

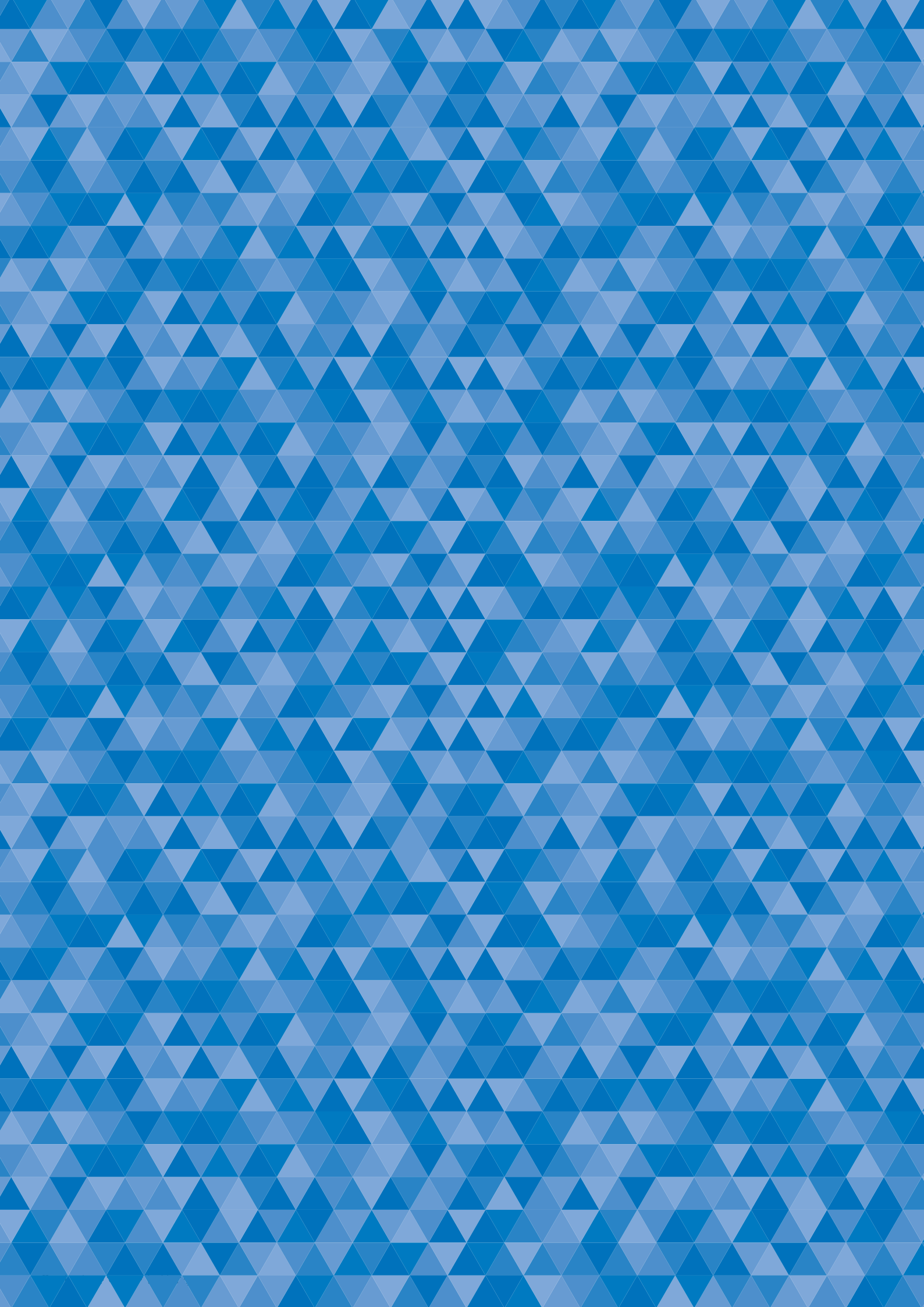


Investment in Hungary

July, 2019.

kpmg.hu







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July, 2019.



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Preface

Investment in Hungary is one of a series of booklets published by KPMG member firms to provide information to those considering investing or doing business in various countries.

This publication has been prepared by KPMG in Hungary to assist those contemplating investment or commencing operations in Hungary. KPMG in Hungary provides Audit, Tax, Legal and Advisory services for Hungarian and multinational companies, government entities and inward investors.

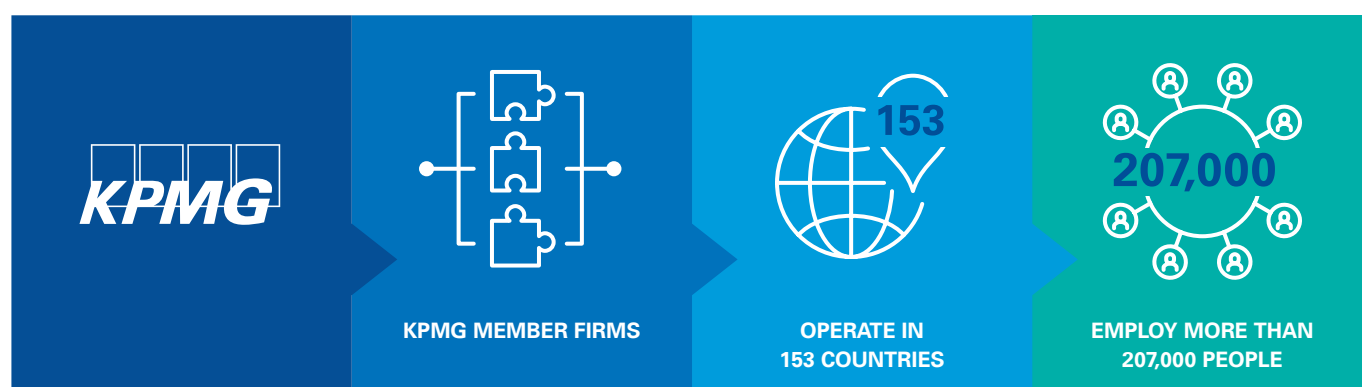
The information in this booklet is of a general nature and should only be used as a guide for preliminary planning purposes. Because of the continually changing legislative environment in Hungary, the complexity of Hungarian corporate, tax and social laws and regulations and the evolving nature of the Hungarian economy, comprehensive professional advice and assistance should always be obtained before implementing any plan to invest or do business in 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.

KPMG in Hungary

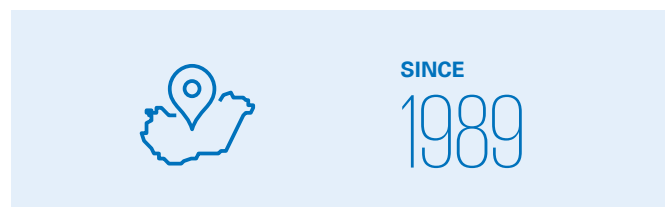


KPMG in Hungary

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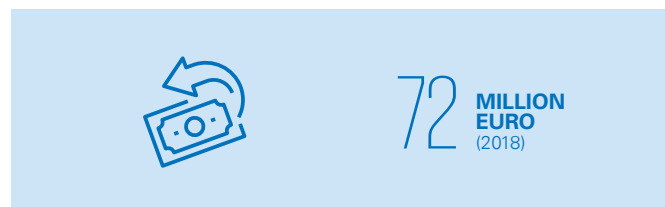
KPMG IN HUNGARY



CLIENTS



REVENUES



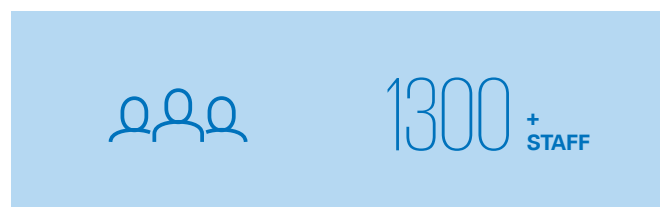
EXPORT REVENUES



CENTRAL BUDGET PAYMENT



PEOPLE



Our services

AUDIT



We provide both independent assurance and insight that goes beyond the audit opinion. Audit is ever more supported by technology and delivery centres. We have set up a Data & Analytics Center (DAC).



AUDIT

- Hungarian Statutory Reporting
- IFRS and US GAAP Reporting
- German, Japanese and Korean Desks

TAX & LEGAL ADVISORY



The high and increasing complexity of regulation is an opportunity for us. We support our clients in tax planning and compliance in order to help manage their tax burden and reduce their tax risks.



