the employment activity is undertaken in Hungary, labor and assignment relationships of foreign countries are treated as labor and assignment relationships based on Hungarian law when applying the social security legislation.

From 1 January 2010, an employer's total social security contributions are decreased to 27% which contains a 24% pension fund contribution, 1.5% in kind and 0.5% in cash health care contribution and a 1% labor market contribution. Contributions by individuals are not changed.

The 9.5% pension contribution is generally divided into two parts. Employees should pay 1.5% to the public scheme and 8% to the private scheme. In case of certain employees, the total 9.5% is payable to the public scheme. There is an annual contribution payment limit regarding an employee's pension contribution. This limit is HUF 7,453,300 (HUF 20,420/day); if an individual's aggregated annual gross income exceeds this amount, no further pension contribution payment liability arises.

Individuals may also contribute to voluntary private pension funds, which make up a third pillar of the system.

A summary of an employer's and employee's contribution rates for 2010 are as follows:

	Pension	Health Insurance		Labor market	
Hungarian Employers	**Insurance**	**Cash support**	**In kind support**	**contribution**	**Total**
(required to pay a contribution calculated on the basis of the wages and salaries of their employees)	24%	0.5%	1.5%	1%	27%
Employees					
(the contribution is withheld from their gross salaries or wages by the employer)	9.5%	2%	4%	1.5%	17%

Social security contributions are mandatory for Hungarian employees, foreign employees employed by Hungarian entities, foreign employees under certain Social Security Totalization Agreement provisions and in certain other cases, including employment by another EU company. Individuals not subject to but wishing to benefit from the Hungarian social security system are allowed to contribute to the system based on a voluntary agreement.

Social security liabilities should be declared to the Tax Authority electronically on a monthly basis by the employer, or in certain circumstances by the individual.

The percentage based health care charge is increased to 27% from 11% and must be taken into consideration when calculating tax advances on income which is part of the

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consolidated income tax base, if no employer's contributions were paid on the income.

There is a 14% health contribution obligation based on the following separately taxed incomes:

- income withdrawn from enterprises
- income from lending securities
- dividends taxed at 25%,
- income from capital gains taxed at 25%
- income from real estate rental (where the rental income exceeds HUF 1 million per annum, 14 % health contribution is payable on the total income, subject to the cap below).

The 14% health contribution payment is capped at HUF 450,000 per annum (including the health insurance contribution paid by the employer plus 27% health care charge on the incomes above).

Non-Hungarian citizen individuals who are regarded as domestic individuals for social security purposes (as well as Hungarian citizens) should pay an HUF 4950 health service contribution, if they are not insured in the Hungarian social security system, or are not entitled to health services based on an International Social Security Agreement or by special regulations of the Social Security Act.

Indirect Taxes

Value Added Tax

The newly codified value added tax (VAT) law entered into force as of 1 January 2008. The totally redrafted and reworded VAT code is amended by provisions, further harmonizing the Hungarian rules with the new EU VAT Directive.

Taxpayers

VAT applies to all natural persons, legal entities and associations of individuals and partnerships, which supply goods or services on a regular basis or in a business-like manner for profit. Foreign entities performing business activities subject to VAT in Hungary are obliged to register for VAT and fulfill their VAT obligations according to Hungarian legislation.

Furthermore, private persons may also become taxable persons and are liable to pay tax upon the sale of certain real estate if this activity is carried out on a routine basis.

Group taxation

Group VAT taxation is a possibility available for all related entities established in Hungary for economic purposes from 2008. The members of a group stop being considered independent taxpayers from a VAT point of view; instead, the group is regarded as a single taxpayer obliged to fulfill its VAT liabilities. All transactions performed within the group are outside the scope of VAT. Group taxation requires advance authorization from the Hungarian Tax Authority.

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Taxable transactions and place of supply

In general, VAT is charged on supplies of goods and services whose place of supply is in Hungary, on intra-Community acquisitions and on importation of goods (for VAT purposes, the territory of Hungary includes customs free and transit zones as well as bonded warehouses). Certain kinds of goods and services are exempt from VAT.

The Hungarian VAT law usually applies the destination principle to cross-border transactions. Therefore, exports of goods and intra-Community supplies of goods are exempt from VAT (with the right to deduct input VAT). Most services when provided to foreign companies are outside the scope of Hungarian VAT with the right to deduct input VAT. In other words, these transactions are not subject to Hungarian VAT. The supplier of such transactions, being a VAT registrant, can nevertheless claim input tax credits to recover the VAT paid on its own business-related purchases.

The exemptions from the destination principle are as follows:

- Supplies connected with immovable property
- Passenger transport
- Cultural, artistic, scientific, educational, sport and similar services
- Restaurant and catering services
- Short-term hire of means of transport.

A temporarily exported good is exempt from VAT if it is returned to the exporter in an unchanged form and if the good is duty-free.

Formerly, the assignment of receivables in case of factoring qualified as a VAT-exempt activity. Currently, the Hungarian legislation qualifies the assignment of receivables for consideration as an activity outside the scope of Hungarian VAT, i.e. it is not deemed to be a supply of services. However, the practical application of this provision sill raises questions.

In the case of acquisition of goods from other Member States and most services acquired abroad, the importer and the recipient of the services must self-assess VAT on the amounts charged to it. Most services must be treated as "imported services" if the supplier has no Hungarian VAT registration or its Hungarian registration does not apply to the transaction.

In the case of hiring means of transportation, the place of supply is to be determined based on the place of effective use and enjoyment.

The VAT legislation defines tax-exempt activities (with no right to deduct input VAT) mainly based on the revised EU VAT Directive, e.g. financial services.

Registration for VAT purposes

Formerly, during 2006–2007 there was no possibility to register for VAT purposes with retroactive effect. Furthermore, the VAT charged before registration for VAT purposes in Hungary was not deductible and not reclaimable.

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As of 1 January 2008, retroactive registration is again allowed. This enables companies to recover input VAT incurred from the commencement of business activities in Hungary (i.e. before the registration procedure but after 1 January 2008).

The duration of the registration procedure is relatively short, as receiving the tax number takes several weeks.

