



# Investment in Hungary

KPMG IN HUNGARY

AUDIT ■ TAX ■ ADVISORY

# Preface

Investment in Hungary is one of a series of booklets published by KPMG 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 eleventh edition is correct and accurate as of 1 January 2009.

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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 Fertő 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 accord 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. This population is expected to decline as a result of the 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.

## Infrastructure

The transportation infrastructure is currently undergoing major reconstruction. In government-supported projects additional highways are being built, while the widely used, state-owned domestic railway system is also under reconstruction.

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, a subway system and railways.

Budapest Airport (BA) served a total of 8 443 053 passengers in 2008, 1.8 percent less than in the previous year. 505 594 passengers used Ferihegy in December of last year, 9.9 percent less than in 2007. The number of passengers travelling with traditional airlines was 5 765 261 in 2008, which is nearly the same as in 2007. Low cost carriers transported 2 071 880 passengers, 133 771 or 6% less than the year before.

The electronic communication sector is undergoing further rapid changes. While traditional voice market is shrinking, fixed and mobile broadband services markets are growing dynamically. Users look 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 consider launching large scale optical network deployment projects. Preparations for the conversion from analogue to digital television have been started, multiplex service provider has been selected. The conversion will make new frequency ranges available for telecommunication purposes which gives further boost to market development. Bidding process for the fourth mobile services provider license has been launched in November.

## 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 71,500 per month, approximately EUR 250 per month.

## **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). Two further minor parties, the conservative Hungarian Democrats (MDF) and the liberal Alliance of Free Democrats (SZDSZ) are also active players in the political arena.

The Socialist party (MSZP) won the 2006 general elections and together with the liberal SZDSZ formed a coalition government. In April 2008, the Free Democrats left the coalition and the Socialists formed a minority government. Socialist party president Gyurcsány Ferenc is serving as Prime Minister.

## **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 the GATT (General Agreement on Tariffs and Trade), 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 the 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.

## The Economy

### GKI forecast for 2009

	2007	2008	2009
	actual		forecast
GDP production	101,1	100,5	95,5
Agriculture (1)	77,4	143,0	90
Industry (2)	106,4	99,7	93
Construction (3)	92,3	94,9	95
Trade (4)	103,4	97,9	96
Transport and telecommunications (5)	105,6	100,1	96
Financial services (6)	102,0	97,7	93
Public administration, education, health care (7)	96,6	100,7	99,5
Other services (8)	100,6	97,7	99,5
Core growth (2)+ (3)+ (4)+ (5)+ (6)	103,5	98,5	94
GDP domestic absorption	99,0	99,9	95
Individual consumption	98,2	99,9	96
Fixed asset accumulation (investment)	101,5	97,4	95
Export	115,6	104,6	91
Import	111,5	104,0	90
Consumer price index (preceding year = 100)	108,0	106,1	103,5
Combined balance of the current account and capital account			
billions of euros	-5,4	-5,7*	-2
as a percentage of GDP	-5,3	-5,4*	-2,2
Unemployment rate (annual average)	7,4	7,9	8,7
General government deficit, percentage of GDP (ESA)	5,0	3,1	3

Source: Central Statistical Office, GKI

\*Estimate

Hungary has seen successful transformation from a centrally planned economy to a fast-growing and robust market economy in the past 20 years.

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 percent of the GDP today.

Between 1997–2006, Hungary made significant progress in achieving sustained economic growth – the growth rate was around four percent in each year in that period. Inflation has declined continuously – from about 30 percent in the mid-90s, the inflation rate is expected to be around 2.5 percent in 2009.

In 2007, the economy lost momentum, Hungary achieved GDP growth of only 1.1 percent, and 0.7 percent (projected) in 2008.

In 2009, the output of the Hungarian economy is expected to shrink by 2 to 3%, and investments likely to decline approximately to the level of 2004, primarily due to the recession as well as the shortage and high cost of credit. Analysts agree that the depth and duration of the global recession is unpredictable. Nevertheless, there is hope that later in the year, the situation will start improving with bank financing returning and the M&A market recovering.

To help its clients amidst the circumstances of the global economic slowdown, KPMG has launched several tools, with focusing on financial restructuring, cost and liquidity management, business process improvement, tax efficiency and accounting advisory, among others.

## Chapter 2

# Foreign Investment in Hungary

The Hungarian Act on Foreign Investment specifies that investments by non-residents enjoy full legal protection and security. Additional protection for foreign investors is guaranteed by bilateral treaties in force.

### **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 organisational 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.

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.

## 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<sup>st</sup> of 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, organised 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, organisation, 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. 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 immovable property; (e) be a member of another European Economic Interest Grouping.

Only the followings 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, organised 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.

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 authorised 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.

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 authorisation (license);
- the pre-company shall not establish a business association, nor shall it join one as a member.

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 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.

## 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, however, 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 fulfil tasks of another nature if those do not risk proper fulfilment 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.

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 realised;
- 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.

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 reorganisations 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 honour payment obligations and can no longer be traced.

## 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 stake of each members;
- 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.

## 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 followings 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.

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.

## 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 of the company;
- 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.

## 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.

## 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 authorise the board of directors to increase the share capital up to a defined maximum limit, unless otherwise provided by the Deed of Foundation. Such authorisation 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, 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 be withdrawn first.

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.

## 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 public company limited by shares the Hungarian law specifies further obligations to comply with if somebody acquires interests.

## 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 Labour 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 one year but may be extended.

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 not 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.

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

Beyond the above, no work permit is required in the following cases: the spouse of a Hungarian citizen living in Hungary does not need a work permit, 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 Labour Code (Act XXII of 1992), which is broadly similar to the employment laws in other European Union countries.

The Labour Code provides a basis for organised labour 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 Labour Code (especially in terms of working time and work scheduling). The Labour 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 Labour 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 has to take a written form – can only be deemed such, if it includes the mandatory minimum contents:

- 1) The basic salary, the place of work and the position (title) has to be stated in the employment contract. The scope of work to be performed has to be specified by the employer, which obligation is usually discharged by issuing a written job description. The employer also has to 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.),
- 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 has to be paid to employees when they are employed full time (40 hours per week). As of 1 January 2009 the minimum monthly salary is HUF 71,500; 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 411).