TAX SERVICES

- Corporate Tax, Deal Advisory and M&A Tax
- Indirect Tax Advisory and Compliance Services
- Financial and International Taxation
- Global Mobility Services
- Transfer Pricing Advisory

Our lawyers deliver full-scale legal advice and insightful support to our clients. Due to technological developments and changing client demands, a new era of legal services has begun – therefore we offer a new approach fuelled by innovation and proactivity.



LEGAL SERVICES

- Corporate and M&A
- Commercial
- Real Estate
- Employment
- Dispute Resolution
- Banking and Finance
- GDPR
- Life Sciences
- Competition

ADVISORY



Our advisors work with clients in addressing issues of growth, performance and compliance. Our professionals combine specialist skills to provide objective advice and execution to help preserve and improve value.



MANAGEMENT CONSULTING

- Business Performance Services
- IT Advisory Services



RISK CONSULTING

- Accounting Advisory, Bookkeeping and Payroll
- Financial Risk Management
- Forensic Services
- Internal Audit, Risk and Compliance Services
- IT Risk Advisory Services

KGSH – KPMG Global Services Hungary provides compliance services to multinational groups in over 37 countries.



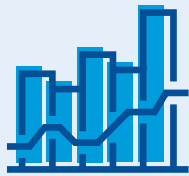
DEAL ADVISORY

- Corporate Finance
- Restructuring Services
- Transaction Services
- Valuation Services

GLOBAL SERVICES



Relevant sectors



FINANCIAL SERVICES



ENERGY & UTILITIES



**GOVERNMENT
& PUBLIC SECTOR**



**INFRASTRUCTURE
& TRANSPORT**



**MEDIA TELECOMMUNICATION
& TECHNOLOGY**



**SPORTS, LEISURE
& TOURISM**



HEALTHCARE



**INDUSTRIAL
& AUTOMOTIVE**



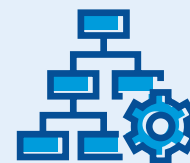
PRIVATE EQUITY



**CONSUMER MARKETS
& RETAIL**

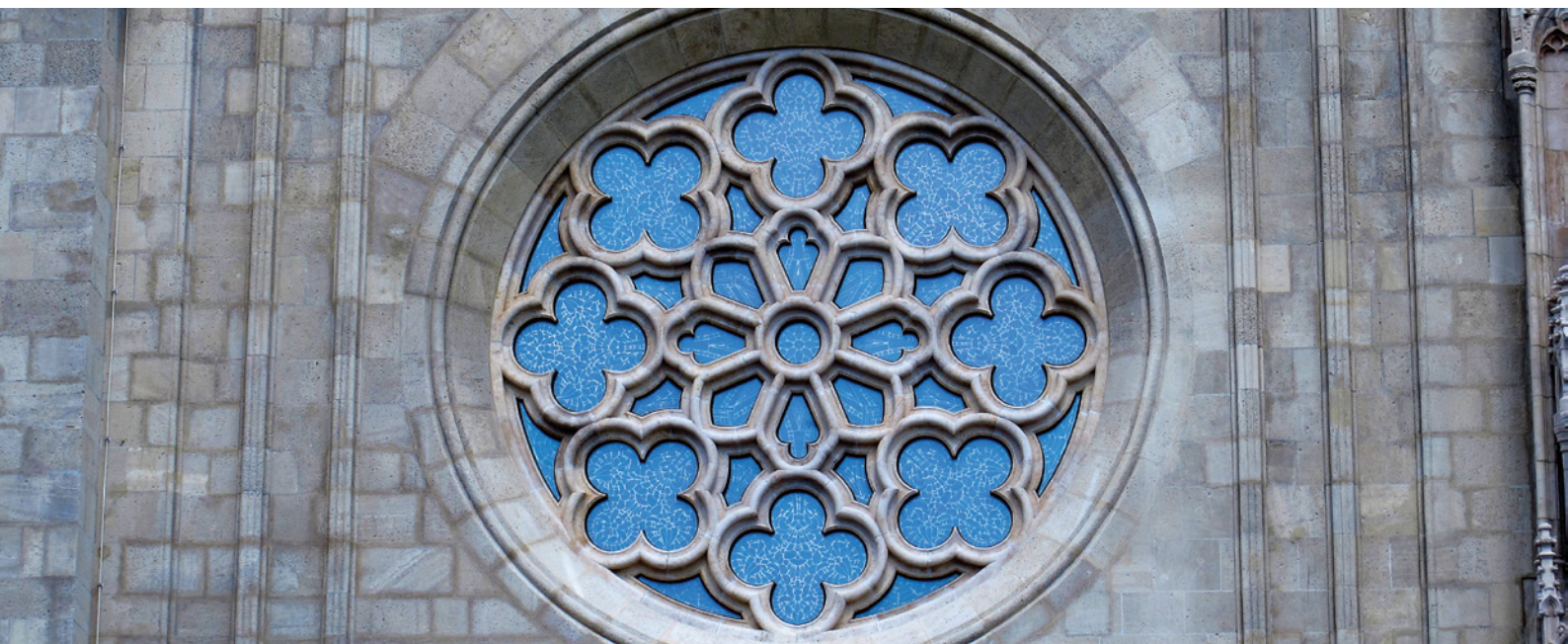


REAL ESTATE



**SHARED SERVICES
& OUTSOURCING**

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1.

GENERAL INFORMATION

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General Information

Internet domain: .hu
International dialling code: +36

1.1. GEOGRAPHY



Centrally located in Europe in the Carpathian Basin
Area: 93,030 sq km (36,000 sq miles)
Capital: Budapest
Time zone: GMT +1

Most of its territory is flat and lies less than 200 metres above sea level.

Highest peak: Kékestető, 1,014 meters
Important rivers: Danube and Tisza, which also serve as waterways

Major lakes: Balaton, Velence and Fertő. Lake Balaton, with a surface area of 600 square kilometres, and its surroundings are a popular destination for both Hungarian and foreign tourists.



Hungary is among the top 5 richest countries in terms of thermal and medicinal waters and springs, possessing the world's largest thermal lake for bathing (Hévíz Lake).

Member of the Schengen Agreement, taking full responsibility for EU borders.

1.2. CLIMATE



Moderate continental climate
High annual proportion of sunshine
Good soil quality



Favourable conditions for agriculture

1.3. POPULATION AND LANGUAGE



Population:
approx. 9.8 million



The capital, Budapest, has approximately **1,7 million inhabitants**. The population of the other 10 major cities ranges from 100,000 to 200,000 people.

Language: Hungarian (English and German are also used frequently in business)

Major religion: Christianity

Life expectancy: 76 years (2017, UN)

1.4. INFRASTRUCTURE

Transportation:

Extended **highway network** to most borders and further developments in progress.



Developed **railway system** with connections to main European logistic centres with further technical improvements underway.



Well developed public transport system in **Budapest**.

Budapest Ferenc Liszt International Airport: serving almost 15 million passengers annually; expanding cargo capacities from 2020.



Telecommunications:



Among the top 5 fastest 4G mobile internet systems in the world (2018, OpenSignal)

Mobile phone penetration: 114% (2018, World Bank)

Mobile voice market: 45% Magyar Telekom / 28% Telenor / 26% Vodafone

Individuals using the internet: 77% of the population
(2017, World Bank)

Fixed line penetration of households: 32%
(2017, Hungarian Central Statistical Office)

Office market:




Ever-growing number of newly built office spaces and industrial parks
Total stock: approx. 3.6 million sq m in Budapest; further 125,000 sq m of space in 2019. (2018, Cushman & Wakefield)

Relatively low rental prices in A category office buildings (from EUR 16/sq m/month) in the region

Unemployment rate: 3.7%
(2018, Hungarian Central Statistical Office)
Higher in the eastern and southern regions than in the central and western areas.