The Hungarian VAT law acknowledges the term import tax agent. If the activity of a foreign taxpayer is limited to the exempt import of goods followed by intra-Community supply, it may appoint an import tax agent. In this way, the foreign taxpayer is able to avoid VAT registration in Hungary. The import tax agent acts in their own name and on behalf of the importer, as long as they are obliged to issue sales invoices, to prove the delivery of goods out of the country and, furthermore, to declare the import and the following intra-Community supply of goods in their own tax returns.

Tax base

The basis of assessment is the sales value of the goods or services. Although, if the sales value is significantly different from the market value, dependent parties have to adjust the VAT base if this impacts non-deductible VAT or the VAT deduction ratio of the seller. Both higher and lower prices might trigger adjustments between dependent parties as of 1 January 2008.

In the case of importation of products, the basis of assessment is the value for customs duty purposes, increased by the amounts of stamp duties and other tax related payment obligations.

Taxpayers are obliged to keep a register for five years to show and control the basis of assessment and the taxes paid.

VAT rates

There are three VAT rates in Hungary:

- 25% - the general rate applied to most products and services as from 1 July 2009
- 18% – the higher reduced rate applied to milk and bakery products, furthermore to hotel and other accommodation services
- 5% – the reduced rate, which is largely restricted to books, daily and other newspapers and some pharmaceuticals.

Reporting obligations

Taxpayers are obliged to file VAT returns on a monthly, quarterly or annual basis depending on turnover levels and on whether they have a Community tax ID.

In connection with intra-Community transactions, administrative obligations, such as Intrastat and EC Sales and Purchase List filings, exist. Taxpayers are obliged to submit Intrastat returns monthly, if the value of their dispatches of goods or arrivals of goods exceeds the annual threshold determined by the Statistical Office. The threshold for both IC supply

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and IC acquisition is HUF 100 million. Taxpayers must submit EC Sales and Purchase Lists monthly or quarterly on intra-Community supply and acquisition of goods and services.

For imported services and intra-Community acquisitions, taxpayers shall report VAT payable. However, taxpayers supplying fully taxable goods or services may deduct the input VAT in the same reporting period, thus resulting in no actual VAT payable on that transaction.

Invoicing

The purchaser may assume the seller's obligation to issue an invoice based on a prior written agreement (self-billing) between the parties. The parties would have joint and several liabilities for the obligations in this case.

It is possible to issue invoices in any foreign language. However, the tax authority may ask for an official translation of an invoice in reasonable circumstances (i.e. when it is required in order to ascertain tax liabilities).

Until the end of 2007, the VAT Law acknowledged the concept of canceling and correcting invoices. As of 1 January 2008, the concept of a document equivalent to an invoice is introduced instead. This document serves the purposes of any kind of invoice modification. The obligatory items to be indicated in terms of format and content are simplified compared to those for ordinary invoices.

Invoices should generally be issued by the date of supply determined by the law, but in any case no later than the 15th day following the date of supply.

If consideration is expressed in foreign currency, not only the daily exchange rate of the Hungarian National bank, but any daily exchange rates for currency sale published by any domestic credit institutions can be applied when converting into Hungarian forint.

Suspension of tax ID

The Tax Authority is entitled to suspend the application of the tax ID under certain circumstances.

Taxpayers are not entitled to deduct input VAT during the time period of the suspension. If the Tax Authority cancels the tax number, the taxpayer will not be able to exercise their right to deduct tax. Should the suspension be ceased retrospectively, deductible tax incurred during the suspension period becomes refundable.

VAT-reclaim for foreign companies

Taxpayers of any EU Member State and from third countries which have concluded bilateral agreements for the avoidance of double taxation on VAT, i.e. Switzerland and Lichtenstein, may obtain a VAT refund under certain circumstances.

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Customs Duties

Exporting to and from Hungary

As a Member of the European Union, Hungary belongs to the Customs Union of the EU.

Customs duties are payable on imported non-community goods from countries or territories not forming part of the customs territory of the EU.

Community goods in free circulation may move across internal EU borders without application of customs formalities and without customs duty payment obligations.

Import procedures

General procedures

All goods must be declared to the Customs Authorities ("Customs") upon import. The clearance procedure can be initiated at the border Customs Office, or non-community goods may be transported to their final destination and may be cleared at the local Customs Office.

The value, classification and origin of the goods and the purpose for which they re being imported will determine whether and how much duty is payable.

Customs Agencies can assist companies to undertake the customs administration accurately and efficiently. Some of these have an indirect customs representative license, which makes it possible to reap certain benefits (such as local clearance procedure, deferred payment, security relief, VAT self-assessment).

The classification and valuation of imported goods is a highly complex area governed by international agreements entered into by the Commission of the EU on behalf of its member states.

Valuation

Although there are six methods of valuation based on WTO rules, they should not be applied indiscriminately, but in strict order. The first and simplest is the transaction method, which is based on the price paid or payable for the goods. Certain costs, such as freight and insurance, must be added to this price. The transaction method cannot be used, for example, where there is no sale, or where the relationship between the parties influences the sale price; in such cases the remaining five methods must be considered in strict order.

Classification

The Hungarian tariff is based on the Community Combined Nomenclature (CN) and on the international Harmonized System (HS) used by many industrialized. This classifies all goods of international commerce so that each article is classified in one place, and one place only, within the tariff. Classification determines the rate of duty applicable to imported goods and whether any special preferential treatment is available.

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Origin

The origin of imported goods and the route they take to the EU have considerable influence on their liability to duty. If they originate in, and are directly consigned from a country which has a preferential agreement with the EU, the duty rate is often reduced significantly or possibly to 0%. The EU has such agreements with other country groupings such as EFTA (European Free Trade Association – now within the European Economic Area), ACP (African, Caribbean and Pacific states), OCT (Overseas Countries and Territories), Mashraq and Maghreb. Suspension of the full rate of duty may be available from specified countries at certain times of the year on particular goods. Similarly, a quota may be in force which allows predetermined quantities of goods of certain tariff headings to be imported at lower than full rates of duty.

Charges at importation

Customs duties are mainly charged on the value of goods, although many agricultural products are also liable to specific duties, assessed according to weight or quantity, under the Common Agricultural Policy of the EU. A few items are subject to compound duties – i.e. a mixture of value-based and specific duties. The rate and type of duty applicable to an item is determined by its classification.