## **Taxation**

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

## 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 and its predecessor, the 1991 Act, draw 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 organisations 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

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 profit and loss account. 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 to have 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 centres). 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 forint. Under limited circumstances, companies with a functional currency other than forint may keep their books and present their financial statements in their functional currency or Euro. To be able to use the company's functional currency or Euro instead of forint in financial statements for periods beginning on or after 1 January, 2009, more than 50% of the total of the absolute amounts of the financial assets and financial liabilities as at the balance sheet date, and more than 50% of the total of the absolute amounts of the income and expense items for the year, must be denominated in the functional currency (from 2010 only 25%) in the previous and in the current year. Additionally, so called 'off-shore companies' are permitted to use another currency set out in their Deed of Association.
- Since 1 January 2004, single-entry bookkeeping is allowed only for a limited group of not-for-profit organisations.
- There is a standard chart of accounts comprising nine prescribed classes of accounts and a memorandum class (Class 0):
  - 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, but 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.)
- Financial transactions should only be recorded in the books if they can be verified. In practice this means that bookkeepers expect to receive authorised 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.

## 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 authorised representatives. The form of report required is determined by the size of the organisation 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.

So called 'pre-companies' (a company whose deed of association has been signed but which has not yet been registered by the Court of Registration) usually must prepare and publish a separate financial report covering the period from their date of formation until incorporation (in which case, the date of incorporation becomes the period end date). A new company does not need to prepare separate financial reports covering 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, a profit and loss account and a supplement (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 profit and loss account 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 profit and loss account must be based on, and supported by, bookkeeping 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 profit and loss account 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 Supplement includes 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.

## 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; or
- the yearly average number of employees does not exceed 50.

A Simplified Annual Report consists of a balance sheet and a profit and loss account simplified to show only certain headings and a simplified Supplement (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, fair value measurements. Additionally, they are not required to attach a Supplement to the balance sheet and profit or loss account. 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 assets at year-end do not exceed HUF 500 million;
- annual net sales do not exceed HUF 1 billion; or
- the yearly average number of employees does not exceed 50.

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.

The consolidated annual report consists of a consolidated balance sheet, profit and loss account and supplement. 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 unrealised foreign exchange gains and losses deriving from the year-end valuations are netted. The net foreign exchange gain or loss is generally recognised in the profit and loss account.

There are special rules for unrealised 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 unrealised loss can be deferred and amortised to the profit and loss account in annual instalments over the repayment period of the loan. On partial or full repayment of the loan previously deferred unrealised losses corresponding to repayment amounts become realised and must be charged to the profit and loss account immediately. Any unrealised 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)

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, capitalised 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 recognised 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 recognised in the profit and loss account 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 profit and loss account as extraordinary 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 amortised 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. "Permanent" means in evidence for at least one year. If the market value has been significantly less than the book value for at least one year, 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 capitalised. 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 reorganisation expenses are permitted, but not required, to be capitalised and written off over a period of up to five years. Recognition criteria for capitalisation of development costs are less restrictive than under IFRSs.

Goodwill might not be recognised under certain types of business reorganisations.

## Inventory

Inventory is valued at the lower of cost or realisable 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.

## Securities

Long-term securities (held for investment or trading purposes) should be valued at cost unless the market value has decreased significantly below cost for at least one year at the date of

preparation of the balance sheet. 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 claimed, not when receivable.

### Capital

A special non-distributable reserve must be separated within equity for certain capitalised costs and future liabilities. Dividends can be paid only if the total equity, excluding the non-distributable reserve, after the dividend payment, exceeds or equals the registered capital. Minority interests are disclosed separately as part of equity.

### 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 recognised 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).

### Profit and Loss Account Presentation

The principle of completeness (grossing up) means that some related items are presented separately in the profit and loss account. 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 recognised 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 categorised 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 per cent 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.

### Fair valuation

Fair valuation of financial instruments and hedge accounting may be applied as an option. 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

The disclosure requirements in Hungarian financial statements 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 with the Court of Registration within 150 days after the balance sheet date. The managing director of the entity must sign the Annual Report. The Annual Report should be supported by the attached auditor's report, where an audit is required, as well as the proposal or 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 preliminary un-audited announcement within 45 days of the year-end, and their audited separate and consolidated financial statements within 120 days 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). However, there is no requirement to publish this information in any publication. The business report is not required to be published. The publication requirement must be satisfied by filing the information at the Company Information Office of the Ministry of Justice (in addition to filing the same information with the Court of Registration).

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

## 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 on incorporation 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 or group 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 certain individuals and firms are authorised to sign audit reports on banks and insurance companies, member firms of the Budapest Stock Exchange ('BSE') or companies listed on the BSE. 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 Chamber of Auditors has had certain responsibilities delegated to it by the Ministry of Finance. To become an individual Registered Auditor it is necessary to have at least three years' relevant work experience and to pass exams set by the Chamber. The Chamber of Auditors is also responsible for auditing standards and has adopted International Standards on Auditing ('ISA'). Individual Standards were introduced over a three-year period (1999 to 2001) and all auditors are expected to comply fully with ISA (adapted as necessary to deal with particular local issues).

## **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 XL 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.

## 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 modernisation 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. As from 2008 a new redrafted VAT law is in force.

The year 1995 witnessed the introduction of a two-tier corporate tax system, 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 have been implemented in Hungarian tax legislation over the last several years 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
- Solidarity tax and Bank surcharge
- 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

- Contribution to the Rehabilitation Fund
- Contribution to the Vocational Training Fund
- Contribution to the Cultural Fund
- Environmental Protection Charge
- Environmental Pollution Charge
- Innovation Contribution
- Energy Tax
- Surtax on energy suppliers and traders
- Registration 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 16 per cent. From 1 January 2006, certain taxpayers which do not obtain tax incentives provided for in the Corporate Tax Act are taxed at a rate of 10 per cent. As of 1 January 2008, the upper limit of the base for this preferential tax base was increased from HUF 5 million to HUF 50 million. The reduced rate is only applicable if requirements are met in respect of the number of employees, connection with the labour authority and the amount paid on pension and health insurance contributions.

