How to Start Business in Hungary

2016

CONTENT

1. Introduction

1.1. Hungary

Hungary has been a member of the OECD since 1996 and a full member of the NATO since 1999, joined the EU on 1 May 2004.

1.2. Key facts

Location	East-Central Europe
Official name	Hungary
Capital	Budapest
Area	93.030 sq. km
Population	9 893 899
Population density	106 inhabitants per sq. km
Currency	Forint (HUF)
Composition of GDP	agriculture: 4.3%; industry: 26,2%; services: 69,5%
Largest towns	Debrecen, Miskolc, Szeged, Pécs, Győr
Time zone	GMT + 1 hour
Ethnic groups	Hungarian 92.3%, Roma 1.9%, other or unknown 5.8% (2001 census)
Religions	Roman Catholic 51.9%, Calvinist 15.9%, Lutheran 3%, Greek Catholic 2.6%, other Christian 1%, other or unspecified 11.1%, unaffiliated 14.5%
Climate	temperate; cold, cloudy, humid winters; warm summers
Geography	landlocked; strategic location astride main land routes between Western Europe and Balkan Peninsula as well as between Ukraine and Mediterranean basin; the north-south flowing Duna (Danube) and Tisza Rivers divide the country into three large regions
Terrain	mostly flat to rolling plains; hills and low mountains on the Slovakian border
Main rivers and lakes	Danube, Tisza, Lake Balaton, Lake Velence
Natural resources	bauxite, coal, natural gas, fertile soils, arable land
Land use	arable land: 49.58%, permanent crops: 2.06%, other: 48.36%
Irrigated land	2,300 sq km
Environment	large ongoing investments to upgrade Hungary's standards in waste management, energy efficiency, and air, soil, and water pollution to meet EU requirements
Per capita GDP	USD 18,647 (at purchasing power parity)
Transportation	railway network: 7,937 km (2,628 km electrified), public road network: 160,680 km, international airports
Public holidays	1 January; 15 March; 1 May; 20 August; 23 October; 25-26 December; Easter Sunday and Monday; Whit Sunday and Monday; 1 November
Head of State	János Áder
Primer Minister	Viktor Orbán

1.3. Benefits of Hungary's EU Membership

The membership has significant effects on the Hungarian economy, and gives important competitive advantages for companies settled in the country.

General Advantages

- Joining a community of stability, democracy, security and prosperity
- Growing internal market, increasing domestic demand
- Free movement of labor force, goods, services and capital

Macroeconomic Effects

- Growing inflow of FDI (Foreign Direct Investment) due to increased business confidence
- Regional hub role – gateway to Eastern Europe

Benefits for companies

- Increasing EU funds for environment protection, education and R&D
- Transparency of taxation and business accounting rules
- No customs or quantitative limitations within the EU
- Free access to a market of 450 million consumers for non-European companies settled in Hungary

Outlook for EMU Membership

- Lower real interest rates boost investments
- No exchange risk and conversion charges

1.4. Hungary: the logical choice

Since the beginning of the transition to democratic market economy at the end of the 1980s, Hungary has attracted a steady stream of foreign capital, well-balanced across the various sectors of the economy. Hungary can currently boast of having attracted Foreign Direct Investment (FDI) of more than EUR 80 to date which represents one of the highest per capita rates in the region.

1.5. Hungary's economy

Hungary is on a balanced and moderate growth path, gradually reducing its macroeconomic imbalances as well as its internal financial imbalances. Labor market developments have been favorable, recently also in the private sector.[1]

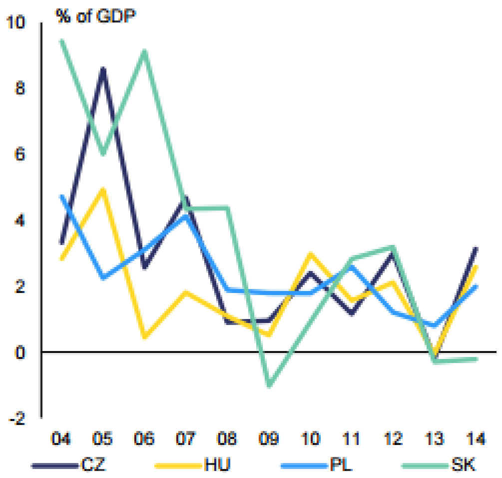
The budget deficit has been contained, keeping the public debt ratio on a gradually declining path. The budget deficit declined significantly in 2015, and is expected to decrease further in 2016- 2017, albeit the latter is mostly due to the improving economic situation.

In 2015, real GDP grew by 2.9% after growing by 3.7% in 2014. In domestic demand, households final consumption posted a slightly higher than 3% real grow, while gross fixed capital formation only grew by 1.9% compared to 2014's 11.2%. Exports grew more than imports so the net export contribution eventually was 1.2 pps.

The unemployment rate reached an all-time low of 6.8% in 2015 and is expected to further decrease to around 6% by the end of the forecast horizon, as activity continues to expand. Employment is set to continue growing, driven by higher job creation in the private sector and the government's public works scheme. Consumer prices remained broadly stable in 2015. HICP inflation is expected to accelerate moderately to 0.4% in 2016.

[1] Sources: European Commission, Eurostat, Hungarian Central Bank

Chart no.1: Net foreign direct investment: Hungary and regional peers. Chart no.2: Corrected and uncorrected net FDI inflows as % of GDP.