VAT is also charged or self-assessed at importation. Any such VAT paid may be recovered as input tax providing the importer is registered for VAT and the goods are for use in its business activities, which are subject to VAT. Evidence of VAT paid in this way is the VAT statement issued by the Customs authorities direct to the importer of the goods every month, in the case of traders with deferred payment facilities. In other cases, invoices from the customs clearance agent are acceptable.

Anti-dumping duties are levied on specific goods imported from a particular country, or even a particular company, and are designed to protect EU industries from foreign competition which is perceived to be unfair.

Once all import duties have been paid, goods are in free circulation in the EU and may pass to any other EU member state without further payment of customs duty.

Customs duty relief and suspension procedures

A number of reliefs are available in respect of imported goods based on the various circumstances below:

- goods that will not permanently enter the community;
- which have already borne duty in the EU;
- which are imported for a specific non-dutiable purpose such as medical or research use, or for testing.

Four of the most common reliefs are:

- Inward Processing Relief (IPR) – where goods are imported from outside the EU for processing and re-export, duty may be waived at import or refunded at export;

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- Outward Processing Relief (OPR) – where goods are temporarily exported outside the EU for processing, a proportion of the import duty is waived on their return;
- Temporary importation – where goods should be re-exported in the same condition to a third country within a specified period of time;
- General Relief laid down in the 918/83/ECC Council Regulation.

The customs warehousing procedure may allow the storage in a customs warehouse of:

- non-Community goods, without such goods being subject to import duties or commercial policy measures;
- Community goods, where Community legislation governing specific fields provides that their being placed in a customs warehouse shall attract the application of measures normally attaching to the export of such goods.

There is no limit to the length of time goods may remain under the customs warehousing procedure.

In order to take advantage of most customs reliefs, authorization must be obtained in advance from the Customs authorities.

Export procedures

As with imports, goods must be declared to the Customs authority at export. The same form is used, but generally fewer details are required (unless the goods being exported are under Customs control for duty relief purposes).

From a VAT perspective, the export of goods to a destination outside the EU can be zero-rated provided the exporter can produce the necessary evidence of export.

For goods destined for other EU Member States the supply may be exempted for VAT purposes provided the customer's VAT number is quoted on the sales invoice and evidence of movement to outside Hungary is retained. Exemption for VAT purposes does not apply to dispatches of goods to customers in other EU member states which are not registered for VAT. In such circumstances, the supplier may be required to register for VAT in the member state to which the goods are supplied, dependent on the level of sales to that state.

Excise Duties

A new version of excise law was ratified by the Hungarian Parliament in November 2003 and became effective on 1 May 2004. The legislation follows the concepts laid down in relevant EU legislation. This tax falls under the responsibility of the Customs and Finance Authority. Excise goods manufactured within the country and excise goods imported shall be subject to excise duty.

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Excise duty is charged on the following excisable goods:

- mineral oils;
- alcohol and alcoholic beverages;
- beers;
- wines;
- sparkling wines;
- intermediate alcoholic products;
- tobacco products.

The general principles of excise duty require that the tax liability commences at the time of domestic production or importation of excisable goods. Production of excise goods, with some exceptions, includes operations involving production, processing and/or packaging (bottling) using any kind of raw material or product and by any technology for the manufacture of excise goods as the final result.

Goods subject to excise duty shall be produced in a tax warehouse; furthermore producers and traders have to possess the relevant licenses to carry on their activity. Excise goods could be either under a duty suspension arrangement or in free circulation depending on whether or not the excise duty has had to be paid. In general, excise duty is related to quantity or weight rather than value (the latter is partly the case in reference to tobacco products).

Gift and Inheritance Duties

Inheritance duty

Inheritance duty is payable on bequests made in Hungary. In case of a bequest located outside of Hungary, but inherited either by a Hungarian citizen or Hungarian legal entity, the rules are also applicable provided that no similar duty has been levied on the bequest in that country.

The applicable rate of inheritance duty depends on the relationship between the descendent and the heir. In case of a close relationship the applicable rates are 11, 15 and 21% according to a progressive scale depending on the value of the inheritance. In case of real estate used for dwelling purposes, the rates are much lower starting from 2.5% (up to HUF 18 million value) through 6 to 11%. The highest rate of inheritance duty is 40% (in case of inhabited real estate 21%).

From 1 January 2009, every portion of legacy inherited by a child, the spouse or the parent of the testator, and by the grandchild – having lived in the same house, without parents – is exempt from inheritance duty up to HUF 20 million. If the inheritance includes real estate for dwelling purposes or a property right related to apartments, its duty base can be reduced by the above amount.

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There are personal and subject-related exemptions from inheritance and gift duties. For example foundations, churches, public organizations and non-profit corporations are not liable to pay duties. Gifts provided for the purpose of domestic scientific, art and educational purposes also enjoy exemptions.

Transfer of assets without consideration

The transfer of assets without consideration under current rules qualifies as a gift subject to duty. Since 9 July 2009, assets received by a company without consideration and receivables provided to another company free of charge will be exempted from gift duty if they are also not subject to transfer duty in case of their provision for consideration (including the acquisition of real estate and motor vehicles). Forgiveness of receivables and assumption of liabilities are within the scope of this exemption. Thus, based on the rules in 2010, real estate, movable property and the establishment of pecuniary value without consideration are subject to gift duty.

The applicable rates for gift duty are almost the same as the rates of inheritance duty starting from 11 through 18 to 21% in case of close relatives. However lower rates are applicable in case of inhabited real estate (5, 8 or 12%). The highest rate ranges from 21 to 40% in case of non-relatives (for inhabited real estate from 10 to 30%).

Should one entity in the transaction be the 100% owner of the other entity, or should both of the companies be 100% owned by a third company, assets acquired without consideration in the course of this transaction would be subject to a preferential rate of duty. The rate of duty, depending on the value of the asset transferred for free, would not exceed 21% (in contrast with the general rule, based on which the rate may be up to 40%).

There are limited situations which are exempted from gift duty (i.e. free transfer of assets prescribed by a legal provision, gifts provided to a public organization). The exemption from duty liability is to be extended to the free provision of remuneration by an employer to an employee, if the transaction is exempt from personal income tax.

From 1 January 2010 the forgiveness of claims up to HUF 10,000 of credit institutions, investment service providers and financial enterprises, derived from financial or investment services are exempt from gift duty.