(OECD countries' average: 5.3%, EU countries' average: 6.8%)

Monthly minimum wage:
HUF 149,000 (approx. EUR 465) per month in 2019
HUF 160,920 (approx. EUR 500) per month in 2020 

Average monthly wage:
HUF 329,000 (EUR 1030)
(2018, Hungarian Central Statistical Office)

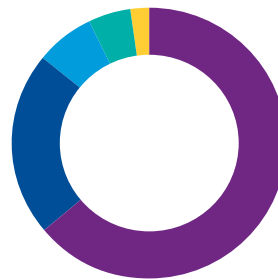
Employment structure by industry
(2017, Hungarian Central Statistical Office)

1.5. LABOUR FORCE



Employment rate: 69.3%
(2018, OECD)

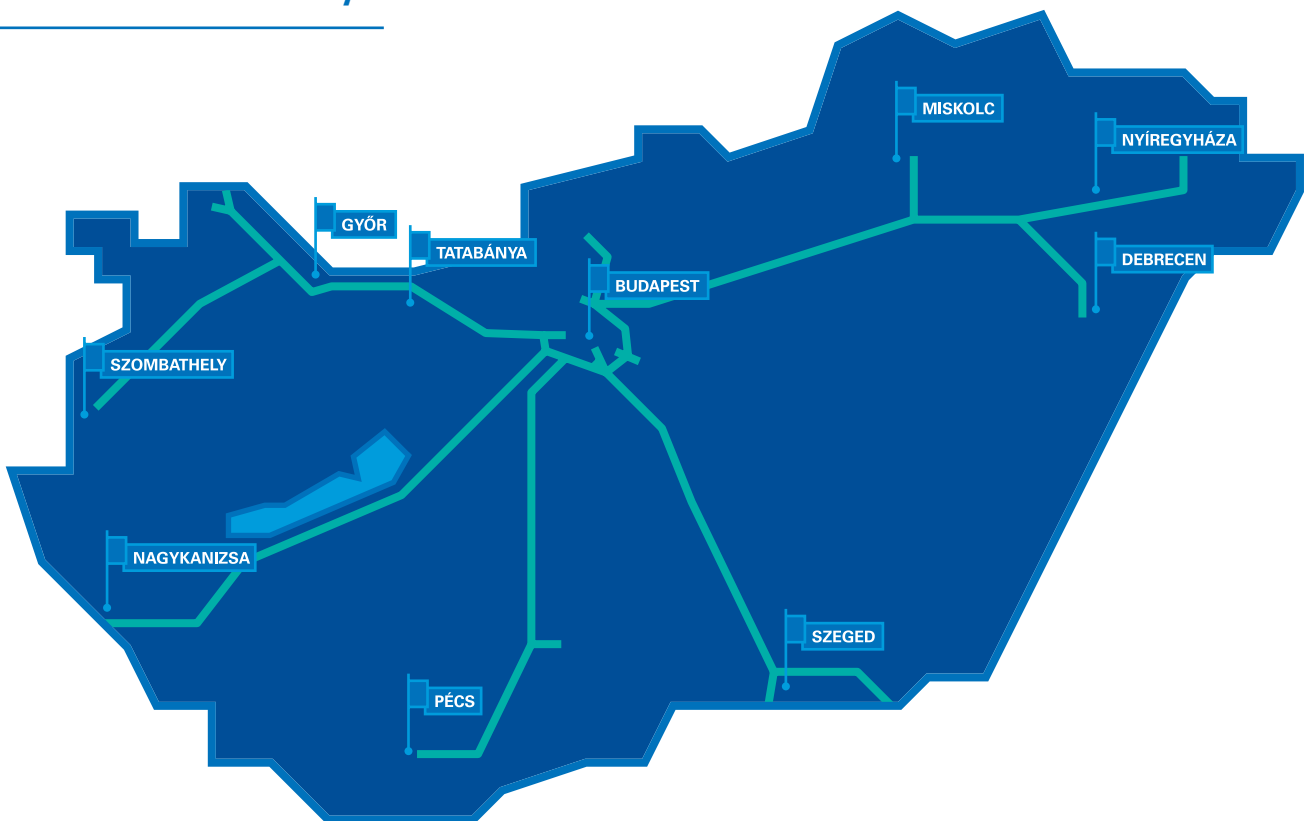
(OECD countries' average 68.4%,
EU countries' average 68.6%)



- **Services** 64%
- **Manufacturing** 22%
- **Construction** 7%
- **Agriculture** 5%
- **Other** 2%



1884 KM
of motorways



The Hungarian labour force is highly skilled and 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 labour force considerably.

1.6. POLITICAL SYSTEM

Form of government: parliamentary republic



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.

1.7. INTERNATIONAL MEMBERSHIPS



Since its accession to the EU in 2004, Hungary has been being among the largest beneficiaries of EU funds.

Other official affiliations:

UN



WTO



ILO



OECD



UNESCO



IBRD



FAO



WIPO



WHO



CEFTA



IMF



NATO



GATT



1.8. ECONOMY



Monetary unit: forint (HUF)

GDP growth: 4.9%

(2018, Hungarian Central Statistical Office)

GDP: USD 140 billion (2017, OECD)

Ranked 58th on the IMF's global GDP Indicators list 2018

GDP per capita: USD 16,000 – ranked 52nd globally

(2018, IMF)

GDP per capita ppp: USD 31,000 – ranked 44th globally

(2018, IMF)

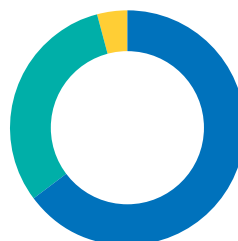
GNI per capita: USD 27.65 (2017, World Bank)

Inflation: 2.8% (2018, Hungarian Central Statistical Office)

Budget balance: -2.2%

(2018, Hungarian Central Statistical Office)

GDP by sector (2017, CIA)



■ Services	64,8%
■ Industry	31,3%
■ Agriculture	3,9%

FDI: EUR 4.3 billion (2018, Hungarian Investment Promotion Agency) – 53rd out of 190 countries (2018, World Bank)

FDI flows by country and industry

(2018, Central Bank of Hungary)

Main investing countries	2018 (Q3), in %
Germany	13.0
Netherlands	10.3
Luxembourg	10.1
Ireland	9.4
United States	9.1
France	7.5
South Korea	6.7
Main sectors for investment	2018 (Q3), in %
Manufacturing	38.0
Wholesale and retail trade; repair of vehicles	13.7
Professional, scientific, technical activities and other services	6.1
Monetary intermediation	3.2

Main exports: machinery and transport equipment, foodstuffs, chemicals

Key indicators of the Hungarian economy (GKI)	2016 actual	2017 actual	2018 actual	2019 forecast
Gross Domestic Product (previous year = 100)	102.3	104.1	104.9	103.5
Agriculture (1)	113.2	91.9	105.3	100
Industry (2)	101.0	103.4	103.2	103
Construction (3)	89.7	117.0	122.9	108
Trade (4)	100.8	108.1	107.9	106
Transport and storage (5)	105.0	103.4	104.6	103
Information, communications (6)	105.8	111.0	107.0	105
Financial services (7)	104.0	104.1	102.4	102
Real estate services (8)	103.2	102.7	104.3	103
Professional, scientific, technical activities (9)	106.5	110.9	106.5	105
Public administration, education, healthcare (10)	101.5	98.6	100.2	101
Arts, entertainment (11)	102.7	103.3	105.5	102
GDP domestic demand (previous year = 100)	101.0	106.8	107.0	104.5
Private consumption	103.4	104.1	104.6	104
Gross fixed capital formation (investment)	89.4	116.8	116.5	107
Exports	105.1	104.7	104.7	105
Imports	103.9	107.7	107.1	106.3
Consumer price index (preceding year = 100)	100.4	102.4	102.8	103.2
EUR billion	7.0	4.9	3	4.5
in per cent of GDP	6.1	4.0	2.3	3.2
Unemployment rate (annual average)	5.1	4.2	3.7	3.5
General government balance in per cent of GDP (based on EU methodology)	-1.6	-2.2	-2.2	-2

A cost-efficient and well-trained workforce, combined with the country's low cost of living, advanced infrastructure, and advantageous geographical position are likely to continue to draw more leading companies to Hungary.

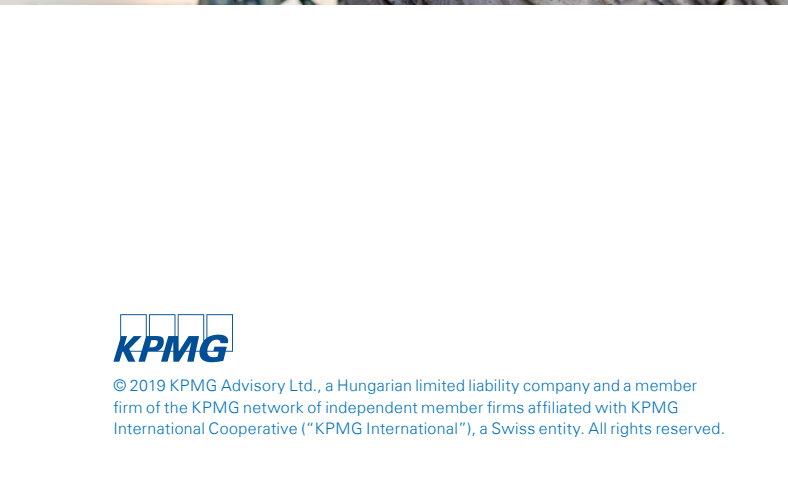
2.