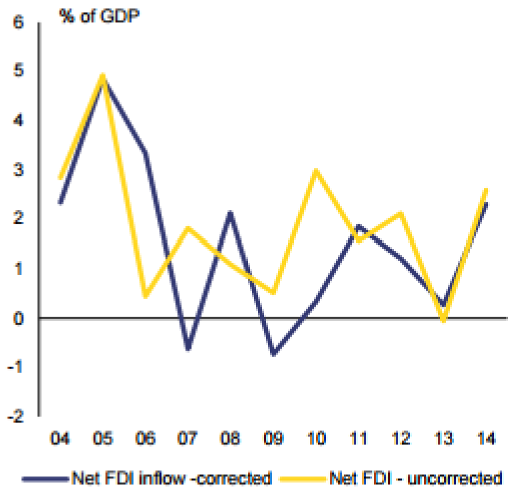
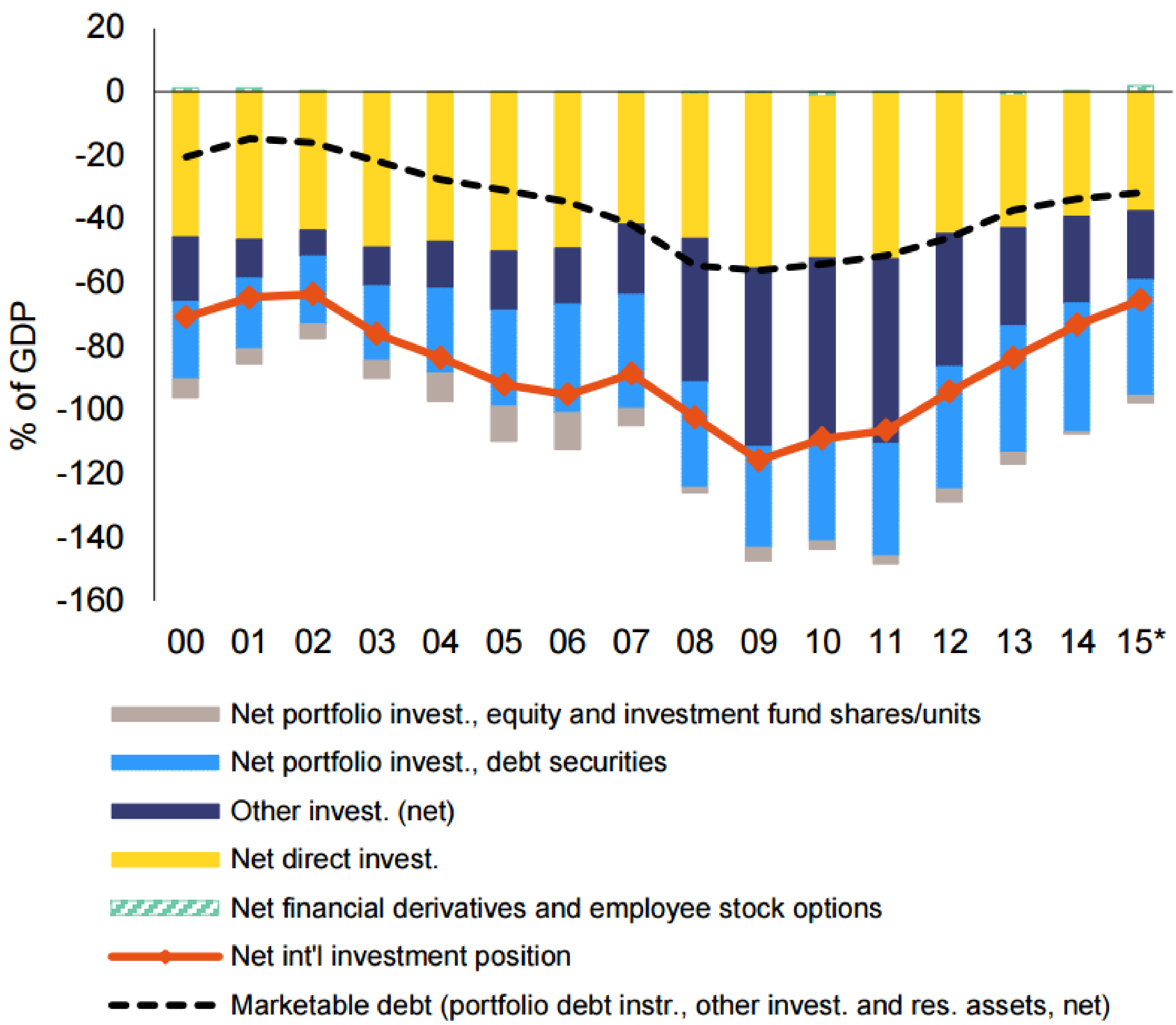


Chart no. 3: Components of net international investment position



1.6. Useful links

Parliament	Hungarian Government	Courts	National Bank of Hungary
National Tax and Customs Administration	Hungarian Academy of Science	Hungarian Central Statistical Office	Hungarian Convention Bureau
Hungarian Lawyers Online Directory	Hungarian News Agency	Hungarian Intellectual Property Office	Hungarian National Asset Management Inc.
Hungarian Tourism Agency Ltd.	Hungarian Export-Import Bank Pte Ltd.	Hungarian Investment Promotion Agency	MNKH Hungarian National Trading House
Hungarian Chamber of Commerce & Industry	Hungarian State Treasury	Database of Hungarian Law	Hungarian Official Gazette Publisher

2. Legal basis

2.1. General Regulations

The corporate law in Hungary has been continuously evolving since the transition to capitalism. Important milestone was when the legislation had to harmonize the national law with the respective EU regulations as well as to establish a modern and comprehensive regulation of business entities. The latest substantial amendment came with the adoption of the new Hungarian Civil Code in 2013 (Act V of 2013 on the Civil Code). The Civil Code, entered into effect on 15 March, 2014, incorporates the fundamental regulations and mandatory rules for all economic entities

The Act V of 2006 on Public Company Information, Court Registration Proceedings and Dissolution Procedures - 'Registration Act' -) provides a flexible and expedient legal regime.

The Civil Code determines five different corporate forms that may serve for investors as a basis to carry out business activity in Hungary. All of these forms can exclusively be established and operated by foreign owners and management:

- unlimited partnership (Kkt.)
- limited partnership (Bt.)
- limited liability company (Kft.)
- company limited by shares which may be privately founded (Zrt.) or publicly founded (Nyrt.)

Companies duly formed and registered under Hungarian law may undertake obligations and acquire rights in their own name (i.e. they have the right to acquire property, may conclude contracts, file lawsuits or be subject to actions brought against them). As a general rule, companies may freely pursue activities; however, a license of the competent authority is required for certain activities. Thus, for example, banks can only be founded and operated as a company limited by shares. Companies can be founded by natural or legal entities, Hungarians and foreign nationals alike. Even a single person can found a company limited by shares (limited corporation or Rt. in Hungarian) or a limited liability company (LLC, or Kft. in Hungarian).

The founders of a company must first sign the company's constitutive document, after which an attorney-at-law (a member of the Hungarian bar) must countersign and file it with the competent Court of Registration.

The company is established by the court's act of registration. A company's fundamental corporate data (articles of incorporation) and its internal regulations are set forth in its constitutive document, i.e. (i) articles of association, or (ii) deed of foundation, or (iii) statutes depending on the corporate form.

<u>The articles of incorporation must specify the following:</u>

- company name;
- registered seat;

- a list of the company's members, with their respective addresses, date of birth, personal tax number (and their mothers' maiden names);
- the company's business (main) activities (certain activities require special administrative permits);
- the amount of the equity capital, the method and date of its availability;
- representation of the company, the method of signing in the name of the company;
- names, addresses, places of birth and personal tax number of the company's officers as well as their mothers' maiden names;
- the duration of the company, if founded for a fixed period of time
- all other items of information relevant to the given form of corporation as required by the prevailing act of law.