Registration Fees and Stamp Duties

There are a number of types of fees and duties that may also apply to business associations. The registration fee at the Court of Registration amounts to HUF 600,000 for public limited liability companies and HUF 100,000 for other legal entities, including private limited companies. Since 1 January 2008, in the case of registration of a branch, the fee is reduced to HUF 50,000 from the former HUF 250,000.

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Property Transfer Tax

Individuals and legal entities are subject to property transfer tax levied on the transfer of Hungarian real estate, motor vehicles or any rights related to such property and also on the acquisition of shares in companies owning domestic real estate. The tax is payable by the transferee and is levied on the market value (including VAT) of the property transferred, at the following rates:

- From 1 January 2010, the general rate of property transfer tax is 4% of the value of the property. For acquisition of real estate or shares in companies holding domestic real estate, the transfer tax rate is 4% up to HUF 1 billion per real estate, and 2% for the market value exceeding this threshold. The property transfer tax is capped at HUF 200 million per item of real estate.
- 2% for apartments and houses for dwelling purposes on the first HUF 4 million of their value and 4% on the remaining value;
- 2% on commercial real estate if the buyer is a property trading company (with specific requirements, which are simplified as of 2009);
- HUF 18 or 24 /cm3 depending on the engine capacity of motor vehicles. From 1 January 2010, the transfer of all motor vehicles registered in Hungary is subject to property transfer tax, without reference to the place of receipt or where the agreement was concluded.

Concerning real estate purchased for token payments or free of charge, the market values defined by common law must be taken into consideration and gift duty must be paid on the difference between the purchase price and 50% of the market price. The remaining value for such transactions will attract transfer tax at the rates applicable for onerous transfers. This provision is effective 23 January 2009.

Although the acquisition of shares in companies owning domestic real estate (Real Estate Company) is subject to property transfer tax from 1 January 2010, no tax should be paid on shares acquired through preferential transactions as defined in the Act on Corporate Income Tax.

Other Taxes

Surcharge for financial institutions

A new contribution by financial institutions replaced the bank tax with effect from 1 January 2007. Under the provisions of the law, financial institutions are subject to a tax of 5% levied on interest or interest-type revenues derived from loans incorporating direct or indirect interest-subsidies regulated by different laws.

Financial institutions must make an advance tax payment each quarter, on the 12th day of each month following the quarter. They are required to settle the difference between the expected annual tax and all accumulated advance payments by the 20th day of the last month of the tax year. The tax must be calculated, declared and paid by the deadline set out

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for preparing annual financial statements, or if there is no obligation to prepare financial statements, the deadline is the 150th day following the end of the tax year.

Property tax

From 1 January 2010, a new tax has been introduced on certain valuable properties, such as watercraft and aircraft registered with the Hungarian authorities, or belonging to resident individuals and organizations, and high-powered passenger cars (run by engines with at least 125 kilowatts of power).

The new law allows deduction for general vehicle tax arising under the vehicle tax act in relation to cars, to preclude double taxation.

Property Tax shall be declared in the Personal Income Tax, Corporate Income Tax or Simplified Entrepreneurial Tax return by the general deadline of these returns.

Taxpayers who are not obliged to file any of the above returns shall declare the Property Tax by 25 February. Tax shall be paid in two equal installments, by the deadline of the declaration and by 30 September.

In case of taxable passenger cars, the tax should be calculated based on the motor vehicle tax rates multiplied according to the relevant provisions of the Act on the Taxation of certain valuable properties. There is a 50% tax allowance for owners having electronic or hybrid vehicles, and to parents owning one car and having three or more children.

Surtax on energy suppliers and traders – Robin Hood Tax

The business entities engaged in energy supplying activity and those foreign entrepreneurs who are carrying out this business activity through a permanent establishment in Hungary are subject to the so called Robin Hood tax effective 1 January 2009. Entities carrying out the following activities qualify as energy suppliers, and are thus subject to tax:

- mining entrepreneurs extracting carbon-hydrogen
- authorized producers and wholesalers of petroleum products
- authorized natural gas traders
- authorized electricity traders
- authorized electricity producers with a power plant capacity of over 50 MW.

The basis of the surtax on energy suppliers and traders is the profit before tax determined under the Act on Accounting amended by some items arising from free of charge transactions, and international treaties and directives, which means it basically corresponds to the basis of the surtax for corporate entities. The tax rate is 8% of the positive tax base, to be assessed, declared and paid simultaneously with the corporate income tax. Ninety percent of the expected tax must be declared and paid by the 20th of the last month of the tax year, but this obligation does not apply to those taxpayers whose revenues did not exceed HUF 50 million in their previous tax year.

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Motor Vehicle Tax

The operators of road vehicles (cars, trucks, etc.) are subject to a differential annual tax payment. In case of passenger vehicles, the motor vehicle tax liability is calculated on the basis of the age and the power (in kW) of the motor vehicle, and in case of buses and trucks the tax liability is calculated on the basis of the weight of the vehicle. In case of passenger vehicles, the tax is HUF 345 per kW in the year of production and the subsequent three years, continuously decreasing to a minimum of HUF 140 per kW applicable to at least 17-year old vehicles. For buses and trucks with air suspension, the tax is HUF 1200 for every 100 kilograms, while for other trucks and buses the tax is HUF 1380 per 100 kilograms.

Organizations financed by the state budget, social organizations and foundations are exempted from motor vehicle tax. Furthermore the operators of buses are also exempted from the tax provided that 75% of their net income from the previous financial year arose from public transport. From 1 July 2009, passenger cars run exclusively by an electric engine are exempted.

Company Car Tax

From 1 February 2009, company car tax relating to cars partly used for private purposes has been dealt with in the Act on Vehicle Tax, rather than in the Act on Personal Income Tax. The company car tax should be paid for all cars (irrespective of whether they are used for private purposes), which are either not personal property or are personal property where business costs have been claimed on them.

The car tax should be paid by the person who is indicated as the owner of the car in the car register. In case of finance leasing, the lessee should pay the car tax. If the car is not registered (e.g. foreign cars) the user of the car must pay the car tax.