As of 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 analysing 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 in reference to this base.

According to the act, the income-(profit)-minimum is 2 per cent 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.

As of 1 January 2006, offshore companies – taxed at a reduced rate of only 4 per cent from 1 January 2004 – lost their offshore status; however, they can operate as normal Hungarian entities going forward, but obviously without the use of a reduced tax rate.

The following table sets out as an example the rates of tax applicable in 2009 to corporate profits including the effect of surtax (so-called solidarity tax) for corporations (introduced from 1 September 2006).

	<b>Tax rate</b>	<b>Tax (HUF)</b>	<b>Income (HUF)</b>
Taxable income			100,000
Corporate tax	16%	16,000	
Solidarity tax	4%	4,000	
Balance of undistributed income available for distribution as gross dividend			80,000
Tax charged on dividend payable to the company	0%	0	
Total tax charged on distributed income		20,000	
Net distributed profits			80,000

#### 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 handling of:

- Non-business expenses
- Development reserves, provisions
- Depreciation
- Loss in value
- Receivables forgiven
- Goods, services, financial assets provided or received without reimbursement
- Thin capitalisation
- Research and Development expenses
- Transfer pricing
- Loss carry forwards
- Inter-company interest; stock-exchange gains; royalties
- Local business tax
- Capital gain participation exemption

### *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 interest of the business, and hence, not deductible.

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

As of 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.

### *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 per cent (with an upper limit of HUF 500 million). In the tax return, development reserves may not be utilised for an investment or an asset purchased, which may not or should not be depreciated (e.g. land) based on the accounting regulations.

Subsequent to the capitalisation 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).

It is important to note that 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 tide-up reserves.

Any tax relating to that part of the development reserve, which is only utilised, or which is not utilised after 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 construction-in-progress.

The Act on Accounting assigns 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.

Effective 1 January 2001, 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:

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

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

- 50 per cent depreciation can be claimed on general IT machinery and on equipment exclusively serving motion picture and video production.
- Taxpayers can claim 50 per cent 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 per cent rate; the same rules apply to intangible properties purchased or produced, and to the capitalised value of experimental development.

#### *Receivables Forgiven*

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

#### *Goods, services, financial assets provided or received without reimbursement*

Taxpayers receiving goods and services without reimbursement are allowed to reduce their tax base while the other party is obliged to increase its tax base.

#### *Thin Capitalization*

New legislation was initiated in 2001 that changed not only the debt to equity ratio for thin capitalization calculation purposes to 3:1 but also the definition of which debt instruments are included in the calculation. The revised definition indicates that 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 capitalisation 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 capitalisation rules provide

an exemption for loans made through certain financial institutions. From 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*

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 the agreement with an institute of higher education, the Hungarian Academy of Science, or with a commonly funded research institute. Double deduction is allowed related to the costs of in-house R&D activity or such services rendered by non-taxpayers. Nevertheless, there is only a single deduction for R&D activities supported by governmental (subsidies to the extent of the subsidies), or if the R&D activity is rendered by other taxpayers directly or indirectly.

### *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 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.

As of 1 January 2007, advance pricing agreements (APA), a legal framework similar to binding ruling requests, is established 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.

### *Loss Carry forwards*

Under the effective legislation, 2004 and subsequent losses can be carried forward without time limitation. However, should the taxpayer have a negative profit before tax position and have tax losses for two consecutive years (after the initial start-up period) or the total revenue of the company in the tax year does not exceed 50 per cent of the total costs and expenses, the carrying forward of losses is subject to permission from the tax authority. The request should be presented by the deadline for tax return filing (or self-revision). Missing such an attachment would mean that the losses incurred cannot be utilised. The tax authority grants such permissions if the taxpayer can prove that the losses were incurred due to unavoidable circumstances or the taxpayer acted in a way that could have reasonably expected to mitigate or avoid losses.

For companies formed before 16 June 1998 the start up losses of the first year of operations and the next two years could be carried forward indefinitely. Companies formed since 16 June 1998 with no predecessors may now 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, although the rules have changed since 2000 in this respect and consequently older losses require some attention. There are anomalies in the law which mandate special attention to this area.

From 1 January 2008, the Act makes it clear that in case of mergers - similarly to the other forms of transformation - the period, after which the carrying forward of losses is subject to permission of the tax authority, should be counted from the date the predecessor's tax-liability arises.

No loss carry forward is available for financial institutions.

### *Inter-company interest; stock-exchange gains; royalties*

The taxpayer can decrease its pre-tax profits by 50 per cent of:

- royalty income received,
- any capital gains realised in excess of expenditure accounted for from stock exchange transactions contracted on a regulated market,
- net inter-company interest receivables,
- income realised on trading in emission quotas (with the exception of the quotas received without consideration from the state), and income realised from commissioning or handling of the quotas of other persons.

The above deductions are collectively limited to a maximum of 50 per cent of profit before tax.

### *Local business tax*

Taxpayers can decrease positive pre-tax profits by 100 per cent of the amount of local business tax payable accounted for as expenditure provided that no outstanding tax liability is recorded by any of the tax authorities as at the last day of the tax year. This effectively means a double corporate tax deduction possibility for local business tax expenses.

### *Capital Gains Participation Exemption*

As an incentive for the establishment of holding companies in Hungary, domestic or foreign participations of over 30 per cent 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) should be added back to the corporate income tax base. As of 1 January 2008, the capital gain on such participations held for at least one year (instead of the previous two years) will be exempted from corporate taxation.

An investment can not be treated as an announced participation and the special rules applied if it was taken in a controlled foreign company. Controlled foreign companies are entities owned by the taxpayer or any of its related parties that have their seat, permanent establishment or tax residence in a country where no corporation tax is levied or the effective tax rate does not exceed 10.67 per cent. This rule should not be applied in case of companies whose seat, permanent establishment or tax residence is in any member state of the European Union, the Organisation for Economic Co-operation and Development (OECD), or in states with which the Hungarian Republic has an operative agreement for avoiding double taxation (Double Taxation treaty).