2.2. Company registration

The registration of business associations is a must in Hungary. The Company's constitutive document must be drafted and countersigned by a Hungarian registered attorney. Incorporation procedure must be initiated by request. The registration request must be filed with the competent Hungarian Court of Registration within 30 days from the conclusion of the constitutive document. Company registration proceeding is fully electronic. If the applicable laws require any official license for the establishment of the company, it must be attached to the request form and the request form must be submitted within 15 days as of the receipt of the official license. When the registration court receives the application for registry a certificate is issued for the company with the company's name, address, temporary tax and statistical number and the number of reference of the registration. After receiving the above certificate the company may commence to operate in the form of a pre-incorporated company. This means that the company may operate as an incorporated company but special provisions regarding personal liability of the founder(s) apply. A pre-company may pursue business activities, but is not allowed to conduct business activities requiring an official license.

Failure to comply with the above deadlines may result is penalty amounting from HUF 50.000 to HUF 900.000[2].

Companies can be incorporated in two ways: simplified or standard electronic filing.

2.2.1. Company incorporation by simplified electronic filing

The Court of Registry shall render a decision within 1 working day from the delivery of the application to the Court of Registry. In the simplified electronic filing, the companies must use a standardized template for the articles of association. The companies have to fill out the application form and file certain corporate documents specified by the provisions of law. Certain other corporate documents are not required to be filed to the Court of Registry but must be reviewed and kept by the attorney proceeding with the incorporation procedure.

Only limited liability company, limited partnership, unlimited partnership and private limited corporation can be established by the simplified procedure. Consequently public limited corporation cannot be incorporated by the simplified procedure.

The stamp duty of the proceeding varies from HUF 15,000 to HUF 50,000

2.2.2. Company incorporation by standard electronic filing

If the court does not decide within the aforementioned periods, the chairman of the registration court must take measures to reach a decision within 3 business days regarding the incorporation or the refusal of such application. If within the above incorporation period the registration court does not decide in the given time frame, the registration will occur ex lege. The company may choose to meet publication requirements by publishing the required information on its website instead of the Company Gazette (*Cégközlöny*). In this case, no publication fees are payable.

A newly registered company must also register with the local municipality, Hungarian Tax Authority, Central Statistical Office and Social Security Authorities. Simultaneously with the submission of the registration

[2] HUF-EUR Exchange rate: 1 EUR~315 HUF

application, the court registers companies with the Hungarian Tax Authority (for VAT and income tax purposes) and with the Statistical Office through an online system.

Branch offices and commercial representation offices should also be registered by the Court of Registration and may start their activities only after the registration. The time of corporation may take up to 15 days.

The registration fees of the different corporate forms are as follows:

- HUF 600,000 in case of a public company limited by shares;
- HUF 100,000 in case of a private company limited by shares or a limited liability company;
- HUF 100,000 in case of any other company bearing a legal personality and not listed in above;
- HUF 50,000 in case of a company not bearing a legal personality;
- HUF 50,000 in case of a branch office of a foreign company;
- HUF 50,000 in case of a representative office of a foreign company.

Companies only have to pay once for their registration (i.e. there are no further payments to the courts to keep their registered data in the Companies Register), as long as their registered data remains unchanged. However, almost any amendment to the company's data must be registered in the Companies Register, which entails the payment of additional duty and publication fees. There are certain exceptions to the above fees, including (i) duty on the registration of a corporate change in the company's registered capital is 40% of the above listed amount payable for the company's registration, irrespective of whether the registered capital is increased or decreased or the level of change; and (ii) changes in the company's scope of activities may be reported to the competent Court of Registration without having to pay duty or publication charges.

Publication fee is HUF 5,000.

2.3. Corporate legislation

The Company Act determines four different corporate forms that may serve for investors as a basis to carry out business activity in Hungary. Each of these company forms can be founded by foreign owner and management, exclusively also, if necessary.

2.3.1. Limited liability company (LLC)

A LLC [in Hungarian: Korlátolt Felelősségű Társaság (Kft.)] is established with a predetermined amount of initial capital that is HUF 3,000,000 provided by its founders. The liability of its members is limited to the provision of the company's initial capital (and, if so stated in the articles of association, other contributions). As a general rule, members are not otherwise responsible for the company's liabilities, meaning that the private property of the members cannot be touched by the liabilities of the company. Members of an LLC may not be recruited through public offerings. The members' rights and their title to the company's assets are represented by quotas in the company. No securities may be issued in respect of the business quotas, which may be (i) ordinary business quotas (quotas providing identical membership rights) or alternatively (ii) preferred business quotas (only if the company's articles of association provide so), which may entitle their holders to, for example dividend preference, preference in voting rights, etc. An LLC may have only one member (a single-member LLC); the company and the member are not separated organizationally and pecuniary from each other, thus certain different rules than in the case of the LLC.

2.3.2. Companies limited by shares (Stock companies)

This is the most strictly regulated corporate form, which shows similarity to the German AG or to the English Plc. There are two types of stock companies (i) private limited company and (ii) public limited company. A stock company is particularly suitable to large business entities with several investors, but it is also possible to establish such entity as a single-person company.

A private limited company shall be founded with an initial capital consisting of a predetermined amount. The minimum of the share capital of a private limited company may be HUF 5,000,000, while in the case of a public limited company it is HUF 20,000,000. The liability of its members is limited to the provision of the nominal or issue value of the shares.

Shares may be (i) ordinary shares, (ii) employee shares, (iii) interest-bearing shares, (iv) redeemable shares or (v) preference shares, which have the following sub-categories:

- dividend preference shares;
- preference with respect to the liquidation ratio;
- preference with respect to voting rights;
- (only in the case of private LC) preference with respect to the appointment of executive officers or members of the supervisory board;
- only in the case of private LC) shares ensuring pre-emption rights.

A public limited company may only issue dematerialized shares.

2.3.3. Limited partnership

In a limited partnership the minimum number of members is two, of which at least one, the general partner bears unlimited liability. The other partners' liability (the limited partner) is limited to the amount of their capital contribution. Only the general partners may manage the partnership and represent the partnership in its dealings with third parties. The profit distribution is generally proportional to the capital contributed, but the parties are free to agree otherwise. It is against the law, however, to exclude any partner from the distribution of profits. No minimum capital is required to found and operate a limited partnership.