FOREIGN INVESTMENTS – A GENERAL OVERVIEW

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Foreign Investments

- A General Overview

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

2.1. 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, which provides important protection for foreign investors.

2.2. BRANCH OFFICES AND REPRESENTATIVE OFFICES



A foreign company may establish a branch office or a representative office in Hungary. Branch offices and representative offices are not separate legal entities but organisational units of a foreign company. Both branch offices and representative offices have to be registered by the competent Hungarian Court of Registry.

Branch Offices

After registration, branch offices can carry out most business activities in Hungary without limitation. Although branch offices are not legal entities, in principle, for activities subject to licensing, branch offices require the same licences as other Hungarian legal entities.



The assets required to operate the branch must be provided by the founder of the branch office. The branch office and its founder have unlimited, joint liability for debts incurred in the course of operation of the Hungarian branch office. Branch offices must keep their books in accordance with Hungarian accounting laws, and prepare annual financial statements. Branch offices of foreign entities with a registered office in one of the Member States of the European Union are exempt from audits. The same applies to foreign entities with their registered office in the territory of Liechtenstein, and Norway.

The acquisition of real property by a branch office established by the foreign entity registered in an EEA member state is subject to the same provisions as the acquisition of real property by resident companies. The acquisition of real property by a branch office established by a foreign entity not registered in an EEA member state is subject to permission with some exceptions. In 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.).

Representative Offices

Limited, administrative activities of a non-resident entity may also be conducted through a representative office. A representative office may provide information concerning the non-resident entity's products and services and, to a limited extent, assist the non-resident entity in concluding contracts. The representative office is an operational unit of the non-resident company. Tax implications should be carefully considered.

Representative offices must be registered with the competent Hungarian Court of Registry. A representative office of a non-resident company is permitted to assist in preparing contracts and to provide advertising services on behalf of the entity it represents. However, it is not allowed to engage in any other kind of commercial activity.

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 tax. For example, acting as an agent for a non-resident may bring a representative office under the scope of Hungarian corporate income tax.

In other respects, the same rules apply for representative offices as for 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 property by a representative office is subject to the same rules as those applicable to the acquisition of real property by branches.

2.3. FOREIGN INVESTMENTS CONFLICTING WITH NATIONAL SECURITY INTERESTS



According to Act LVII of 2018 on the control of foreign investments conflicting with Hungary's security interests, from 1 January 2019, foreign investors can only carry out certain activities, have dominant influence or acquire shares in companies carrying out any of the activities mentioned in the Act to the extent defined in the Act if they acquire the competent minister's approval.

Among others, the following services fall under the scope of the Act:

- financial services;
- operation of payment systems;
- services which fall under the scope of the acts on electric energy, natural gas, public water services, or electronic communication.

The new law only applies to entities registered outside the EU, EEA or Switzerland.

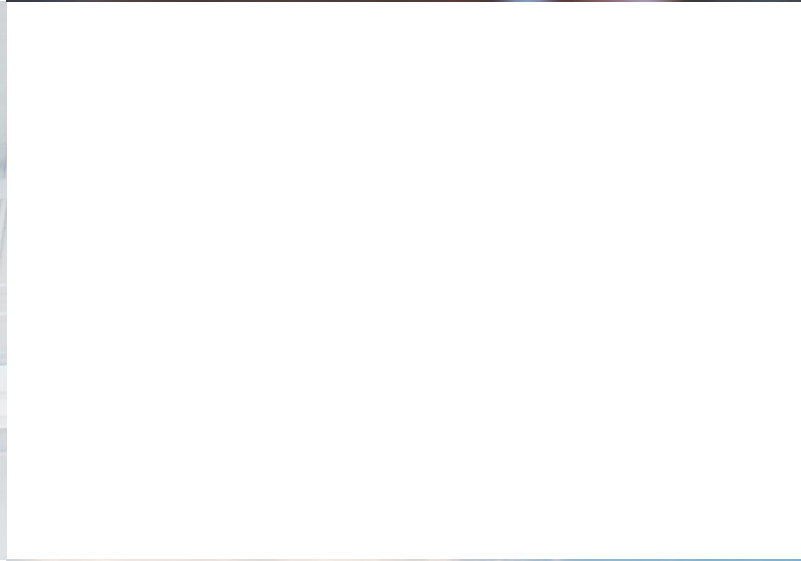
Foreign investors not complying with the provisions of the Act may be fined by the competent minister.



3.

SETTING UP A BUSINESS

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Setting Up a Business

On 15 March 2014 the new Hungarian Civil Code (Act V of 2013, hereinafter the “Civil Code”) came into force. The Civil Code was adopted after more than a decade of preparation. The Civil Code includes not only general civil law provisions, but Hungarian corporate law as well, and the main rules relating to cooperatives, succession law and family law.



The establishment of new companies or any changes to existing companies after 15 March 2014 is regulated by the Civil Code.

Act V of 2006 on Company Registration and Voluntary Liquidation is applicable for the registration and dissolution of business associations, branch offices, representative offices, EEIG and SE.

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

Four types of business associations may be established under the Civil Code:

- **Unlimited Partnership** (in Hungarian: Közkereseti Társaság – Kkt.)
- **Limited Partnership** (in Hungarian: Betéti Társaság – Bt.)
- **Limited Liability Company** (in Hungarian: Korlátolt Felelősségű Társaság – Kft.)



- **Company Limited by Shares** (in Hungarian: Részvénytársaság – Rt.); a company limited by shares can operate as a “private company limited by shares” (in Hungarian: Zártkörűen Működő Részvénytársaság, “Zrt.” for short) if its shares are not in public circulation (i.e. through a stock exchange), or as a public company limited by shares (in Hungarian: Nyilvánosan Működő Részvénytársaság, “Nyrt.” for short) if its shares are in public circulation.

The Kkt. and Bt. have elements which resemble partnerships in some ways, but not to the extent that they would be treated as such in all EU countries. The most important factor separating the Kkt. and Bt. from the Kft. and Rt. is that the members of a Kkt. and general partners of a Bt. have unlimited liability for the obligations of the company, while the members of a Kft. and shareholders of an Rt. bear only limited liability (up to the amount of their shares/quotas). 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 persons may establish or become members in a Kft. or shareholders in Rt. if they are either a company under their domestic law or if they are individuals.

3.1. RULES APPLICABLE TO ALL FORMS OF COMPANY

Articles of Association / Deed of Foundation / Statutes

The first step in founding a company is preparing the Articles of Association or Deed of Foundation for a sole member Kft. and Statutes for a Zrt. which must be signed by all members (or their authorised representatives under a power of attorney). The Articles of Association / Deed of Foundation / Statutes (except for the Nyrt) may be based on templates laid down in the Schedules to the Decree of the Minister of Justice No. 21/2006 (V.18). The Articles of Association / Deed of Foundation / Statutes must be prepared and countersigned by an attorney, the legal counsel of one of the founders, or prepared by a notary public.

The Articles of Association / Deed of Foundation / Statutes must contain:

- the name, the company form and the registered office of the company;
- the name, registered office, representative and company registration number of the founders (if the founder is a legal entity); or the name, address and mother’s maiden name, date and place of birth of the founders (if the founder is a natural person)
- the main and other activities of the company (all activities actually carried out must be registered at the tax authority within 15 days of 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;
- name, address and mother’s maiden name, date and place of birth of executive officers and other representatives of the company and the method of representation (joint or individual);
- name, address and mother’s maiden name of the auditor and supervisory board members, if an auditor or supervisory board members were elected by the members;
- term of the company, if it was established for a definite period of time;
- other matters required by the legislation for the given form of company.

Single Member Companies

A Kft. or Rt. may be established and operated by a single member (shareholder); however, at least two persons are required for the establishment of a Kkt. or a Bt.

When establishing a single member Kft., the in-kind contribution of a company founded by a single member must be provided in full prior to submission of the registration application. However, in case of cash contributions, only half of the contribution has to be paid in prior to submission of the registration application, or even less if permitted by the Deed of Foundation. The remaining amount may be paid within one year after incorporation the latest, unless the Deed of Foundation permits a longer period for the payment. In such case the company cannot pay dividend as long as the sum of profits and cash contributions already paid does not reach the level of the registered capital of the company.