The monthly tax rate is HUF 7,000 for cars having an engine capacity up to 1600 cm^3 or capacity of rotary-piston engines up to 1200 cm^3, and HUF 15,000 for cars whose engine capacities exceed that limit. To avoid double taxation, the Act gives the possibility to deduct vehicle tax from this company car tax in each quarter where both tax liabilities arise. Company car tax must be self-assessed and paid to the Hungarian Tax Authority quarterly, by the 20th of every month following the quarter.

Local Taxes

There are a number of local taxes that may be imposed at the discretion of various local authorities. Although the local authorities may decide on the introduction and on the rate of local taxes, from 1 January 2010 the Hungarian Tax Authority has become responsible for the administration of local taxes.

Local Business Tax

Enterprises pay local business tax on all business performed on a permanent or temporary basis in municipal areas. The basis of this tax is the enterprise's gross sales

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revenue less cost of goods acquired for resale, material costs and the value of mediated services and subcontractors' fees (both terms defined somewhat narrowly). From 1 January 2010, the direct costs of R&D are also fully deductible.

Part of the tax base (up to 100%) is exempt from local business tax if it results from an activity carried out abroad. Until 2010, this exemption could be used only if local tax was imposed by a local authority abroad, but as of 1 January 2010 the tax base attributed to the foreign permanent establishment can be exempted without limitation.

The maximum rate of tax is 2% of the tax base, which can be lower depending on the particular municipal area where the company is undertaking its business. Service providers get very limited relief and are required to compute their local tax based almost on gross revenues. Financial income (e.g. interest) and certain royalty revenue have been excluded from the local business tax base since 1 January 2006.

As the national law provides no minimum levy, it is up to each municipality to determine whether it will impose this tax and, if so, the rate it will charge. There still exist some municipalities that do not charge this tax at all.

If the taxpayer hires new employees, it is possible to obtain a local business tax base decrease of HUF 1 million for each new individual (provided that the employees are taken over from unrelated parties). However, if the number of the employees decreases by more than 5%, the tax benefit should be repaid.

Property Taxes

A property tax can be imposed in each year. For buildings, the tax is based on square meters (maximum HUF 1,241 per m^2 per year) or on the market value of the building (maximum 3%). Similarly for land, the tax is based on square meters (maximum HUF 276 per m^2 per year), or on the market value of the land (maximum 3%).

Community Tax

This tax is based on the number of employees, and may be imposed at a maximum rate of HUF 2,758 per employee per year.

Contribution to the Rehabilitation Fund

This fund provides assistance to disabled employees. Disabled people should comprise a minimum 5% of an employer's headcount. Any employer not meeting this criterion is obliged to pay a contribution of HUF 964 500/disabled person not employed per annum (for 2010). The contribution is not levied if the total number of employees does not exceed 20.

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Contribution to the Vocational Training Fund

Employers are required to contribute to this fund, which supports various vocational schools in Hungary. The contribution is at a rate of 1.5% of the total annual base of social security contributions.

Environmental Protection Charge

This single-stage tax is imposed on persons putting a taxable product defined in the Act on Environmental Product Charge into circulation or utilizing it for own purposes in Hungary for the first time. Taxable products are those which could prove to be harmful to the environment or turn into waste.

These products include:

- certain oil products
- rubber tires
- wrapping materials (special rules to commercial packaging such as PET containers)
- batteries
- commercial printed paper
- electric and electronic equipment.

The amount of levy is specifically set out for each type of product and is computed as an amount per kilogram of product. Until 2010, in case of commercial packaging, the charge was calculated per piece, but since 1 January 2010, the charge on commercial packaging is also calculated on a kilogram-base. Companies can apply for a specific Environmental Protection Charge exemption if they comply with the formal and substantial conditions and strict deadlines.

From 1 January 2008, this tax falls under the responsibility of the Customs Authority, and taxpayers should be registered with the Customs Authority.

Environmental Pollution Charge

Any person emitting pollutants into the environment (air, water, soil) is liable to the environmental pollution charge. The basis for this charge is the total amount of the pollutant emitted annually, expressed in its relevant unit of measurement. The size of the pollution charge is determined by the unit charge of the pollutant. As of 2008, for air pollution and water pollution the emitter must pay 100% of the fee actually payable according to the law. For the soil charge, the payable quota is 100% from 2009.

Each charge is paid quarterly in the form of a tax advance; the difference between the actual pollution emission charge and the tax advances paid should be settled not later than 31 March of the following year. In certain instances exemptions or allowances may be available to those that fulfill certain conditions.

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Innovation Contribution

The innovation contribution is payable by every entity subject to the Accounting Law, with the exception of micro- and small enterprises. The base of the contribution is the same as for local business tax. The applicable tax rate is 0.3%.

The annual amount of the innovation contribution payable can be reduced by the cost of R &D activity carried out by the taxpayer itself (state subsidies received for this purpose are excluded) or provided by entities prescribed in special law (i.e. foundations).

The tax return is to be filed by the last day of the fifth month following the relevant year. Quarterly advance payments are due by the 20th day of the month following the quarter.

Energy Tax

The energy tax is payable based on megawatts for electricity, on gigajoules for natural gas and on thousands of kilograms for coal. The rate of energy tax is defined as HUF 295/MWh for electricity, HUF 88,50/GJ for natural gas, and HUF 2,390/thousand kilograms for coal. This tax is related to national and administrative institutions and energy-intensive producer sectors. Tax must be paid by:

- energy traders selling energy to eligible consumers
- eligible consumers purchasing energy directly from a producer or in an organized market
- eligible consumers purchasing energy directly from another EU member state
- eligible consumers purchasing energy directly from a third country
- legal entities, non-legal entities, individuals performing business activities, who produce energy for their own use (with some exceptions)
- energy traders utilizing energy for their own purpose
- eligible consumers purchasing previously non-taxed energy,
- eligible consumers in case of coal purchasing where the eligible consumers submitted false declaration to the energy traders.

The tax liability arises on the day of performance as defined by the VAT law or on the last day of the period for tax return or on the day of private utilization respectively. The monthly tax return is to be filed by the 20th day of the following month.

This tax falls under the responsibility of the Customs Authority.

Registration Tax

Registration tax payment liability arises on the sale of cars and motorcycles, through which cars are put into circulation in Hungary. The tax is borne by the seller, importer, and the party acquiring the vehicle from another member state or the one transforming the vehicle. The amount of tax varies between HUF 250,000 and 9,622,000 depending on the engine capacity and the environmental classification and does not form part of the VAT base. Motor vehicles purchased from EU States are taxed more beneficially from 1 January 2006.