## **Non-resident Companies**

### *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 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 by the relevant authority, 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 the loan contract is entered into and the contract must have been entered into on or after 1 January 2000.

The available tax incentive equals 40 per cent of the interest paid on the loan in a tax year.

### *Development allowance*

The Ministry of Finance grants tax incentives for a maximum 10-year period for investments, which are executed within the framework of the development programme published by the Government. The Corporate Income Tax law prescribes the following investments, for which taxpayers could be entitled for a development tax allowance:

- 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 utilised:
  - 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 prior to the commencement of the investment; 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 prior to the commencement of the investment, or
- 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 as of 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 course of equity increase receive listings in the Hungarian or other EU stock exchange.
- 3) For investments creating new jobs for the initial year and the following five years. The requirements for this allowance depend on the size of the corporations (large/medium/small) and on their location (such as preferred, small county, etc.). For example, in cases of a new investment category applicable in the 48 most disadvantaged regions the required minimum increase of employees will be 20 or five for small and medium-sized corporations. As of 1 January 2008, in order to utilise this type of development allowance, at least 20 per cent of those employed in the newly created jobs must be new entries into the workforce.

The tax allowance can be utilised in relation to the above investments if the project in question 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.

To receive eligibility for the tax allowance, requests should be submitted to the appointed minister who shall grant an authorisation in decree when the present value of the investment, costs and expenditure exceeds 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 benefit of this incentive is a tax relief of up to 80 per cent of the corporation tax liability, however in total no more than a certain 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*

10 per cent (in case of small and medium-sized enterprises, 15 per cent) 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 payable corporate income tax in the respective tax year and in the next three years in equal instalments, provided that the taxpayer has payable corporate income tax in the respective period. If there is no tax liability in that tax year, any remaining amount can be carried forward to be utilised in the following year. The maximum amount of tax benefits is capped at 70 per cent of the calculated tax liability.

#### *Motion Picture and Video Production*

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

The indirect state support consists of the following corporate income tax regulations:

- The aid granted by any taxpayer for film production is allowed for CIT purposes up to the amount indicated in the Sponsorship certificate of the Hungarian Film Office;
- At the same time the taxpayer can reduce its corporate tax liability by the certified amount, in the year of investment or in the subsequent three years.

The tax incentive system is beneficial for all taxpayers, and 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.

### *Surtax (so-called 'solidarity tax') for corporations*

From 1 September 2006, a surtax of 4 per cent is levied on corporate entities. The tax is calculated on the accounting pre-taxation profit increased by grants provided, assumed liabilities, amounts of free service provision and the tax paid abroad accounted as expenditure, and decreased by grants, income received from assumed liabilities, amount of services received for free and dividends received. When calculating the tax base for solidarity tax, the tax base amendment rules for EU harmonised preferential transformations, preferential exchanges of share, preferential transfer of assets and the rules of announced participation should be used.

Four per cent of the tax base should be declared and paid by the deadline for preparing the financial statements. In addition, quarterly tax advances should be paid in equal amounts based on the previous year's tax liability that should be supplemented up to the actual year's tax liability by the 20th of the last month of the tax year (top-up liability).

In accordance with international treaty regulations, foreign taxes can be credited against the surtax or income taxable abroad can be exempted. The surtax should be accounted for similarly to the corporate income tax, and so it does not decrease the amount of pre-taxation profit.

## **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 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 centre 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 individual income tax on their worldwide income.

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 (any property value) situated in Hungary.

The provisions of double taxation treaties could be 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 as employment income. The term 'director' is not defined under the income tax law.

### *Rates*

The individual income tax is levied on the aggregate taxable base according to a progressive scale. There is a two-level tax table for 2008, as illustrated below.

Annual taxable income in HUF	Tax payable
0 – 1,700,000	18%
Over 1,700,001	306,000 + 36% on the excess over 1,700,000

### *Surtax (so-called 'solidarity tax') rate*

A new tax is in effect for individuals as of 1 January 2007. According to the applicable rules, all individuals are obliged to pay an additional 4 per cent surtax on their annual gross income which exceeds the annual pension contribution limit. (This limit is HUF 7,446,000 annual gross income as of 1 January 2009). Individuals would be obliged to pay surtax advance on a quarterly basis if their income is expected to exceed the above-mentioned limit during the calendar year.

Surtax advance should be paid to a separate bank account of the Tax Authority.

A private individual will not be obliged to pay solidarity tax advances where the payer company has not deducted this already. He/she would be liable to pay this solidarity surcharge only by the due date of the annual income tax return. The payer company will be obliged to deduct the solidarity tax advance also where the private individual declares that he/she has already paid the pension contribution up to the annual limit.

*Flat rates applicable to certain types of income are as follows:*

- 20% on interest income from saving deposits
- 20% on capital gains realised on stocks on EEA countries or on OECD countries exchange market
- 25% on income from the lending of securities
- 10% on dividends from securities on EEA country's exchange market
- 25% on certain capital gains from trading options and futures
- 25% on gains from the alienation of immovable property and valuable rights and interests
- 54% on the value of benefits provided in kind (payable by the provider).

*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 seconded 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 cash benefits.
- Reimbursement of home leave expenses of family members is taxed as a cash benefit.
- Professional training of employees may be treated as business expenses (if circumstances and relating documents prove business-related costs).
- 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 – then the difference is taxable as income from dependent activities (salary income). Salary advances not exceeding five times the minimum wage (currently HUF 71,500/month) are not treated as below market rate loans, if the loan is re-paid 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 or other income of the individual.
- Meals are taxed as fringe benefits or employment income depending on the circumstances. In 2008 lunch vouchers are tax exempted with a monthly limit of HUF 12,000 in case of hot meal vouchers and monthly HUF 6,000 for cold meal vouchers.
- Certain life assurance premiums paid by the employer for the benefit of an employee may be tax-exempt.