When a single member Rt. is established, the in-kind contribution must be paid up in full and 25% of the cash contribution must also be paid prior to submission of the registration application.

It is the right and duty of the single member to make decisions on all issues that would otherwise fall under the authority of the members’ / shareholders meeting and said individual must notify the executive officers thereof in writing.

Registration

As of 1 July 2008, registration applications must be submitted electronically.

The establishment of a company must be reported to the competent Court of Registry within 30 days from signing the Articles of Association (Deed of Foundation). Generally speaking, the Court must also be notified of any change in the company data within 30 days. 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.

Management of a Company – Executive Officers

The duty of the executive officers is to manage company operations. Individuals can be appointed as executive officers (managing director, member of the board of directors, etc.) for a definite or indefinite term. Unless provided otherwise in the Articles of Association / Deed of Foundation / Statutes the appointment of the executive officers is for a period of five years. Managing directors may be re-appointed, removed or recalled at any time without justification. The decision to appoint or recall executive officers and establish their remuneration falls under the exclusive authority 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 manage the company with due care and diligence expected of persons in such positions, giving priority to the interests of the company. However, in the event of an imminent threat of insolvency, the executive officers shall manage the business association giving priority to the interests of the company's creditors.

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

Supervisory Board

For supervision purposes, the members (shareholders) may or, in certain cases, must appoint a Supervisory Board comprising non-executive officers in their Articles of Association / Deed of Foundation / Statutes.

The Articles of Association / Deed of Foundation / Statutes (except for an Nyrt.) may empower the Supervisory Board to appoint or remove executive officers, set their remuneration or approve particular transactions (e.g. contracts).

All Nyrt.s are obliged to set up Supervisory Boards unless they are controlled by a "one-tier system" (i.e. a corporate structure where the directors perform the duties of the supervisory board).

A private company limited by shares is not obliged to set up a Supervisory Board, but a Supervisory Board must be set up if requested by shareholders representing at least 5% of the votes.

The establishment of a Supervisory Board is obligatory for companies whose annual average number of full-time employees exceeds 200 persons, as this requires employee participation (one-third of the Supervisory Board members). The establishment is not compulsory if the work council waives the right of employee representation in the Supervisory Board.

Any company regardless of its form is obliged to set up a Supervisory Board if this is prescribed by law in the interests of public property (e.g. at companies managing public property) or with regard to particular activities at the company.



Permanent Auditor

The permanent auditor of a company, appointed by the shareholders/members of the company, is responsible for carrying out the audit work in accordance with the Accounting Act and to determine whether the annual report of a company provides a true and fair view of the company's assets and liabilities, financial position and profit or loss, and is prepared in full compliance with effective legal regulations.

These tasks assigned to the auditor are prescribed by law to protect public interest, therefore an auditor of a company may only fulfil tasks of another nature if this does not put the orderly fulfilment of auditing tasks at risk.

The appointment of a permanent auditor is optional from 1 January 2008, except for when it is required by the Accounting Act or prescribed by law in the interests of protecting public property or protecting public funds and creditors.

The appointment of an auditor becomes effective if the auditor accepts its appointment and enters into an agreement with the management of the company on auditing services.

A company's members (shareholders), executive officers, supervisory board members, their relatives and employees (during the period of employment and for a period of three years thereafter) may not be elected as the auditor of the company.

If appointed, the auditor must be indicated in the Articles of Association and may be appointed or reappointed for a fixed period not exceeding five years. In certain cases, reappointment is excluded by law.

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

The auditor must keep the information obtained about the affairs of the company in strict confidence.

If appointed, the auditor must take part in the members' / shareholders' meetings of the company relating to its financial report.

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 request to attend 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 the company will probably lose a significant part of its net equity, it must request that a members'/shareholders' meeting be convened at short notice.

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

Closing Down a Company

A company terminates:

- if the period set forth in the Articles of Association / Deed of Foundation / Statutes expires or any other condition for termination arises;
- if it is terminated without a legal successor;
- if it is terminated with legal succession (transformation – merger, demerger);
- if the number of its members falls to one person, unless otherwise permitted 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 Registry;
- based on other conditions depending on the actual type of company.

Companies cease to exist when deleted from the company registry.

If a company ceases to exist without a legal successor, "final accounts" 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 and Liquidation Procedures.



Transformation of Companies

Transformations can occur through the changing of one company form to another (e.g. a Kft. can re-register as an Rt., or vice versa).

Merger, Demerger

These can take on a variety of different forms:

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

A separate act, Act CLXXVI of 2013 on the transformation, merger and demerger of certain legal persons, outlines in detail the transformation of companies.

Compulsory Transformation

If a company's equity shown in its annual report is less than the minimum capital required for its type of company for two consecutive years, the company is required to transform into a company form where its minimum equity meets the registered capital requirement.

Liability of Members of a Company

Loss of limited liability is possible for members (shareholders) if the company ceases to exist after being deleted from the register with an unsettled debt, and the members have abused the limited liability status.

This situation can be determined in cases where the members used the assets of the company as their own, have decreased the assets of the company when the members had knowledge, or should have had knowledge with due care that the company will not be able to cover its liabilities.

Loss of limited liability is also possible for members (shareholders) holding at least 75% of the voting rights, directly or indirectly, in a company ("Majority Member") if the company ceases to exist after being deleted from the register with an unsettled debt, and the unsettled creditors initiate a court procedure against the members where the court establishes the unlimited liability of the Majority Member as a result of the Majority Member's continuous and detrimental business policy regarding the terminated company. This rule does not apply in the case of voluntary winding up.

Liability of Executive Officers

The New Civil Code changed the liability of executive officers (managing directors in a Kft. and members of the board of directors in an Rt.) as follows.

Damages or Losses Caused to the Company

An executive officer shall be held liable for damages caused to the company in relation to his/her management duties in accordance with the provisions on "liability for damages or losses caused by non-performance of an obligation" (i.e. liability for breach of contract).

Causation of an event by itself is not always sufficient to establish such legal liability. Accordingly, the officer will be released from liability if [he/she can prove](#) that:

- the damage occurred in consequence of unforeseen circumstances beyond his/her control, and
- he/she could not be reasonably expected to take action for preventing or mitigating the damage.

If the liability is established, the amount of compensatory damages will be limited to such damages and losses (also including loss of profits and consequential damages) for which [the company can prove](#) that they were foreseeable to the executive officer at the time of the conclusion of the relevant contract (that was subsequently breached).

It is possible to limit the amount of damages, but not in all cases, e.g. if it is a result of a deliberate action on the part of the executive, for the loss of life or for personal injury, etc.

In most cases, however, it has become possible to limit the liability of the executive officer in a contract to which the company is a party and to directly limit the officer's liability in an executive contract he/she enters into with the company.

Damages or Losses Caused to Third Persons

If an executive officer causes damages or losses to a third person in his capacity as executive officer by a breach of contract to which the company is a party (e.g. non-performance of a contractual obligation), then the damaged party cannot sue the officer directly for damages but only

the contracting party (i.e. the company) on whose behalf the executive has acted.

If the plaintiff is awarded damages, then the company that has to pay such damages may have a recourse against its executive officer (see the above section "Damages or Losses Caused to the Company").

If an executive officer causes damages or losses to a third person in his/her capacity as executive officer by a tortious act (or omission), i.e. in a way other than through a breach of contract, then the officer and the company he/she represents shall be jointly and severally liable to the damaged party (or injured person) in accordance with the provisions of "liability for torts". In such case, the executive officer may be sued directly, either together with or without the company.

Tort liability, however, is different from contractual liability. The executive officer will be released from tort liability if [he/she can prove](#) that:

- he/she acted as it was generally reasonably expected from him/her under the particular circumstances.

3.2. 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-member Kft. The Kft. form is the most common company form for wholly-owned subsidiaries in Hungary.





Capital

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

In-kind contributions constituting part of the registered capital may be any marketable object or intellectual property with pecuniary value, any right representing a pecuniary value or any claim that is acknowledged by the debtor or that has been established by a final and definitive court decision.

Only 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 in-kind contributions. The amount of initial capital shall not be less than HUF 3 million (approximately EUR 10,000).

Each member of the company has an identified percentage of the total capital ("quota"). A quota may be owned by more than one person. The quota cannot be less than HUF 100,000 (approximately EUR 340). As a treasury quota the company may buy back up to 50% of the quotas.