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Simplified Tax and Contributions ('EKHO')

With the introduction of a new type of tax ('EKHO') from 1 January 2006, private persons working in the field of culture, media or arts and their contracting payers can fulfill tax and contribution obligations in a simplified procedure.

The precondition of the possibility of opting for EKHO is that in connection with the private person's activity, personal income tax and social security contributions must have already been paid according to the general rules in virtue of at least one legal relationship.

EKHO is paid jointly by the individual and the payer. The rate is 15% for the private person and 20% for the payer. EKHO can be chosen by individuals earning income of up to HUF 25 million per annum.

From 1 January 2008, private persons receiving their income via invoicing, can take over the assessment, reporting and payment of EKHO instead of the income payer.

Simplified Entrepreneurial Tax (EVA)

Since 1 January 2003, an optional simplified entrepreneurial tax regime (*egyszerűsített vállalkozói adó,* i.e. 'EVA') has been available to entrepreneurs, general and limited partnerships, limited liability companies, cooperatives and certain other business forms, and as of 1 January 2010 also to individual companies, under certain conditions. This regime replaces entrepreneurial/corporate income tax, dividend withholding tax, VAT and company car tax.

This regime is available if certain conditions are met. The most important requirements for choosing EVA are that (i) the taxpayer's annual turnover, increased by VAT, should not exceed HUF 25 million in the two years preceding the tax year in question; (ii) the taxpayer does not carry on any business activity subject to special regulations, e.g. activities subject to excise duty regulations; (iii) the taxpayer has a Hungarian bank account. The taxpayer cannot apply the EVA regime's rules when its annual turnover, increased by VAT, exceeds HUF 25 million following the day when it goes beyond the threshold.

Taxpayers may only opt for the EVA regime if (i) their members are exclusively individuals, and (ii) they do not have a participation in another company (publicly-traded shares and participating bonds in a cooperative-credit institution may be held).

The basis of tax is the taxpayer's turnover, increased by VAT, and adjusted in respect of certain items as specified by law (e.g. increased by the amount of income received from affiliates). As of 1 January 2010, the 25% flat rate tax has been increased to 30%. If the taxpayer's turnover exceeds HUF 25 million, 50% tax should be applied on the amount exceeding HUF 25 million.

A taxpayer opting for the regime for a tax year must inform the tax authorities by 20 December of the preceding year (the annual obligation). The tax year for the regime is the calendar year. Annual tax returns for a tax year must generally be filed by (i) 25 February

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of the following year for taxpayers that are not subject to the Accounting Law, and (ii) 31 May for taxpayers that are subject to the Accounting Law.

The tax is self-assessed and must be paid upon the filing of the return. Advance tax payments must be made quarterly for the first three quarters by the 12th day of the month following each quarter.

A taxpayer applying the regime is not regarded as a taxable person for VAT purposes, and is thus not entitled to deduct input VAT. However, in spite of the fact that the taxpayer is not required to pay VAT, it is obliged to reflect the amount of VAT (calculated from the gross amount) in its invoices issued. This VAT remains deductible for the customer. From 1 January 2010, taxpayers applying the EVA regime should be considered as taxable persons for VAT purposes, when determining the place of performance of services.

Taxpayers applying the simplified entrepreneurial tax must pay vocational training contributions at 1.5% of twice the minimum monthly wage per employee.

Offshore companies

The Hungarian offshore regime was abolished from 1 January 2006. Hungarian offshore companies ("HOCs") lost their offshore status as of 31 December 2005, at the latest, but were permitted to operate as normal Hungarian entities. This means that the profits of former HOCs are taxed at the general CIT rate (currently 19%) and they do not enjoy local business tax exemption solely by virtue of their status.

Nevertheless, HOCs can retain their foreign currency accounting status even after 31 December 2005 and the following rules can still significantly lower the tax burden of former offshore companies if they continue their current main activities (intra-group financing, receiving royalties).

- Under certain circumstances, taxpayers can exempt 50% of royalty for corporate tax purposes (i.e. an approximately 9.5% effective tax rate might be achieved).
- Unrealized gains or losses arising from foreign exchange fluctuations on long term investments or liabilities can be deferred.
- Interest and royalty income is exempted from local business tax. No Hungarian withholding tax is levied on dividend payments from Hungary to corporates in any other country anywhere.
- Since 1 January 2010, 30% withholding tax is to be withheld on certain Hungarian source income (interest, royalties and some types of service fees) of foreign corporations resident for tax purposes in states with which Hungary does not have an operative double tax treaty.

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Chapter 7

Property Investments by Foreign Investors

Introduction

Interest in property investment in Hungary continues to be high. The main tax issues involved with the acquisition and use of property are described below.

Possible Forms of Investment

1. Use of a Hungarian subsidiary of a foreign company.
2. Use of a Hungarian branch office of a foreign company. The Branch Offices Act, effective from 1 January 1998, is interpreted such that foreign-registered enterprises can only do business in Hungary via branch offices. This requirement also refers to foreign entities' direct property investments in Hungary.
3. Direct investment by foreign individuals.

Acquiring Property

Real estate

General Overview

Until 1989, the fundamental concept of real estate ownership in Hungary was that all land belonged to the state — apart from a relatively small proportion of privately-owned property and land owned by local co-operatives — and companies could only obtain a right to use land.

In the 1990s, the interest of foreign investors and the number of foreign-owned property investment companies both increased rapidly, particularly in Budapest and in certain cities in the Western part of Hungary. There have been significant investments in modern office, retail and industrial premises, plus numerous residential developments.

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Acquisition of Real Estate by a Business Venture

Business ventures can acquire real estate in two ways:

- if it is provided by an investor as a contribution in-kind;
- if it is purchased by a business venture.

Properties in Hungary are registered in the land register, which is open to the public, and anyone can access the registered data and pay for an official extract from the records.

Companies which own properties in Hungary are generally allowed unrestricted use of their property and may sell it, utilise it (e.g. rent out) or take out loans secured on it (e.g. to mortgage it), or sell rights associated with it.