*Exemptions*

Some types of income are exempt or not taxed under Hungarian tax legislation. The most significant types are the following:

- income from the disposal of real estate if the real estate was purchased 5 years prior to the sale;
- certain housing subsidies;

- educational, health and social welfare benefits in kind, insurance compensation, compensation for meals and work clothes provided by the employer;
- certain scholarships.

### *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 per cent of gross revenues. Increased allowances are available for small entrepreneurs.

The value of shares which may be granted by the employer in a non-taxable way will be increased from HUF 500,000 to HUF 1 million.

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.

According to the proposed changes tax allowances may be deducted up to an annual income limit of HUF 3.4 million and up to an income tax amount of HUF 100,000, which is 30 % of the so-called consolidated allowance basis. To the current tax allowances would be added a household tax allowance. According to the new regulation certain household services, based on invoices, may be taken into account as an allowance.

The Employer's Pension Fund contribution has entered into force as a new type of tax allowance. The 30 per cent of a complementary member's fee paid by the employee to this fund can be credited on his pension account.

The currently applicable income limit of HUF 400,000 will be terminated in case of taxable non-wage employer-provided benefits.

As of 2008, there is a new regulation in force according to which 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 tax of the consolidated tax base if there are at least three children in the family, and an income limit should be considered. This allowance is applicable if the individual's annual gross income does not exceed HUF 6,000,000, in case of three children. If the individual has more than three children, the limit extends by an additional HUF 500,000/child up to HUF 8,500,000.

### *Tax assessment*

In certain cases, individuals can ask a tax assessment from the Tax Authority that is equal to an individual's 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 the income taxed abroad does not form part of the Hungarian 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

In order to reduce administration costs, the base of the Employer's contribution (3%) and the Employee's unemployment contribution (1.5%) would be equal to the base of the social security contributions, while the base of the Employee's contribution (1.5%) would be equal to the base of employee's health contribution as of January 1, 2009.

Health insurance contribution payable by employees is 6 per cent which is divided into two parts. An amount equal to 2 per cent is payable for cash support and 4 per cent for in-kind support.

The 9.5 per cent pension contribution is generally divided into two parts, too. Employees should pay 1.5 per cent to the public scheme and 8 per cent to the private scheme. In case of certain employees, the total 9.5 per cent is payable to the public scheme. There is an annual contribution payment limit regarding employee's pension contribution. This limit is HUF 7,446,000 (HUF 20,400/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 2008 employer's and employee's contribution<sup>1</sup> rates are as follows:

<b>Hungarian Employers</b>	<b>Pension Insurance</b>	<b>Health Insurance</b>		<b>Unemployment contribution</b>	<b>Total</b>
		<b>Cash support</b>	<b>In kind support</b>		
(required to pay a contribution calculated on the basis of the wages and salaries of their employees)	24%	0.5%	4.5%	3%	32%
<b>Employees</b>					
(the contribution is withheld from their salaries or wages by the employer)	9.5%	2%	4%	1.5%	17%

<sup>1</sup> Please note that personal income tax and surtax for individuals described previously are also payable by employees and contribution to the vocational training fund covered later is compulsory for employers (a further 1.5% of the total annual wages).

Social security contributions are mandatory for Hungarian employees, foreign employees employed by Hungarian entities, foreign employees under certain Social Security Totalisation 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 an agreement.

In addition, there is a fixed health care charge payable by the Employer of a maximum HUF 1,950/month per employee. An 11 per cent health care charge is due on a broad range of receipts including (among others):

- remuneration and benefits-in-kind not subject to the 29 per cent social security contribution noted below;
- income from discounted interest rate loan provided by a Payer Company;
- other small amount payments.

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

- income withdrawn from enterprises
- income from lending securities
- dividends taxed at 25 per cent
- income from capital gains taxed at 25 per cent
- income from real estate rental (if the rental income exceeds HUF 1,000,000, 14 per cent health contribution is payable on the total income, subject to the cap below).

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

Where entrepreneurs performing supplementary activities are involved in more enterprises, Health Care Contribution must be paid only once, but the monthly charge rises from HUF 4,350 to HUF 4,500 (HUF 150 per day).

Social security liabilities should be declared to the Tax Authority electronically on a monthly basis by the employer.

## **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 harmonising 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 business-like manner for profit. Foreign entities performing business activities subject to VAT in Hungary are obliged to register for VAT and fulfil their VAT obligations under the Hungarian legislation.

Furthermore, as a newly-introduced element, 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*

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

### *Taxable transactions and place of supply*

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

Generally, the Hungarian VAT law 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). Certain 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.

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. The rationale for the modification is that effectively only the purchaser of receivables, i.e. the factoring company, provides business services.

In the case of import of goods and certain services acquired abroad, the importer and the recipient of the services must self-assess VAT on the amounts charged to it. The most important services that must be treated as "imported services" if the supplier has no Hungarian VAT registration are as follows:

- 1) If the purchaser is a Hungarian resident
  - hiring out of movable tangible property
  - transfer and assignments of copyrights, licenses, trade marks and similar rights
  - advertising services
  - consultancy, legal, accounting, tax, IT, translating, and engineering services
  - data processing
  - banking, financial and insurance services
  - the supply of personnel
  - telecommunication services
  - radio and television broadcasting
  - electronically-supplied services
  - granting access to gas and electricity systems and the transport of gas and electricity and related services
  - agency services to intermediate the supply of services mentioned above.
- 2) If the services are physically carried out in Hungary
  - cultural, artistic, scientific, educational, sport or similar activities
  - services ancillary to transportation
  - work on movable tangible property
  - valuation of movable tangible property.
- 3) Services connected with immovable property located in Hungary.

In the case of services listed in the law, i.e. “imported services” or truck hiring, other legislation may prescribe that the place of supply is to be determined based on the place of effective use and enjoyment.

The new VAT legislation re-defines tax exempt activities (with no right to deduct input VAT), mainly based on the revised EU VAT Directive. The definition of financial services changed significantly as well as of 1 January 2008.