The company may only be registered if, prior to the submission of the registration application, an in-kind contribution has been made available to the company according to the Kft.'s Articles of Association, as follows:

- 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.
- If the value of the in-kind contribution is less than half of the registered capital, the in-kind contribution shall be provided according to the provisions of the Articles of Association.

The remaining cash contribution must be paid within one year of the registration, and the remaining in-kind contribution has to be provided within three years of the registration.

The Articles of Association can lower the percentage of the cash contribution to be provided at the time of the foundation of the company and can prolong the period for contributing the remaining percentage of the cash contribution to more than one year from the date of registration.

In such cases – besides the above time limits – a restriction has been created by the Civil Code on dividends: dividends cannot be paid as long as the sum of profits and cash contributions already paid do not reach the level of registered capital of the company, and the member is liable up to the value of the pending contribution.

Members' Meeting

The supreme body of a Kft. is the members' meeting.

If permitted by the Articles of Association, the members' meeting can be held with the members participating via conference call. It is up to the members to decide if they will participate in the member's meeting personally or via teleconference. Members' resolutions may be passed without holding any meeting, if permitted by the Articles of Association.

Matters falling under the exclusive authority of the members' meeting, include, but are not limited to, the following:

- approval of the annual financial reports of the company, including the decision on the appropriation of after-tax profits (dividend);
- decisions on the payment and the repayment of additional capital contributions;
- decisions to pay interim dividends;
- consent for the division of quotas, and approval for the withdrawal of quotas;
- resolutions initiating the exclusion of a member;
- decisions on the repurchase of quotas by the company, and the sale of these to members;

- election and removal of a managing director, and the setting of his or her remuneration, as well as the exercising of employer's rights if the managing director is an employee of the company;
- election and removal of supervisory board members, and the setting of their remuneration;
- election and removal of the permanent auditor and the setting of their fee;
- approval to conclude contracts between the company and one of its members, its managing director, supervisory board member, permanent auditor or their close relatives;
- enforcement of indemnification claims against members responsible for founding the company, managing directors or supervisory board members;
- decision to terminate without legal successor or to transform the company;
- decisions on increasing or decreasing registered capital;
- amending the Articles of Association;
- all issues assigned to the members' meeting by law or by the Articles of Association.

Although under the resolution of the members' meeting a company may acquire its own quotas, the company shall alienate the business shares in one year from acquisition, or shall convey them to the members in the percentage of their capital contributions without compensation, or shall withdraw such business shares pursuant to the rules of capital reduction.

The members' meeting has a quorum if the majority of the eligible votes are represented, unless the Articles of Association stipulate a higher rate of participation. If the members' meeting does not have a quorum, any reconvened members' meeting shall have a quorum for the items on the original agenda, regardless of the percentage of the capital or voting rights represented by those present at the reconvened meeting, unless otherwise provided by the Articles of Association. The date of the reconvened meeting shall be at least three days and maximum 15 days later than the date of the original meeting.

A three-fourths majority is required to approve members' resolutions amending the Articles of Association except for resolutions concerning the name, registered address, branches, or scope of activity other than the major activity of the company. In such exceptions a majority vote is sufficient. The Articles of Association may set a higher majority requirement. Any amendment to the Articles of Association which is detrimental to the interest of any of the members requires a unanimous vote of all members.

An extraordinary members' meeting must be convened promptly by the managing director to consider any necessary action if, due to losses, the equity of the company has fallen to half of the registered capital, or the equity has fallen below

the minimum prescribed by the Civil Code, or the company is at risk of insolvency or has suspended its payments, or the assets of the company do not cover its debts.

Managing Directors

The company's affairs are handled and the company is represented by the managing director (or directors). The managing director can be a natural or a legal person as well.

If there are at least two managing directors, one can object to the decision of the other. In such case the members' meeting (sole member) has to settle such dispute. Before that the decision cannot be executed.

3.3. COMPANY LIMITED BY SHARES (RT.)



A company limited by shares is the other popular corporate form for medium-sized or large 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).

Capital

An Rt. may be a private company or a public company. An Rt. is a private company ("Zrt.") if its shares are not listed in a stock exchange. An Rt. is a public company ("Nyrt.") if its shares are listed on the stock exchange. The main difference between the Zrt. and Nyrt. is whether the shares are (at least partly) issued publicly or privately. An Rt. can be established as a Zrt. only, and later on the shareholders can decide to change the form if the company becomes listed. In order to change the form between the Zrt. and the Nyrt., and vice versa, the general meeting has to make a resolution with at least a three-fourths' majority.

The share capital of an Nyrt. must be no less than HUF 20 million (approximately EUR 65,000). The share capital of a Zrt. must be no less than HUF 5 million (approximately EUR 15,000). The cash contribution cannot be less than 30% at the time of the establishment.

The Rt. may only be registered if, prior to the submission of the registration application:

- the contribution in-kind has been made available to the company in full unless the value of the in-kind contribution does not reach 25% of the registered capital, and/or
- at least 25% of each cash contribution has been made available.

The remainder of the cash contribution must be paid within one year of the registration, and the remaining in-kind contribution has to be provided within three years of the registration.

In connection with in-kind contributions, the report of the auditor or another expert qualified to assess the in-kind contribution shall be attached to the Statutes. This report should verify that the value of the in-kind contribution – as previously determined by the founders – complies with the quantity and nominal value of the shares to be provided in exchange. No report is required if the shareholder that has provided the in-kind contribution has an audited financial report prepared within three months from the date when the in-contribution was provided, containing the value of the contribution, or if the contribution is comprised of assets the price of which is listed on the stock exchange.

the company limited by shares below the minimum required share capital of an Rt.

Rt.s are entitled to acquire their own shares up to 25% of the share capital.

An Rt. may grant a loan for the purchase of its shares by a third person. For an Nyrt. this requires a three-fourths' majority decision of the general meeting and the loan shall be granted under normal market conditions from the amounts which can be used for dividend payments. The proposal of the board of directors shall contain the details of the financial



Shares and Shareholders' Rights

Shares are securities embodying membership rights and they can only be registered shares (bearer shares cannot be issued). Shares of a Zrt. may be printed or issued as dematerialised shares, while shares of an Nyrt. may only be issued as dematerialised shares.

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

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

Shareholders are entitled to dividends voted on by the shareholders' meeting in proportion to the face value of their shares and subject to the specialities of the shares they hold (e.g. preference shares).

No dividends may be paid if this activity reduces the equity of

assistance and such proposal has to be submitted to the relevant Court of Registry.

General Meeting

The supreme body of a Zrt. of Nyrt. is the general meeting of shareholders.

Actions which fall under the exclusive competence of the general meeting include, amongst others:

- establishment and alteration of the Statutes;
- decisions to change the form of the company;
- decisions on transformation or termination without legal successor;
- the election and removal of members of the board of directors or the General Director (only in case of a Zrt), members of the supervisory board and the auditor, and the setting of their remuneration (the Statutes of a Zrt. can delegate these decisions to the supervisory board);

- approval of the Annual Report, including the decision on the appropriation of after-tax profits (dividend);
- decisions to pay interim dividends;
- decisions on the acquisition of own shares;
- decisions to change the type of the shares;
- decisions to convert printed shares into dematerialised 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 subscription rights;
- 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 (in) every year. Extraordinary general meetings may be held at any time as required. The general meeting is normally 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 stipulate 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 irrespective of the number of those present, unless otherwise specified in the Statutes. The date of the reconvened meeting shall be at least three days (for a Zrt.) or 10 days (for an Nyrt.) later, but cannot be later than 21 days from the date of the original meeting.

If permitted by the Statutes, the general meeting can be held via conference call. It is up to the shareholders to decide if they will participate in the general meeting personally or via conference call, unless otherwise provided by the Statutes. If shareholders holding at least 5% of the votes oppose, indicating the reason, the participation via conference call within five days from the publication of the invitation, then no general meeting "conference" can be held.

Board of Directors

The board of directors is responsible for managing the company (except if the Statutes of a Zrt. 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/Chief Executive Officer).

The board of directors must consist of at least three members, all natural persons. The board of directors elects its chairman from among its members, and must exercise its rights and perform its duties as an independent body. The rules of procedure approved by the board of directors govern



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 accounting law.

The board of directors must prepare reports on the management, financial situation and 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. The Statutes of an Nyrt. may provide that a Management Board shall operate at a company implementing an integrated management system, instead of the supervisory board and board of directors. The Management Board must consist of at least five members, all natural persons.

Supervisory Board

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

- for Nyrt., except for any public limited company that is controlled by an integrated management system ("one-tier system");
- for Zrt., if requested by the shareholders controlling at least 5% of the total number of votes;
- 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;
- where so prescribed in the Civil Code in order to ensure the control rights of employees are exercised.