2.3.4. Unlimited partnership

In an unlimited partnership (or general partnership), the liabilities of its members are joint and unlimited for the partnership's obligations. No minimum initial capital requirement is set forth by law and its members are not required to take part personally in the activities of the partnership. By law, every member is entitled to represent the partnership unless its articles of association state otherwise. The partnership must have at least two members. Individuals may also become members of an unlimited partnership, however minor persons and individuals already bearing a joint and several liability in another company are excluded. The active participation of the partners in conduct of the partnership's business is legally required. No minimum capital is required to found and operate an unlimited partnership.

2.3.5. Representative office, branch office

There are two other forms foreign investors might choose in Hungary to establish presence in Hungary. Through a representative office foreign investors can perform normal liaison functions, including assisting with contract negotiation, advertising and exhibiting products and other forms of marketing on behalf of the parent company; but the office is not allowed to pursue core business activities. This form can be useful if the foreign undertaking intends to familiarize itself with the local business conditions before embarking on an investment.

The other form to establish a presence in Hungary can be done via a branch office, which is an organizational unit of a foreign company, being authorized to carry out independently normal business activities.

3. Accounting

3.1. Financial reporting and auditing

In Hungary, legislation governs accounting principles. Hungarian professionals generally regard the Ministry for National Economy as the final arbiter on issues not clearly provided for by the law. The Act C of 2000 on Accounting, which came into effect on 1 January 2001, has been framed to bring Hungarian financial reporting practices closer to the International Financial Reporting Standard (IFRS) and in line with the EU 4th and 7th Directives. The Act applies to all entities including Hungarian commercial representative offices of foreign-registered companies. Additional accounting and financial reporting requirements for government agencies, municipalities, financial institutions, insurance companies, pension funds, investment funds and brokerage companies are laid down in other acts and government decrees.

3.2. Fundamental concepts

Accounting principles adopted from the Act on Accounting include the going-concern principle, completeness, existence, "true and fair" view, clarity, consistency, matching, grossing up, cost-benefit, continuity, the accrual method of accounting, prudence, substance over form, materiality, and individual valuation. Bookkeeping is required by law to be kept in Hungarian. Deviation from the provisions of the Act is allowed only in exceptional cases where application of the relevant provisions fails to provide a “true and fair” view.

Financial statements must be prepared in conformity with the above principles. Special accounting principles apply to liquidations as well as to transformations such as split-ups, mergers and changes in company form. The accounting principles followed by economic entities must be consistent from year to year. These principles may only be changed if factors causing the change persist for more than one year.

3.2.1. Financial year

With certain exceptions, the financial year shall coincide with the calendar year. The financial year may differ from the calendar year:

- for branch offices of foreign-registered companies if it is the same as the foreign-registered company's financial year.
- for consolidated subsidiaries of foreign parent companies – with the exception of credit institutions, financial enterprises and insurance companies – and for subsidiaries of such subsidiaries, if it is different for the foreign parent company.
- for European public limited liability companies and European cooperative societies, if other than credit institutions, financial firms and insurance companies.

The duration of a financial year is 12 months except in the following cases:

- when a newly-formed company is in its pre-registration period, which lasts from the date of foundation until the legal registration of the company. This period is considered a separate financial reporting period (“pre-kept company period”). It is not necessary to prepare separate financial statements on the pre-company period where both the newly-formed company has not commenced its actual business activity during this period and the company has been registered prior to the balance sheet date of its first normal financial year. In this case, the first financial year lasts from the signing off the deed of foundation until the calendar year-end or the selected the balance sheet date, if this is different.
- when a company is terminated due to transformation, the financial reporting period commences on the balance sheet date of the previous financial year and ends on the date when the transformation is registered by the Court of Registration or on the effective date of the transformation as appointed by the company if it is different.
- when a company is established through transformation, the financial reporting period commences on the date when the transformation is registered by the Court of Registration and ends at the end of the fiscal year which is the same as the calendar year end, unless otherwise determined by the parent company.
- when a period of liquidation shall be construed as one financial year regardless of its duration.

3.2.2. Significant accounting concepts for investors

Current assets and non-current assets are carried at the historical cost value or the market value, whichever is the lower. Writing back up to the historical cost value after devaluation is accepted if the market value has increased.

3.2.3. Tangibles and Intangibles

Intangible assets are concessions and similar rights (with the exception of rights in real estate), intellectual products, goodwill, advances or prepayments on intangible assets and value adjustments of intangible assets.

The cost value (purchase or manufacturing value) of an asset is the expenditure incurred in the acquisition, creation, commissioning and/or validation of the asset before commissioning or delivery to the warehouse.

The cost value includes the purchase price minus any discounts plus any extra charges such as:

- costs and charges paid to intermediaries for delivery, loading, foundation, installation, commissioning and validation services received in connection with the purchase; or
- commissioning and delivery of the asset to the warehouse (if any or all of the capitalized value of direct prime costs are performed by the undertaking); or
- any commissions as well as taxes (consumer tax and excise tax paid at purchase and non-refundable VAT) and customs charges.

The interest charged on a loan for the period until the asset is commissioned or delivered to the warehouse and the exchange difference of a loan (in a foreign currency) which is directly related to an asset in the course of construction (or a concession or similar right applicable for the period until the asset is commissioned or delivered to the warehouse), also constitutes a part of the cost value.

Tangible and intangible assets are depreciated over their useful lives down to their residual values. Extraordinary depreciation shall apply in connection with intangible and tangible assets, if: (i) the book value of the intangible or tangible asset (not including assets in course of construction) remains permanently and substantially higher than the market value of such asset; (ii) the value of intellectual property and tangible assets (including assets in course of construction) drops permanently because such intellectual property or tangible assets (including assets in course of construction) have become unnecessary due to a change in the entrepreneurial activities, or cannot be used for the original purpose thereof as a consequence of damage or destruction, or cannot be used at all; (iii) a concession or similar right can only be exercised to a limited extent or cannot be exercised at all due to the amendment of the contract; (iv) an activity implemented as a result of a completed experimental development project is limited or terminated, or produces no result; (v) the book value of goodwill - in consequence of any change in the circumstances that affect expectations concerning future economic benefits - remains permanently and substantially higher than its market value (the amount of the expected return).

No ordinary depreciation can be claimed in connection with assets that do not depreciate when used, but rather, due to their unique characteristics and properties, appreciate over the years.

The capitalized value of formation / reorganization expenses and the capitalized value of research and development may also be shown under intangible assets. The cost of these assets should be amortized over a maximum of 5 years, and the net book value of capitalized value of formation/reorganization expenses and research and development costs should be allocated to a non-distributable reserve within the equity.