### 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.

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 short, as receiving the tax number takes several days.

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, increased by the amounts of stamp duties and other tax related payment obligations.

As of 1 January 2008, 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.

For taxation purposes, 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 two VAT rates in Hungary:

- 20 per cent – is the general rate and is applied to most products and services as from 2006
- 5 per cent – the reduced rate, which is largely restricted to books, daily and other newspapers and some pharmaceuticals.

The preferential rate of 15 per cent was abolished in 2006, and the standard VAT rate of 20 per cent is applicable to all supplies of goods and services previously classified as preferential supplies.

### 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 and IC acquisition is HUF 100 million. Taxpayers must submit EC Sales and Purchase Lists quarterly as part of the VAT return on intra-Community supply and acquisition of goods.

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 liability 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 such 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 cancelling 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.

As of 1 January 2008, 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.

## 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.

## 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 their 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 are 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 licence, which makes it possible to benefit from the special licences of the representative (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 Harmonised System (HS) used by many industrialised nations of the world. 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.

### *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 per cent. 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 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.

The acquisition of goods into Hungary from other EU Member States by a person registered for VAT in Hungary is known as an intra-community acquisition. A person making an intra-community acquisition in Hungary is required to self-account for Hungarian VAT on their VAT return at the rate of VAT applicable to the goods by reference to the consideration paid. Provided the goods are acquired for a non-VAT exempt purpose, that person may make a simultaneous matching deduction on their VAT return for the VAT arising on the intra-Community acquisition.

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 different circumstances below:

- They will not permanently enter the community;

- they have already borne duty in the EU;
- they 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;
- 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 the 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 custom reliefs, authorisation 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 for 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

The 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 the 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.

Excise duty is charged on excisable goods that are:

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

The general foundation of the excise duty requires that the tax liability commences at the time of domestic production or importation of excisable goods. Production of excise goods with some exception 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 tax warehouse; furthermore producers and traders have to possess the relevant licenses to carry on their activity. Excise goods could be either under duty suspension arrangement or in free circulation depending the fact that the excise duty had to be paid or not. In general, excise duty is related to quantity or weight rather than value (the latter is partly the case regarding tobacco products).

## Gift and Inheritance Duties

### Inheritance duty

Inheritance duty is payable on bequests located 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 decedent and the heir. In case of a close relationship the applicable rates are between 11, 15 and 21 per cent 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 per cent (up to HUF 18 million value) through 6 to 11 per cent. The highest rate of inheritance duty is 40 per cent (in case of inhabited real estate 21 per cent).

As 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 property right related to apartments, the duty base of it can be reduced by the above amount.

Real estate, movable property and the establishment of pecuniary value without consideration are subject to gift duty. The applicable rates of gift duty are almost the same as the rates of inheritance duty starting from 11 through 18 to 21 per cent in case of close relatives. However lower rates are applicable in case of inhabited real estate (5 per cent, 8 per cent or 12 per cent). The highest rate is also 40 per cent (for inhabited real estate 30 per cent).

There are personal and subject-related exemptions from inheritance and gift duties. For example foundations, churches, public organisations 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.

Effective from 1 January 2008 the release of claims could also be subject to gift duty. As of 23 January 2009 in case of release of receivables, assignment, assumption of debt and other similar acquisitions the provisions of the Act must be applied if the acquirer is a domestic resident individual (as defined in the Act on Personal Income Tax) or organization.

Should one entrepreneur in the transaction be the 100 per cent owner of the other entrepreneur, or should both of the companies be 100 per cent 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 per cent (in contrast with the general rule, based on which the rate may be up to 40 per cent).

No duty is payable in respect of gift (free) transactions taking place by 31 December 2006 if it is prescribed by a legal provision and regarding acquisition of assets without consideration (not including the acquisition of real estate and motor vehicles) if the acquisition is based on a contractual arrangement concluded and performed prior to 31 December 2006.

There are limited cases which are exempted from duty (i.e. free transfer of assets prescribed by a legal provision, gifts provided to a public organisation) from 1 January 2007.

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.

## 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. As of 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.

## Property Transfer Tax

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

- 2 per cent for apartments and houses on the first HUF 4 million of their value and 6 per cent on the remaining value;
- 10 per cent for all other real estate properties and any taxable right;
- 2 per cent on commercial real estate if the buyer is a property trading company (with specific requirements, which are simplified as of 2009);
- 18 or 24 HUF/cm<sup>3</sup> depending on the engine capacity of motor vehicles.

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 stamp duty at the rates applicable for onerous transfers. This provision is effective as of 23 January 2009.

## 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 per cent levied on interest or interest-type revenues derived from loans incorporating direct or indirect interest-subsidies regulated by different laws.

The financial institutions have to make an advance tax payment each quarter, on the 12th day of each month following the quarter. The financial institutions must 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 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.

## 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 as of 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, international treaties and directives, so it basically corresponds to the basis of the surtax for corporate entities. The tax rate is 8 percent of the positive tax base, to be assessed, declared and paid simultaneously with the corporate income tax. 90 percent of the expected tax has to be declared and paid by the 20th of the last month of the tax year, however this obligation does not apply to those taxpayers whose revenues did not exceed 50 million forint in their preceding tax year.

## 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 300 per kW in the year of production and the subsequent three years, continuously decreasing to a minimum of HUF 120 per kW applicable to at least 17-year old vehicles. In case of buses and trucks, the tax is HUF 1200 per every 100 kilograms.

Organisations financed by the state budget, social organisations 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 regarding the previous financial year arisen from public transport.

## Company Car Tax

From 1 February 2009, company car tax relating to cars partly used for private purposes will be 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 used for private purposes), which either are not personal property or are personal property where business costs have been accounted 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 would be HUF 7,000 for cars having an engine capacity up to 1600 cm<sup>3</sup> or capacity of rotary-piston engines up to 1200 cm<sup>3</sup>, and HUF 15,000 for all kinds of cars above these capacities. 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.