Acquisition of Real Estate by Non-Residents

According to the Act on Acquisition of Real Estate by Foreigners, foreign individuals and legal entities may acquire Hungarian real estate (excluding arable land) provided they obtain a permit granted by the local director of the regional public administration office (certain exemptions apply for EU nationals). No permit is needed if the acquisition occurs through succession.

A permit may be issued if the acquisition does not infringe any local or public interests. The director shall request a statement by the mayor of the local council in respect of this. If the permit is denied, the decision can be appealed in court.

Long Term Rental

Non-residents are allowed to rent apartments or houses in Hungary. During the rental period, the tenant has exclusive use of the property and is considered a "quasi-owner".

Restrictions on Acquisition of Certain Land

No foreign party, whether a private individual or company, may acquire title or any other right to Hungarian arable land. This same restriction applies to acquisitions by Hungarian undertakings (including subsidiary companies of foreign investors).

Following accession to the EU (1 May 2004), Act LV of 1994 on Arable Land makes acquisition of arable land possible for EU citizens who plan to settle down in Hungary as an independent agricultural manufacturer entrepreneur and have been legally resident and pursuing agricultural activity in Hungary for at least three years. The acquisition of arable land by a foreign natural person may only be exercised in accordance with the rules stipulated for an acquisition of arable land by domestic natural persons, i.e. ownership may not exceed 300 hectares or the value of 6000 gold crowns ("aranykorona").

Foreign legal or natural persons may only acquire title to property not classified as arable land (henceforth "property") with an acquisition permit, unless the property is inherited, or the foreign person is an EU resident. Permits are issued by the head of the relevant county administration. However, land acquisitions carried out by certain foreign legal entities are not subject to such a permit if the acquisition is carried out on behalf of their Hungarian branch.

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As of 1 May 2004, a citizen of a member state of the EU and for legal entities registered in an EU member state, in a member state of the treaty on the European Economic Area, or any other country, which shall be similarly classified on the basis of an international treaty, may acquire property under the same conditions as domestic persons (no permit is required). This does not apply to acquisition of a secondary place of residence, which will be subject to the necessary permit for an additional five years. (Should the EU citizen be legally resident for a continuous period of four years, no permit is needed for the acquisition of a secondary place of residence).

Transfer Tax Issues Involved with Acquisition

Those acquiring property are required to pay a property transfer tax of 4% of the first HUF 1 billion of the commercial value of the property, and 2% thereafter, but no more than HUF 200 million per property. This duty is reduced to 2% for enterprises whose main core activity is either trading in real estate, and 50% of income is achieved in the last tax year from such activity (the general rule is that such property must be sold by the enterprise within two years of acquisition, but for the time being four years are allowed), or the enterprise conducts licensed financial leasing activity; for a residential property transfer tax is 2% for the first HUF 4 million of commercial value, and 4% thereafter.

For further details on taxation of real estate please refer to Chapter 6.

Foreign Exchange Regulations

Since June 2001, there have been no foreign exchange restrictions on the Hungarian forint (HUF). Property acquisitions may now be paid for in any currency.

Rules on Existing Properties (Sale or Use of Properties)

Tax Regulations

VAT

Investors must register for VAT in Hungary when selling or renting/leasing a property. Private persons may also become taxable persons and are liable to pay VAT upon the sale of certain real estate if this activity is carried out on a routine basis.

The general rule is that the sale and renting out of real estate is exempt from VAT. This also means that the input VAT incurred in connection with properties cannot be deducted. There are, however, exceptions from the main rule as follows:

- the sale of new real estate is taxable; real estate qualifies as a new property if sold before completion or within two years after putting into use;
- taxpayers may opt for VAT-able status at the beginning of a tax year regarding property transactions, enabling them to deduct the input VAT based on the general rules

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Where the transaction is subject to VAT, VAT is payable at the general rate of 25% on the use (sale or rental) of the properties.

Other taxes may be charged on property (building tax, land tax, local business tax and community tax); please refer to Chapter 6.

Income Taxes and Dividend Tax

Rules governing taxation of income from the use or sale of property in Hungary are outlined below. However, where an effective double tax treaty exists, the terms of that treaty would override Hungarian tax provisions in any cases where the two contradict.

Foreign Individuals

Foreign individuals are taxed at 25% on income from the sale of property in Hungary. Documented costs of acquiring and developing a property allowed by Hungarian law may be deducted from sales proceeds. In the case of residential property, the period for which capital gains are now subject to tax is five years, thus, income deriving from the sale of residential property purchased more than five years before is not taxable. In case of other real estate, the period for exemption is fifteen years.

Hungarian Subsidiaries of Foreign Companies

Subsidiaries are liable to 19% corporation tax under general rules as described in Chapter 6. The tax base is the profit before tax calculated using the rules of the Act on Accounting adjusted for specific items under the Act on Corporation Tax.

Capital gains derived from alienation of real estate are taxed as ordinary business income.

Income for investors selling property is the sales price of a property. An accounting balance recorded as the value of a tangible asset may be included in the cost of sales figure. If a vendor and a buyer of a property are related parties, particular care must be taken to set a price at arm's length

If selling price exceeds book value, the difference is defined as profit and is subject to 19% corporate income tax. Income calculations are based on nominal, historical forint figures; there are no rules for relief for inflationary gain.

A buyer must register the property at a competent Land Registry Office and depreciation is tax-deductible each year regarding corporate income tax (19%). For tax purposes, the maximum tax-deductible depreciation on industrial buildings and long-use buildings is 2%, while rental properties can be depreciated at a preferential rate of 5%. When calculating book depreciation, it is important to ensure that it corresponds to an anticipated useful life and residual value of a property and to the company's accounting policy.

Dividend withholding tax was abolished with effect from 1 January 2006.
From 2010, withholding tax of 30% has been introduced for payments to certain foreign corporations of income connected to interest, royalties and certain service fees such as

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activities of head offices, management consultancy activity, market research and public opinion pooling, business agency activity or other professional, scientific and technical activities.

Domestic or foreign participations of over 30% acquired from 1 January 2007 would be considered as an "announced participation", where this is reported to the Tax Authority within 30 days following the acquisition. Any loss on write off, foreign exchange or loss suffered during cancellation from the books (except during transformations) is not tax deductible. The holding period to receive exemption from corporate tax on capital gains for an announced participation was reduced from two years to one year as of 1 January 2008; the capital gain on such participations held for at least one year is exempted from corporate taxation.