The capitalized value of formation / reorganization expenses consists of the costs incurred in connection with the commencement of the entrepreneurial activity (along with the entrepreneur's substantial expansion and restructuring or reorganization) that are not classified as assets in the course of construction or renovation. In addition, these costs are likely to be recovered following the formation or reorganization, such as expenses invoiced by subcontractors and costs incurred during operations, which are defined as direct prime costs.

Expenses relating to the introduction of a quality assurance system are also included in this category. Capitalized value from research and development may only include costs directly incurred in connection with the systematic application of knowledge obtained through research and improved by experience. The purpose of the regulation is to create new materials, products and structures, implement new technologies, systems and services, or achieve substantial improvements in those materials, products and structures already existing or implemented.

Goodwill should be recorded in the case of an acquisition of the qualified majority of a company (a qualified majority refers to more than 75% of voting rights) when the consideration paid (i) is higher than the market value of the assets less the value of liabilities of the company concerned, proportionate to the shares acquired, or (ii) is higher than the stock exchange price of the acquired company's listed shares.

Negative goodwill (shown under deferred income) needs to be recorded when the consideration paid for a qualified majority of a company is less than the market value of the acquired company, proportionate to the shares acquired.

There are no specific amortization rules for goodwill. At initial recognition of goodwill, companies must decide (and record in their accounting policy) whether the value of the acquired company is expected to decrease over time, with a resulting depreciation in goodwill, or whether the value will not decrease (in practical terms, it has an indefinite useful life) and, as such, won't be depreciated. In this case, extraordinary depreciation should be charged if a decline in value still continues.

Negative goodwill is written off against income over a period of minimum 5 years.

3.2.4. Inventories

The cost of inventories includes the direct costs and the allocated charges directly attributable to production. Valuation of raw materials and purchased items is normally based on the FIFO method or on average price, while average annual cost is normally used for self-manufactured products.

3.2.5. Self-manufactured stocks

The cost of self-manufactured stocks and services rendered shall be determined based on the post-calculation method for entities which meet the following criteria:

- sales (reduced by the purchase value of the goods sold and the value of intermediation - net sales revenues) exceed HUF 1 billion in any financial year; or
- total costs exceed HUF 500 million from the start of the following financial year. No forward exemption is granted from this obligation under any circumstances, even if relevant conditions are satisfied.

3.2.6. Investments

Investment means the purchase, creation and production of a tangible asset, commissioning of a purchased tangible asset, the activities performed up to the time when the asset is placed into operation (shipping, customs formalities, mediation, foundation work, commissioning, and all activities performed in connection with the acquisition of the asset, such as planning, preparations, execution, arranging a loan and obtaining an insurance policy etc.); any operation for the expansion, conversion, transformation of an existing tangible asset or to increase the useful life and/or capacity of an existing tangible asset shall also be included in this category.

Investments are accounted for at the lower of cost and market value. The cost of the investments is the purchase price, which should also include the option price or commission paid for acquisition, if no goodwill or negative goodwill is required to compute upon acquisition, i.e. acquiring less than a qualified majority of a company. Upon acquisition of a qualified majority of a company, the investment should be recorded at the market value of the assets less the value of the liabilities of the company concerned, proportionate to the shareholding acquired and the difference should be recorded separately as goodwill or negative goodwill, as described above under the section entitled “Tangibles and Intangibles”. For investments in shares of business associations, whether listed under current assets or financial investments, the loss in value is accounted for by the negative difference between the book value and the market value of the investment if it appears permanent and is of a substantial amount. If, later on, the market value of the investment is substantially and permanently higher than its book value, the loss in value previously accounted for will be written back up to the original cost of the investments.

3.2.7. Debtors

An allowance is established for overdue and doubtful debts.

3.2.8. Shareholders' equity

A company's equity shall consist of subscribed capital (decreased by the amount which has not yet been paid up), capital reserve, retained earnings, tied-up reserves, valuation reserve, and the balance sheet total for the current year.

Revaluation reserve is made up of the valuation adjustment arising from the fair valuation of tangible and intangible assets, and specific financial instruments as detailed under the concept of fair valuation.

Tied-up reserve includes a few specific elements of capital reserve and retained earnings, and certain other contributions by shareholders.

The after-tax profit for the year can be disbursed as dividend, profit-sharing or other yields on equity only if the amount of equity, decreased by the tied-up capital reserve and the valuation reserve, does not fall below the amount of subscribed capital following disbursement of such dividends or profit-sharing. Advances on dividends are paid based on interim financial statements, applying the same rules as dividend payments. Advances on dividends should be accounted for as receivable at the payer and liability at the payee respectively, until such time as the financial statements and the dividend for the financial year are officially approved by the shareholders, and in the event that the annual financial statements indicate a lower amount of distributable dividend, the difference must be paid back by the owners.

Tied-up reserve and revaluation reserve are not distributable to shareholders.

Fair value reserve is also part of Shareholders' Equity for all companies which have adopted fair value accounting.

Share capital and share premium incurred in foreign currency remains at historical value and is not revalued over time.

3.2.9. Provisions

Provision should be made for payment obligations derived from past or ongoing events or contracts, where future occurrence is certain or probable as of the date on the balance sheet, but either the amount or date are uncertain. Such liabilities might include warranty obligations and other guarantees, contingent liabilities, certain future liabilities, early retirement pensions, severance payments, and environmental obligations.

Provisions can also be made to cover any significant future costs (whose occurrence is certain or probable, based on the information available on the balance sheet date, but either the date or amount is uncertain and may not be included within the value of accrued expenses) which may recur periodically. Such costs might include maintenance, costs of reorganization and environmental costs.

Financial institutions, insurance companies and brokerage companies may establish provisions or allowances in accordance with special regulations.

3.2.10. Subordinated liabilities

Liabilities can be short-term, long-term and subordinated liabilities.

Subordinated liabilities shall include all loans that were in fact provided to the company, and where the relevant contract contains the lender's consent by which to permit the company to use the loan to pay off its debts and to acknowledge that the installments to repay the loan are ranked one before the last, preceding only the claims payable to the owners, and that - in the event of liquidation or bankruptcy of the borrower - repayment is subordinated whereas to satisfy the other creditors first, furthermore, that the deadline of repayment of the loan is either unspecified or is adjusted to future events, however, the original term is set for five or more years and that the loan cannot be repaid before the original maturity or before the date of termination fixed in the contract.

Furthermore, the deadline for loan repayment is either unspecified or is adjusted to future events (the original term being set for 5 or more years). The loan cannot be repaid before the original maturity date or before the date of cancellation stipulated in the contract.