As of 2009, the usage of cars for private purposes provided by a payer, legal entity with foreign residence or other organisation, and furthermore the provision of a single ticket in relation to motorway-usage, would be tax free benefits-in-kind, according to the Act on PIT. In addition, all cost related to company cars are allowed for CIT purposes.

## Local Taxes

There are a number of local taxes, which may be imposed at the discretion of the various local authorities:

### *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 an enterprise's gross sales revenue less cost of goods acquired for resale and the value of mediated services and subcontractors' fees (both terms defined somewhat narrowly). Material costs are also fully deductible. Part of the tax base (could be 100%) is exempt from local business tax if it results from an activity carried out abroad. This exemption can be used only if local tax is imposed by a local authority abroad. The maximum rate of tax is 2 per cent 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 per cent, 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 1,170 per m<sup>2</sup> per year) or on the market value of the building (maximum 3 per cent). Similarly for land, the tax is based on square meters (maximum HUF 260 per m<sup>2</sup> per year) or on the market value of the land (maximum 3 per cent).

Besides the above, from 2009 property taxes could be levied based on the market value of building and property depending on the decision of the local tax authority. The rate of tax would be 0.5 per cent for residential buildings and the connected land and 1.5 per cent for other properties.

### *Community Tax*

This tax is based on the number of employees, and may be imposed at a maximum rate of HUF 2,600 per employee per year.

### **Contribution to the Rehabilitation Fund**

This fund provides assistance to disabled employees. Disabled people should comprise a minimum 5 per cent of an employer's headcount. Any employer not meeting this criterion is obliged to pay a contribution of HUF 177,600/disabled person not employed per annum (for 2009). The contribution is not levied if the total number of employees does not exceed 20.

### **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 per cent of the total annual base of social security contributions.

### **Contribution to the Cultural Fund**

Retailers of certain listed products (films, magazines, construction, etc.) and providers of certain services (such as video-rentals and advertisements) are obliged to pay contributions to the cultural fund. As of 2008, for products which are disposed of in or outside the European Community and are exempted from VAT, there is no obligation to pay contributions to the cultural fund.

The basis of payment is a percentage of the net sales revenue (excluding VAT) minus the purchase price of listed services and products used for products or services sold. The rates vary from 0.2 per cent to 25 per cent depending on the particular product or service provided.

According to the Act on the Programme of the National Cultural Fund, constructors of buildings and other build-ups with a value exceeding HUF 120 million are obliged to pay contributions to the Cultural Fund of 0.2 per cent of the investment value. The investor should

include in the subcontractor agreement whether or not the total value of investment will exceed HUF 120 million. Where the investment value exceeds HUF 120 million, the investor must notify the constructor in writing that the building will be subject to cultural contribution. In case of failure to notify, the cultural contribution is accounted for by the investor.

### Environmental Protection Charge

This single-stage tax is imposed on the domestic manufacturer, importer or intra-Community acquirer of certain listed products used within the territory of Hungary which could prove to be harmful to the environment.

These products include:

- certain oil products
- rubber tyres
- cooling agents
- wrapping materials (special rules to commercial packaging such as PETs)
- batteries
- commercial printed papers
- electric and electronic equipment.

The amount of levy is specifically set out for each type of product and is generally computed as an amount per kilogram of product (or on the amount of commercial packaging)

Companies can apply for a specific Environmental Protection Charge exemption if they comply with the formal and substantial conditions and strict deadlines.

As of 1 January 2008, this tax falls under the responsibility of the Customs Authority, and the 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, the emitter must pay 100 per cent for air pollution and water pollution, of the fee actually payable according to the law. For the soil charge, the payable quota is 100 per cent as well effective as of 2009. The payable amount increases continuously from year to year.

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 can be available to those which fulfil certain conditions.

## Innovation Contribution

The innovation contribution is payable by every entity subject to the Accounting Law, with the exception of micro- and small enterprises which are exempted. The base of the contribution is the same as for local business tax. The applicable tax rate is 0.3 per cent from 2006 onwards.

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 thousand kilograms for coal. The rate of energy tax is defined as HUF 252/MWh for electricity, HUF 75,60/GJ for natural gas, and HUF 2,040/thousand kilograms for coal. This tax is related to national and administrative institutions and energy-intensive producer sectors. Tax must be paid by:

- public utility providers selling energy to public utility consumers
- energy traders selling energy to eligible consumers
- eligible consumers purchasing energy directly from a producer or in an organised 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)
- public utility providers, energy traders and distributors, which purchase energy for their own use, except if this purchasing is in order to compensate for a network loss, and
- end users purchasing previously non-taxed energy,
- user in case of coal purchasing where the user 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 utilisation respectively. The monthly tax return is to be filed by the 20<sup>th</sup> 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 Hungarian circulation. 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.

### 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 fulfil 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 per cent for the private person and 20 per cent 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 invoice, can take over the assessment, reporting and payment of EKHO instead of the income payer.

### Simplified Entrepreneurial Tax (EVA)

From 1 January 2003, an optional simplified entrepreneurial tax regime (egyszerűsített vállalkozói adó, i.e. 'EVA') is available to entrepreneurs, general and limited partnerships, limited liability companies, cooperatives and certain other business forms. 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 does not have or is not obliged to have an EU VAT identification number, and (iv) the taxpayer has a Hungarian bank account.

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).

As of 1 October 2006, the tax is levied at a flat rate of 25 per cent on 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).

A taxpayer who opts for the regime for a tax year must inform the tax authorities by 20 December of the preceding year (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) 15 February 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.

Taxpayers applying the simplified entrepreneurial tax must pay vocational training contributions at 1.5 per cent 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 16 per cent), they do not enjoy local business tax exemption by virtue of their status, and are subject to solidarity tax.

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 per cent of royalty or net interest income and gains realised on stock exchanges for corporate tax purposes (i.e. an approximately 8 per cent effective tax rate might be achieved).
- Unrealised 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 country in the world.