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.

Audit Committee

For a Nyrt. an Audit Committee has to be established assisting the Supervisory board or the Management Board, as the case may be, in the review of the financial reporting system, the selection of and cooperation with the auditor. According to the Civil Code, the Audit Committee shall consist of three members. The members are elected from among the so-called independent members of the Supervisory board or the Management Body. At least one member has to have accounting or auditing qualifications.

Increase of Share Capital

Share capital may be increased:

- by issuing new shares;
- by transferring all or part of its assets other than the share capital;
- by issuing employee shares;
- by converting convertible bonds (as a conditional capital increase).

The general meeting of the company may authorise the board of directors to increase the share capital up to a defined maximum limit during a limited period up to five years.

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 million in case of Zrt. or HUF 20 million in case of Nyrt.), except in cases when the registered

capital is increased at the same time, through which the minimum amount of registered capital is reached. If reduction of the share capital is prescribed by law, the company's general meeting shall adopt a decision on the reduction of share capital within 60 days following the event serving as basis for the obligation.

If the share capital may not be reduced because the share capital of the company would fall below the minimum registered capital required, and the shareholders do not replenish the share capital within three months, the general meeting must pass a resolution to transform the company into another form of business association, to merge into another company or to terminate the company. In the event of share capital reduction, own shares held by the Rt. shall be withdrawn first.

In respect of printed share certificates, share capital may be reduced:

- by exchanging the shares;
- by stamping the shares;
- by reducing the number of shares.

Winding-up

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 it is deregistered from the company register.

If an Rt. is terminated without legal successor, the assets remaining after creditor claims are satisfied must be distributed among shareholders based on payments and contributions in-kind actually provided, and in proportion to the face value of their shares.



3.4. EUROPEAN ECONOMIC INTEREST GROUPING AND SOCIETAS EUROPAEA



Following the accession of Hungary to the European Union as of 1 May 2004, new forms of business associations were integrated into Hungarian company law, including the European Economic Interest Grouping and the Societas Europaea.

European Economic Interest Grouping

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 Hungary is a legal entity formed, organised and operated in accordance with Council Regulation (EEC) No. 2137/85 on EEIG, unless otherwise regulated by the

EGE Act. The EGE principally differs from a firm or company 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 is 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.

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 conduct 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.



Societas Europaea

The other new type of business association that may be established is the European public limited-liability company or Societas Europaea ("SE"; in Hungarian: "Európai Részvénytársaság").

Based on Act XLV of 2004 (the SE Act), an SE having its seat in the Republic of Hungary is a legal entity and is formed, organised and operated in accordance with Council Regulation (EEC) No 2157/2001 on SE, unless otherwise regulated by the SE Act.

The capital of an SE is divided into shares, expressed in euros, and must not be less than EUR 120,000. Employee involvement in an SE is 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, EEIG and SE.

4.

WORKING IN HUNGARY

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Working in Hungary

4.1. WORKING REQUIREMENTS FOR FOREIGNERS



No work permit is required in the following cases:

- for spouses of Hungarian citizens living in Hungary, or
- for the heads of a branch or representation office of a foreign company.

As of 31 December 2013, in certain cases the authority will issue a combined license which includes the work permit and the stay visa. A combined license can be issued if the foreigner applies for an EU “Blue Card” or the purpose of the immigration is family reunification. Combined licensing procedure is also applicable if the former license is to be renewed and the applicant already holds an EU Blue Card or residence permit for working or humanitarian purposes.

Working Requirements for third country nationals

As a general rule, third country nationals – not Hungarian citizens and stateless persons except persons with the right of free movement and residence (EEA nationals and accompanying family members of EEA citizens and Hungarian citizens) – cannot usually be employed in Hungary unless they hold a valid work permit and long-stay visa or residence permit.

Third country nationals who want to enter Hungary to work must apply for a stay visa unless there is an agreement between Hungary and the relevant country. Long-stay visas are granted by any Hungarian embassy in the home country of the applicant, and can be applied for after obtaining a work permit.

If a third-country national intends to work in Hungary and his/her stay visa has expired, a residence permit is required.

The person must register and apply for a residence permit at the competent Regional Office of Immigration and Nationality. The registration procedure is subject to a fee.

An application must be submitted by the employer to the 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, heads of the Hungarian representation office and of the Hungarian branch offices)

appearing in the company’s documents filed with the Court of Registry are not subject to work permit requirements. The data and documents required must be included in the application. Work permits are granted for a maximum of two years, but may be extended for an additional two-year period. Employees may only begin working in Hungary after having received all the necessary permits.

Working Requirements for EEA Citizens

EEA citizens - citizens of the EU member states and those of the states party to the Agreement on the European Economic Area (citizens of the European Union, Switzerland, Norway, Iceland, and Liechtenstein), with the exception of Hungarian citizens - do not require residence permit, but they must submit an application to have a registration certificate, if they intend to stay for more than three months. EEA citizens are required to report their stay to the regional directorate competent on the basis of their future residence by supplying their personal data at the latest on the ninety-third day from entry. The applicant is required to appear before the acting authority in order to obtain the registration certificate.

EEA citizens do not require a work permit. Employers on the other hand must notify the local employment office no later than the start date of employment.

The employment centre registers each notification; however, this is not a pre-requisite for employment. Moreover, the termination of the employment relationship must also be reported to the relevant office.

4.2. EMPLOYMENT LAW



Employment law has undergone radical changes in 2012 as a completely new set of regulations (Act I of 2012 - Labour Code) was adopted. The Labour Code is broadly similar to employment laws in other European Union countries, the new provisions aiming to loosen the tight formalities of employment issues and introduce a new, more employer-friendly framework.

The Act provides for organised labour negotiations with trade unions or other representative bodies of employees (e.g. work councils); however, these bodies are considered at different levels of importance. An employer may only enter into one collective agreement at a time. Notwithstanding this, an employer may be affected by more than one collective agreement (e.g. collective agreements of industrial branches or regions, if any).



By means of the collective agreement it is possible to deviate from a number of otherwise mandatory provisions in applicable legal standards with the exceptions of Section XIX and XX of the Labour Code. Under the Labour Code, and as a new general standard, deviations from the legal provisions are possible both for the benefit and to the detriment of employees. The applicable laws and the collective agreement will prevail over any contradictory provisions of employment agreements.

Employment agreements can only be concluded after having obtained all the necessary permits, if any are needed. An employment agreement – which must be in written form – can only be deemed valid if it includes the mandatory minimum content:

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

The employer is obliged to notify the employee within 15 days from the date of commencement of the employment relationship concerning:

- basic daily working hours;
- other components of salary (e.g. bonus, fringe benefits, etc.);
- payroll accounting, the frequency of payment of wages, and the day of payment;
- scope of work;
- amount of paid leave and the procedures for allocating and determining such leave;
- rules governing notice periods to be observed by the employer and the employee should the contract or employment relationship be terminated;
- whether a collective agreement applies to the employee;
- the person exercising employer's right.

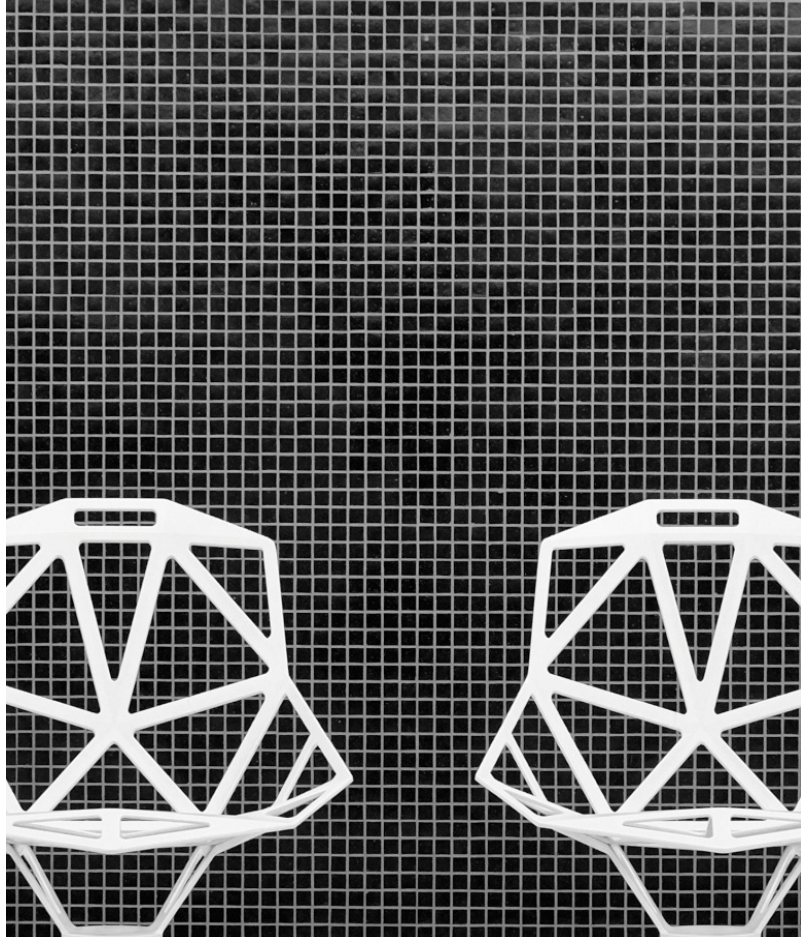
As set out in Government Decree No. 324 of 2018 on the minimum wage and guaranteed wage minimum the gross amount of the monthly minimum wage shall be HUF 149,000 (approx. EUR 465) in 2019, and HUF 160,920 (approx. EUR 500) in 2020.