3.2.11. Deferred income taxes

Accounting profit and taxable profit are not necessarily the same. Temporary and permanent differences may occur in the calculation of the tax base. Under Hungarian accounting rules, only the current tax liability shown on the tax return is reflected in the financial statements, i.e. deferred taxes may not be accounted for. However, certain temporary differences are carried forward in the income tax return (outside of the financial statement) and tax loss carried forward can be taken into consideration as a deduction in subsequent income tax calculations.

3.2.12. Foreign-currency transactions

Transactions in foreign currencies are converted into Hungarian forint (HUF) at the prevailing rate of exchange on the transaction date. Assets and liabilities denominated in foreign currencies are converted into HUF at the prevailing rates of exchange on the balance sheet date. Unrealized foreign currency exchange gain or loss is recognized in the income statement.

The HUF value of assets and liabilities denominated in foreign currencies are determined by the official foreign exchange rate published by the National Bank of Hungary, or the average rate between the buying and selling rate of a credit institution of the enterprise's choice. When determining the HUF value of assets and liabilities denominated in foreign currencies, instead of the average rate between the buying and selling rate of foreign exchange, all assets and liabilities denominated in foreign currencies may be uniformly evaluated at buying or selling rates. In their written accounting policy, companies have to specify which foreign exchange rate they would use for revaluation purposes.

3.2.13. Bookkeeping and statutory financial reporting in a foreign currency

Economic entities keeping double-entry books are required to draw up annual accounts and annual reports.

However, economic entities keeping double-entry books may prepare a simplified annual account if, on the balance sheet date in two consecutive financial years, two of the following three size-related indices do not exceed the limits indicated below:

a) the balance sheet total does not exceed 500 million forints;
b) the annual net sales revenues do not exceed 1,000 million forints;
c) the average number of employees in the financial year does not exceed 50 persons.

Non-resident companies (customs free zone companies, including those construed as non-residents under foreign exchange laws), must prepare their annual reports and keep their books in the Hungarian language and in the currency defined in their deeds of foundation. European Economic Interest Groupings, European public limited liability companies, and European cooperative societies must prepare their annual reports in the currency defined in their articles of incorporation.

According to the Act on Accounting it is also possible for other companies to keep their books in a currency other than the Hungarian forint. In order to be able to apply the “functional currency” option, a taxpayer must have 50% of both its (a) income and expenses and (b) financial assets and liabilities, taken together, having been incurred in a single foreign currency. This condition must be fulfilled both during the reporting year and the previous year. When determining the required percentages, transactions linked to foreign currency can also be considered as if they were incurred in a foreign currency.

Where the currency, other than euro, in which the annual account is denominated, is in compliance with the above requirements, the economic entity shall have the option to replace the currency in question with euro. In that case euro shall be indicated in the instrument of constitution as the currency of denomination.

3.2.14. Concept of fair valuation

Transactions are recorded at historical cost. However, accounting law allows the revaluation of fixed and intangible assets to the current market value against a revaluation reserve. This means that the revaluation doesn't affect the income statement. Any such revaluation must be specifically approved by the statutory auditor of the company and must be performed annually thereafter. For companies that do not require auditing, the law implies that an auditor would need to be appointed for this specific purpose.

Fair valuation cannot be applied to (a) financial instruments held to maturity; (b) loans and other receivables originated by the company; (c) equity securities in a subsidiary, a jointly controlled company or associated company shown under financial investments;(d) repurchased debt securities of own issue and equity securities in another company; (e) financial instruments with special characteristics;(f) spot delivery futures and options for commodities (non-derivative transactions);(g) futures and options contingent on climatic, geological or other physical variables; (h) other financial liabilities; (i) any financial instrument whose fair value cannot be determined by a reliable method.

A 2003 amendment to the Act on Accounting introduced the definitions and categories of IAS 32 and IAS 39 on financial instruments. The Act basically distinguishes between the same four categories of non-hedging financial assets as the aforementioned standards: held for trading; held to maturity; available for sale; and originated by the enterprise. Non hedging financial liabilities can either be held for trading or other financial liabilities.

According to the Act on Accounting, an enterprise may apply the concept of fair valuation for its financial instruments, although the decision should be put down in writing in the company's accounting policy and then applied consistently. The following should be taken into consideration during the fair valuation of financial instruments:

- Fair valuation must not be applied to (i) financial assets held until maturity or originated by the enterprise (ii) interests in subsidiaries or joint ventures or associates, (iii) repurchased bonds issued by the enterprise, treasury shares, and other exceptions enumerated by IAS 39, and (iv) when fair value of the financial instrument cannot be reliably measured.
- Financial assets held for trading should be valued at their fair value on the balance sheet date. Profit or loss on the fair valuation should be recognized in the profit and loss account as a financial expense or income.
- Financial assets available for sale can be valued at their fair value on the balance sheet date and any positive difference from the fair valuation should be recognized in the equity, in the form of a fair valuation reserve. A negative difference should first be offset against the previously accounted fair valuation reserve of the specific financial instrument. The remaining difference should be recognized in the profit and loss account as impairment loss.
- The result of the fair valuation of fair value hedges should be recognized in the profit and loss account similar to financial assets held for trading. The result of the fair valuation of cash-flow hedges and net investment hedge in a foreign entity should be accounted for in the fair valuation reserve within the equity. When the cash-flow hedge or the net investment hedge in a foreign entity is closed, the previously accounted fair valuation reserve should be reversed.

3.2.15. Consolidated financial statements

A company must prepare consolidated financial statements that include its subsidiaries, jointly controlled investments and associates. The consolidation method is the full integration method with respect to subsidiaries, whilst the proportional integration method applies with respect to jointly controlled entities, and equity accounting for associates. A company must prepare consolidated financial statements that include its subsidiaries if, in the two years preceding the financial year, the group met at least two of the following criteria:

- balance-sheet total (total assets) exceeds HUF 2.7 billion (EUR 10 million),
- annual net revenue exceeds HUF 4 billion (EUR 15 million),
- average number of employees for the year exceeds 250.

A company must treat another company as a subsidiary if any of the following apply:

- It holds more than 50% of the equity of, or has a voting majority in, another entity; or
- It is entitled to elect or recall the majority of senior officers and members of the supervisory board; or
- It exercises decisive direction and control over an entity.

Separate financial statements must also be prepared for each company in the consolidated group.