## Chapter 7

# Property Investments by Foreign Investors

### Introduction

Interest in property investment in Hungary has grown sharply in recent years. We describe the main tax issues involved with the acquisition and use of property 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 means that foreign-registered enterprises can only do business in Hungary via branch offices. This restriction on forms of doing business also refers to foreign entities' direct property investments in Hungary.
3. Direct investment by foreign individuals.

### Acquiring Property

#### Real estate

##### *General Overview*

Up 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. These investors have been attracted by the demand for modern office, retail and industrial premises and for real estate in general. Prices have risen rapidly.

The following real estate opportunities exist for foreign investors:

- acquisition of real estate by a foreign-owned Hungarian legal entity or a foreign legal entity;
- acquisition of real estate by non-resident individuals;
- long-term rentals.

#### *Acquisition of Real Estate by a Business Venture*

A business venture may acquire ownership and other real estate rights, except for agricultural land, provided that this falls within the scope of its business activity as defined in its Articles of Association.

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 purchase an official copy of information in the register.

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

#### *Acquisition of Real Estate by Non-Residents*

According to the Act on Acquisition of Real Estate by Non-residents, non-resident 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. 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 will have 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 subsidiaries of foreign investors.

With the effect of the accession to the EU (1 May 2004) Act LV of 1994 on Arable Land makes acquisition of arable land possible for such EU citizens who plan to settle down in

Hungary as independent agricultural manufacturer entrepreneur, have been legally resident and have been pursuing agricultural activity in Hungary for at least three years. The above acquisition of arable land by a foreign natural person may only be exercised in accordance with the respective rules stipulated for an acquisition of arable land by domestic natural persons not exceeding the size of 300 hectares or the value of 6000 gold crown ("aranykorona") of the total arable land owned by such a natural person.

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. 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.

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) except in case of acquisition of the secondary place of resident, 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 the secondary place of residence).

#### *Transfer Tax Issues Involved with Acquisition*

Those acquiring property are required to pay a property transfer tax of 10% of the commercial value of the property in general. This duty is reduced to 2% for enterprises whose main core activity is trading in real estate (effective from 1999, such property must be sold by the enterprise within two years of acquisition); for a residential property transfer tax is 2% for the first HUF 4 million of commercial value, and 6% thereafter.

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

#### *Foreign Exchange Regulations*

As of June 2001, the Hungarian Forint (HUF) received "hard currency" status and foreign exchange regulations changed. Property acquisitions may now be paid for in any currency, whether Hungarian Forint or foreign currency.

## **Rules on Existing Properties (Sale or Use of Properties)**

### **Tax Regulations**

#### *VAT*

Use by foreign parties of any Hungarian property is liable for VAT reporting (but not necessarily VAT payment - see below for exemptions), except for the non-commercial sale

of an individual's property. Nevertheless, the newly codified value added tax (VAT) law entered into force as of 1 January 2008 introduced a new element whereas 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. Investors must thus register for VAT in Hungary and issue VAT invoices when selling or renting/leasing a property.

Based on rules effective as of 1 January 2008, rental of real estate and sale of new real estate are exempt from VAT under general rules. Under these rules rental fees and sales proceeds are VAT exempt, meaning that the input VAT incurred in connection with the properties cannot be deducted. Nevertheless, taxpayers may opt for VAT-able status for a certain period of time at the beginning of a tax year regarding these transactions enabling them to deduct the input VAT based on the general rules.

VAT is payable at the general rate of 20% on the use (sale or rental) of all other properties which are not considered exempt.

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 a double tax treaty exists, terms of that treaty would override Hungarian tax provisions in any cases where the two might contradict one another.

#### *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 an income from a sale. In the case of transferring residential property, the period for which capital gains are now subject to tax is five years, thus, the 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 for 16% corporation tax and 4% surtax 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 reconciling items under the Act on Corporation Tax and the Act on Surtax.

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

Income of investors selling property is the selling price of a property. An accounting amount recorded as a value of a tangible asset may be included in cost of sales figure.

If a selling price exceeds book value, the difference is defined as profit and is subject to 16% + 4% corporate income tax and surtax. 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 (16 %). Amounts of depreciation are governed by rules outlined below. 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.

Depreciation on a property for tax purposes recognised under the Act on Corporation Tax. 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 a company's accounting policy.

Dividend withholding tax was abolished with effect from 1 January 2006. As withholding taxes on royalty and interest income were abolished earlier, companies (foreign or domestic) will not be liable to any withholding taxes on any type of Hungarian source income paid to companies (but not to individuals).

Domestic or foreign participations of over 30 per cent 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) should be added back to the corporate income tax base. The holding period to receive exemption from corporate tax on capital gains for an announced participation is reduced from 2 years to 1 year as of 1 January 2008; the capital gain on such participations held for at least one year will now be exempted from corporate taxation.

### *Branch Offices of Foreign Enterprises*

General rules on taxation of Hungarian branch offices state that such offices of foreign enterprises 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 at branch offices is taxed in the same way as that performed by legal entities. Accordingly, branch offices must assess and pay tax on their taxable profits. However where a double tax treaty applies, it may be possible to apply somewhat different principles toward determination of a branch's tax base.

Foreign-registered enterprises owning 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 on 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*

There is no specific Hungarian legislation regulating companies whose core activity is the ownership or use of property. General corporate legislation applies to these companies.

Property sales affected by way of transferring shares in a property holding company (rather than selling a property itself) are not subject to either transfer stamp duty or VAT.

Sale by a foreign entity of a holding in a Hungarian company is not liable to Hungarian corporation tax. A foreign individual is liable to 25% Hungarian personal income tax on gains from selling the holding, but this could be reduced or eliminated by an applicable tax treaty.

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

# Appendix A

## Income Tax Treaties and Withholding Tax Rates

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

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

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

\* In Hungary tax on dividends is eliminated as of 1 January 2006. Withholding tax on interest and royalties has been eliminated earlier, thus there should no longer be any withholding taxes on payments made from Hungary to non-individuals.

\*\* (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. Application of the treaty with Montenegro has to be confirmed by Hungary.

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

# Appendix B

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

- All EU member states
- Liechtenstein
- Switzerland

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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