Branch Offices of Foreign Enterprises

The impact of the general rules on taxation of Hungarian branch offices mean they are treated identically to Hungarian-registered companies unless otherwise stipulated in an act of law or by a government decree issued pursuant to such a law. One such stipulation is a restriction on property acquisition mentioned above.

Thus, branch offices are treated like domestic companies for corporation tax purposes. Business performed in branch offices is taxed in the same way as that performed by legal entities. However where a double tax treaty applies, it may be possible to apply different principles to determination of a branch's tax base.

Foreign-registered enterprises which have set up a branch office, as defined in the Act on Corporation Tax, may only withdraw branch office profits in the form of a dividend. As of 1 January 2006 there is no withholding tax on dividends.

Certain business activities can only be carried out through a branch or a subsidiary, and since income related to real estate is deemed to create a permanent establishment, registration of a branch is obligatory.

Transfers of Ownership of Property Holding Companies

From 1 January 2010 there are specific rules regarding the taxation aspects of the sale and purchase of companies that hold real estate properties.

The acquisition of a holding company is subject to 4% property transfer tax for the first HUF 1 billion of commercial value of the property concerned, and 2% thereafter, but no more than HUF 200 million per property, provided that the purchase results in acquisition of at least 75% of the shares.

Furthermore, the sale of a share in a holding company is subject to 19% corporation tax. The basis for the tax is the commercial value of the property decreased by the purchase price paid and other justifiable costs. Foreign individuals are liable to 25% Hungarian personal income tax on gains from selling their holding. In both cases, the tax could be reduced or eliminated by an applicable double tax treaty.

Hungarian companies or branch offices selling property must include in their books the selling price of an investment as income, reduced by the book value of the investment.

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Appendix A

Income Tax Treaties and Withholding Tax Rates

Income	Dividends (%)	Minimum Holding (%)	Interest (%)	Royalties (%)
Non-treaty Rates *	**0**	**-**	**30**	**30**
Country:			**0**	**0**
Albania	5/10	25	**0**	**5**
Australia	15	-	**10**	**10**
Austria (EU) **	10	-	**0**	**0**
Azerbaijan	8	-	**8**	**8**
Belgium (EU)	10	-	**15**	**0**
Belarus	5/15	25	**5**	**5**
Brazil	15	-	**10, 15**	**15, 25**
Bosnia-Herzegovina***	10	-	**0**	**10**
Bulgaria (EU)	10	-	**10**	**10**
Canada	5/10/15	25	**10**	**10**
China	10	-	**10**	**10**
Croatia	5/10	25	**0**	**0**
Cyprus (EU)	5/15	25	**10**	**0**
Czech Rep. (EU)	5/15	25	**0**	**10**
Denmark (EU)	5/15	25	**0**	**0**
Egypt	15/20	25	**15**	**15**
Estonia (EU)	5/15	25	**10**	**5, 10**
Finland (EU)	5/15	25	**0**	**5**

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Income	Dividends (%)	Minimum Holding	Interest (%)	Royalties (%)
France (EU)	5/15	25	**0**	**0**
Germany (EU)	5/15	25	**0**	**0**
Greece (EU)	10	-	**10**	**10**
India	10	-	**10**	**10**
Indonesia	15	-	**15**	**15**
Ireland (EU)	5/15	10	**0**	**0**
Israel	5/15	10	**0**	**0**
Italy (EU)	10	-	**0**	**0**
Iceland	5/10	25	**0**	**10**
Japan	10	-	**10**	**10**
Kazakhstan	5/15	25	**10**	**10**
Korea	5/10	25	**0**	**0**
Kuwait	0	-	**0**	**10**
Latvia (EU)	5/10	25	**10**	**5, 10**
Lithuania (EU)	5/15	25	**10**	**5, 10**
Luxembourg (EU)	5/15	25	**0**	**0**
Macedonia	5/15	25	**0**	**0**
Malaysia	10	-	**15**	**15**
Malta (EU)	5/15	25	**10**	**10**
Moldova	5/15	25	**10**	**0**
Mongolia	5/15	25	**10**	**5**
Montenegro****	5/15	25	**10**	**10**
Morocco	12	-	**10**	**10**
Netherlands (EU)	5/15	25	**0**	**0**
Norway	10	-	**0**	**0**
Pakistan	15/20	25	**15**	**15**
Philippines	15/20	25	**15**	**15**
Poland (EU)	10	**-**	**10**	**10**
Portugal (EU)		15-	**10**	**10**

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Income	Dividends (%)	Minimum Holding	Interest (%)	Royalties (%)
Romania (EU)	5/15	40	**15**	**10**
Russia	10	-	**0**	**0**
Serbia *****	5/15	25	**10**	**10**
Singapore	5/10	25	**5**	**5**
Slovakia (EU)	5/15	25	**0**	**10**
Slovenia (EU)	5/15	25	**5**	**5**
South Africa	5/15	25	**0**	**0**
Spain (EU)	5/15	25	**0**	**0**
Sweden (EU)	5/15	25	**0**	**0**
Switzerland	10	-	**10**	**0**
Thailand	15/20	25	**10,25**	**15**
Tunisia	10/12	25	**12**	**12**
Turkey	10/15	25	**10**	**10**
UK (EU)	5/15	25	**0**	**0**
Uruguay	15	-	**15**	**10, 15**
Uzbekistan	10	-	**10**	**10**
US	5/15	10	**0**	**0**
Ukraine	5/15	25	**10**	**5**
Vietnam	10	-	**10**	**10**

* In Hungary tax on dividends is eliminated as of 1 January 2006. From 2010, withholding tax of 30 % has to be paid by the foreign corporation on interest, royalties and certain service fees. (For further information please see Chapter 6.)

** (EU): EU Parent-Subsidiary Directive enacted legislation may bring the rate to 0% provided certain ownership conditions are met.

*** Based on double taxation treaties concluded with former Yugoslavia (1985).

**** Montenegro has declared that it will honour all tax treaties that applied with respect to Serbia Montenegro.

***** Based on double taxation treaties concluded with former Serbia and Montenegro (2001).

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Appendix B

Treaties Concluded by Hungary in Order to Avoid Double Taxation on VAT

- All EU member states
- Liechtenstein
- Switzerland

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