Listed companies, under the scope of Regulation 1606/2002/EC on the application of international accounting standards, are obliged to prepare their consolidated financial statements in accordance with the International Financial Reporting Standards as adopted by the EU. Other enterprises may also prepare their consolidated financial statements in accordance with the International Financial Reporting Standards, as adopted by the EU. In such cases, no Hungarian statutory consolidated financial statements should be prepared. However, this does not apply to standalone (non- consolidated) financial statements, which should always be based on the statutory requirements of the Act on Accounting.

No consolidated financial statements have to be prepared for parent companies, which are also subsidiaries of a superior parent company, if the superior parent company prepares and discloses a consolidated annual report according to the Act on Accounting or Council Directive 83/349/EEC of 13 June 1983 or the European Parliament and Council Decree 1606/2002 of 19 June 2002. However, in this case, the exempted Hungarian parent company must provide for the publishing of the official Hungarian translation of the consolidated annual report and the consolidated business report of the superior parent company, including the auditor's report, within 180 days from the balance sheet date indicated in the consolidated annual report of the superior parent company.

3.2.16. Related party disclosures

Companies must disclose related-party information in the supplement (notes to financial statements). Required disclosures include the names of subsidiaries, associated companies and jointly managed companies, other enterprises with a share ownership relationship, and loans and advances to directors, management and the supervisory board and, in particular, any significant transactions with related parties carried out outside of the normal course of business or under non-market conditions. The statutory form of the balance sheet (defined in the Act on Accounting) requires that companies show the balances in separate lines arising from the following transactions with related companies:

- long and short-term investments
- given long-term loans
- receivables
- subordinated liabilities
- long and short-term liabilities

3.3. Disclosure, reporting and filing requirements

3.3.1. Financial reporting of Hungarian branches of EU registered companies

Hungarian branches of foreign enterprises that have their registered seat within the territory of any member-state of the European Union (or within any other country included on the list issued by the Minister of Finance) are exempt from the statutory depositing, publishing and auditing requirements regarding their financial statements if financial reporting, depositing and auditing requirements of the foreign enterprises are declared to be in harmony with relevant European Union regulations.

In the above case, the Hungarian branch is obliged to publish and deposit the financial statements prepared by the foreign enterprise in accordance with the relevant regulations of the State in which the enterprise has its registered seat.

3.3.2. Reporting requirements

The minimum reporting obligations for a business entity depend on the following:

- the entity's size
- the nature of its operations

- ownership control and whether the company has a controlling interest over other companies.

The three alternative levels of statutory reporting are the following: (i) a full annual report, (ii) an abbreviated annual report, and (iii) a consolidated annual report. Entities may choose to maintain more extensive records, and prepare more complete reports than the required minimum.

An abbreviated annual report is allowed for entities with less than HUF 500 million (EUR 2 million) in total assets, with up to HUF 1000 million (EUR 4 million) in turnover, and an annual average of less than 50 employees over two consecutive years.

Entities not satisfying these criteria must prepare a full annual report. Separate guidelines apply to financial institutions and insurance companies.

3.3.3. Disclosure requirements

The notes on the accounts shall include all numerical data and explanatory information prescribed by the Act on Accounting. In addition to the financial data already contained in the balance sheet and in the profit and loss account, financial information, which is necessary for a true and fair demonstration of the undertaking's financial and earnings position, must be included in the statutory financial statements and the results of its operation for the owners, investors and creditors. The notes to the accounts must also contain information on any unique or special activities. The constituent parts of the accounting policy, any change thereof, and the effect of any change on the profit or loss figure, must be separately illustrated in the notes to the accounts.

3.3.4. Filing requirements

The management of a business entity is responsible for issuing an annual report within 150 days of the end of the financial year (180 days in the case of a consolidated annual report). The annual report must include a balance sheet, an income statement, and notes in support of the financial statements. The notes must include the cash flow statement. The preparation of a business report is mandatory, although any such business report does not form part of the annual report.

All registered companies must file annual financial statements and reports with the Ministry of Justice that are available to the public.

Publicly quoted companies must file their financial statements with the Budapest Stock Exchange. The stock exchange also requires other filings by listed companies, including quarterly interim reports.

Public limited companies must publish their financial statements in a Hungarian national newspaper. In addition to the financial statement filing obligations, business entities must file a standard-format return with the tax authorities including a copy of their annual report.

3.4. Audit requirements

In accordance with the Act on Accounting all companies keeping double-entry books must have a statutory auditor. Auditing is not compulsory for any company whose annual net sales do not exceed HUF 300 million and whose average number of employees does not exceed 50 on the average of two financial years preceding the financial year under review (both requirements should be met). Financial institutions and any such Hungarian branches of foreign registered companies, which are not otherwise exempted, cannot apply this exemption rule. In all cases, when an audit is not compulsory on the basis of Hungarian Accounting Law or another legal regulation, the undertaking is free to decide whether to employ an auditor to review its books or not. The audit has to be conducted in accordance with the Hungarian National Standards on Auditing.

Auditors must be members of the Hungarian Chamber of Auditors. To qualify as an auditor, an individual must have three years of experience, and have passed the qualifying examinations. A qualified auditor may apply to the Chamber of Hungarian Auditors for an audit license not less than three years after passing the final qualification exam. To conduct audits for financial institutions, insurance companies and pension funds, a qualified auditor must hold separate audit licenses.

4. Taxation

4.1. Taxation in general

Personal income tax and VAT were introduced into the Hungarian tax system in 1988. This was a first step in a long process of tax reform. The next major step, undertaken in 1991, was the modernization of the corporate income tax system. In 1993, the VAT legislation was further modified to conform, at least in principle, to the VAT systems used in the European Union. 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 whilst replacing the supplementary tax with a withholding tax. With Hungary's accession into the European Union, several changes have been implemented in the Hungarian tax legislation during the past few years to comply with the EU tax directives (e.g. parent-subsidiary directive, mergers directive, and further harmonization with the sixth VAT directive).

4.2. Tax procedures

The Hungarian taxation system has developed in recent years is now close to the level of complexity found in Western Europe. Tax laws in Hungary are enacted by Parliament. The Tax Authority provides only interpretative and administrative guidelines for these laws. Court decisions currently play an increasing role in interpreting tax laws and, as a result of Hungary’s accession to the EU, European Court of Justice (ECJ) case law is also applicable.

Act XCII of 2003, severally amended, provides for the order of taxation and, within this, the uniform regulation of the rights and duties of taxpayers and tax authorities.

Hungarian taxation operates under a self-assessment system. Taxpayers are required to register, determine their tax obligation, make advance payments, file tax returns on their own behalf, make corrections to the tax returns as needed, keep records and supply information as required by law. Authorities randomly examine tax returns to enforce the self-assessment system. Corporations are subject to continuous assessment throughout the year. The Commissioner of National Tax and Customs Administration determines the target areas to be audited in each tax year. The tax year is the calendar year for individuals and the calendar year or the business year for companies. In general, tax returns must be filed annually. However, for VAT, payroll and withholding taxes, entrepreneurial tax quarterly or monthly filing may be required.

Corporate income tax returns for companies are due by 31 May following the calendar year-end (or should be submitted within 150 days of the year-end with regard to companies whose business year differs from the calendar year).

Under general circumstances, if the tax authority carried out a full-scope tax audit regarding a specific tax year, the period concerned generally cannot be re-opened and revised again.

4.3. Taxation by corporations

4.3.1. Corporate income tax

With the exception of individual entrepreneurs, businesses (commercial enterprises, branch offices of foreign enterprises) are subject to corporate income tax. The corporate tax rate is 10 % of the positive tax base up to five hundred million forints and 19 % for the part above five hundred million forints.

The 10 % tax rate may be applied by any taxpayer: (a) who did not claim any tax allowance; and (b) whose average number of employees registered in the tax year is at least one; and (c) whose tax base for the current tax year and in the year before that reaches the income (profit) minimum; and (d) who had not been found in dissent with the requirement of distinguished labor relations as set out in the Act on Public Finances during the current and the previous tax year by a final and executable authentic resolution adopted by the employment authority, the tax authority or the authority vested with powers to monitor and enforce compliance with the principle of equal treatment, and - in the case of judicial review of the said resolution - had not been sanctioned by final court verdict by an employment penalty, a penalty under the Act on Equal Treatment and the Promotion of Equal Opportunity or a default penalty under the Act on the Rules of Taxation; (e) who declared pension and health insurance contributions during the tax year in the amount equal to at least double of the prevailing monthly minimum wage in effect on the first day of the tax year, or - if the taxpayer is established in any one of the regions and communities deemed most underprivileged pursuant to the relevant regulation - in the sum received by multiplying the average number of employees employed during the current year by the annualized average of the prevailing monthly minimum wage.

4.3.2. Amortization

When determining taxable income for the corporate income tax, the tax law allows for calculating with amortization. Accounting is done on a gross value basis: depreciation increases a corporation's pre-tax earnings, while amortization under the tax law reduces a corporation's earnings before taxes. In certain cases, the tax law allows for amortization or permits accelerated depreciation (e.g. immaterial assets, leased equipment).

4.3.3. Losses carried forward

All losses can be carried forward without any time limit. Beginning with the fourth tax year from the start of operations, corporations may, with a permit from the tax authority, carry forward their losses if they produced losses for the previous two years or if revenues did not reach 50 percent of all expenses in the given tax year. The tax authority issues such a permit only if the loss was caused by unavoidable external circumstances. Losses by credit institutions can not be carried forward.

4.3.4. Tax credits

Tax credits reduce corporate income tax and can also reduce taxable corporate income.

4.3.5. Corporate withholding tax

As of January 1, 2010 the withholding tax will be introduced aiming to receive tax after the income of foreign organizations. The tax rate of withholding tax is 30%. With regard to the fact that the Republic of Hungary has bilateral double taxation agreement with the members of the European Union, the withholding tax exists only vis-à-vis third countries. It shall be noted that dividends paid for abroad are exempted from withholding tax without regard to the other country.

4.4. Taxation of private individuals

The income of private individuals resident in Hungary is subject to taxation (complete taxation liability), whereas private individuals living abroad can only be taxed for earnings originating in Hungary or foreign earnings taxable in Hungary in accordance with a tax treaty. Wages earned by foreign nationals employed in Hungary are also taxable, excepting where the foreign employer cannot be taxed in Hungary in accordance with a tax treaty. Earnings abroad do not need to be transferred to Hungary in order to be eligible for taxation.

In accordance with the income tax law, Hungarian citizens are classified as private entities with domestic residence. Foreign nationals are classified as private entities with domestic residence if their permanent address or usual residence or the centre of their interests is located in Hungary. If a tax treaty is applicable to a case, then it overrules the provisions of domestic law.

The rate of the personal income tax is 15%.

4.5. Indirect taxes

4.5.1. Value-added tax

VAT (ÁFA in Hungarian) is the most significant indirect tax in Hungary. VAT rate is normally 27 %, but for certain products and services is only 5 %. Hungarian companies may request EU VAT ID. Depending on the turnover, companies are required to submit a VAT report once per year, quarterly or monthly. Companies with EU VAT ID are to submit a VAT report at least quarterly.

Banking and insurance services and certain other business activities are exempted from VAT.

4.5.2. Excise tax

This type of tax is paid upon the domestic production and import of products liable to excise tax.

Products burdened with excise tax are as follows:

- Petroleum products
- Alcoholic beverages, beer, wine, champagne, intermediary alcohol
- Tobacco products.

4.6. Other taxes

The general characteristic of these is that they can be accounted as expenses, and they therefore reduce the amount of taxable corporate income.

4.6.1. Local taxes

As empowered by law and at maximized values, local governments have the right to levy local taxes within their jurisdiction. These may include the following:

- Property tax
- Utility tax
- Tourist tax
- Local business tax

4.6.2. Vehicle tax

The owner or the operator must pay a vehicle tax for each vehicle registered in Hungary and for all trucks registered abroad (except for those registered in EU Member States).

4.6.3. Innovation contribution

The innovation contribution rate is 0.3% and is set nationally and is paid by entities who under the scope of the Act on Accounting. It is important to note that the amount spent on research and development is deductible from the tax itself. Newly incorporated entities, which are in the calendar year of their incorporation (as well as small and micro-sized entities), are not subject to innovation contribution.

4.6.4. Environmental pollution charge

Those companies emitting environment-polluting materials into the air, the waterways, or the soil must pay this tax in proportion of the type of materials emitted, their concentrations and the location as specified by the prevailing laws.

4.6.5. Energy tax

This tax must be paid in certain cases on natural gas and electric power (e.g. when selling energy products outside the scope of the residential range, to service providers, energy brokers, or so-called authorized main energy consumers).

5. Investment incentives

The Hungarian Investment and Promotion Agency supports high value-added investment projects with a one-stop-shop service including a VIP treatment and comprehensive information about available subsidies for investment projects.

In cases where no EU co-financed subsidy is available, the Hungarian Government offers tailor-made incentive packages for projects with eligible costs exceeding EUR 10 million (or EUR 50 million for tourist projects).

The incentive package may consist of the following elements:

- cash subsidy decided individually by the Hungarian Government
- development tax allowance
- training subsidy
- job creation subsidy.

6. Contact us

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