The gross amount of the monthly guaranteed wage minimum – to be paid in positions requiring at least high school degree – shall be HUF 195,000 (approx. EUR 610) in 2019, and HUF 210,600 (approx. EUR 660) in 2020.

5.

ACCOUNTING AND AUDIT

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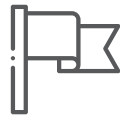


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Accounting and Auditing



5.1. INTRODUCTION



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

The Act draws on the Directives of the Council of the European Union. These Directives regulate 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 also based upon the Directives of the Council of the European Union.

Separate financial statements are generally required to be prepared and presented in accordance with the Act. However, entities may prepare and present their separate financial statements in accordance with International Financial Reporting Standards (“IFRSs”) as adopted by the EU (“EU IFRSs”) if certain conditions are met. Entities meeting certain conditions and entities in specific industries are required to present and prepare their separate financial statements in accordance with EU IFRSs.

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

This chapter is not a complete summary of the requirements of the Act C of 2000 on Accounting as of 1 January 2019. Possible changes during 2019 have not been reflected in this document.

5.2. 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, 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. It also recognizes the concepts of materiality and of substance over form. Departure from the provisions of the Act is allowed when it is necessary to achieve a fair presentation.

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

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

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





5.3. BOOKKEEPING



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

- Entities' accounting records 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.
- Accounting records are generally closed out on 31 December each year. However, entities except for banks, other financial institutions and insurance companies can account to another reporting date if the nature of the business makes this reasonable.
- Accounting records must be kept in the Hungarian language.
- Generally, the accounting records are kept and the financial statements are presented in Hungarian forints (HUF). Except for companies reporting under EU IFRSs (for which functional currency is determined based on EU IFRSs), a company can prepare its financial statements and keep its accounting records in euro or in US dollars, provided that it has specified the euro or US dollar as its functional currency in its Deed of Foundation and in its detailed accounting policy rules, before the beginning of the relevant financial year. In addition, those companies not reporting under EU IFRSs that are not preparing their financial statements and keeping their accounting records in forint, euro or US dollars may keep their books and present their financial statements in another currency if more than 25% of the total of the absolute amounts of the company's financial assets and financial liabilities as at the reporting date, and more than 25% of the total of the absolute amounts of the income and expense items for the year, were denominated in that currency in the previous and in the current year.
- Single-entry bookkeeping is allowed only for a limited group of not-for-profit organizations.
- Hungarian accounting regulations define a compulsory fixed numbering of account classes from 0 to 9:
 - The asset accounts are in classes 1-3, while class 4 includes the equity, provisions and liabilities accounts.
 - Costs are recorded in account classes 5 and 8 based on their nature, and revenues are recorded in the class 9 accounts.
 - Classes 6 and 7 may be used to account for direct and indirect costs based on their function. Their use is not mandatory. Each entity is free to decide whether and how to use these classes of account.

There is flexibility to choose specific account headings to suit the business's 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.)
- The financial statements of companies whose average net sales in the last two previous financial years exceed HUF 10 million must be prepared by a person or company registered as an auditor or bookkeeper with appropriate qualification.
- If a company prepares its separate or consolidated financial statements in accordance with EU IFRSs, the person responsible for the preparation of these accounts must hold a special IFRS qualification.

The Criminal Code stipulates that any person who breaches the documentary requirements or bookkeeping and annual reporting obligations prescribed in the Act on Accounting or in regulations adopted on the basis of that Act, and thereby triggers an error that is construed as materially affecting the true and fair view, is guilty of an offence punishable by imprisonment of up to 3 years, or 8 years for certain entities.

For the purposes of the Criminal Code, an error materially affecting the true and fair view arises if the aggregate absolute amount of all errors detected for a given financial year and the

impacts thereof – increasing or decreasing profit or loss or equity – exceeds:

- the higher of 20% of the net sales revenue of the financial year in which the error was made, and 20% of total assets reported as at the end of the same financial year; or
- HUF 500 million.

5.4. FINANCIAL REPORTING



All entities must issue financial statements following the end of each business year. The financial statements are the responsibility of the entity and its authorized representatives.

The required form of financial statements is determined by the size of the entity and, in some cases, its method of bookkeeping. There are different kinds of financial statements for companies:

- Annual Financial Statements
- Two types of Simplified Annual Financial Statements (normal or for micro enterprises)
- Consolidated Annual Financial Statements.

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

Annual Financial Statements under the Act

Companies are generally required to prepare Annual Financial Statements. The Annual Financial Statements consist of a balance sheet, an income statement and supplementary notes (including a summary of accounting policies applied, notes to the accounts and a cash flow statement). In addition to Annual Financial Statements, a Business Report must also be prepared.

The balance sheet and the income statement must each be presented according to a prescribed structure, the narrative captions must be in the Hungarian language (another language can be provided as well) and the amounts must generally be expressed in HUF thousands or millions (see the *Accounting and bookkeeping* section for exceptions from using the forint as a presentation currency).

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

The supplementary notes include additional information necessary to give a true and fair view of the financial position and results of operations. This includes description of the accounting policies applied in the accounts. A statement of cash flows is also required to be presented as part of the supplementary notes to the annual financial statements.

The Business Report provides a commentary by management on the financial position presented in the accounts. It is required to include a corporate governance declaration for companies whose transferable securities are admitted to trading on a regulated market of the European Economic Area, and a non-financial statement on, e.g., the entity’s policies regarding environmental protection, social and employment issues, anti corruption and anti bribery for public interest entities above a certain size.

Annual Financial Statements prepared in accordance with EU IFRSs

Entities whose securities are traded on a regulated market in the European Economic Area, as well as banks and financial enterprises subject to prudential regulation equivalent to that of banks, are required to prepare their separate annual financial statements in accordance with EU IFRSs

In addition, the following entities (with some limited exceptions) are permitted to prepare their separate annual financial statements in accordance with EU IFRSs:

- any entity with an ultimate or any intermediate parent company preparing its consolidated financial statements in accordance with EU IFRSs;
- an insurance company;
- any entity subject to the supervision of the Hungarian National Bank;
- a company subject to audit obligation;
- a branch office of a foreign company.

An entity is required to prove its preparedness to apply EU IFRSs before the transition by obtaining a report from an auditor which is to state whether:

- a person with IFRS qualification is engaged with the preparation of the EU IFRS report;
- the entity has an approved EU IFRS accounting policy;
- the entity has an opening balance sheet prepared in accordance with EU IFRSs for the first day of the financial year before the transition.

The intent to apply EU IFRSs is generally required to be announced to the Tax Authority and, if applicable, to the Hungarian National Bank at least 30 days before the transition date (i.e. before the beginning of the financial year for which the entity first prepares its annual financial statements in accordance with EU IFRSs). The above-mentioned report from the auditor is required to be attached to the announcement.

An entity shall apply the requirements of the Act for issues that are not regulated by EU IFRSs including rules on documentation, stock-taking, depositing, publication and auditing.

Entities applying EU IFRSs for their separate annual financial statements for the first time are required to make disclosures about the effect of the transition in accordance with EU IFRS 1 *First-time Adoption of International Financial Reporting Standards*, even if they are not first-time adopters under EU IFRS 1. The Act also sets out additional disclosure requirements to those required by EU IFRSs. The notes to the Annual Financial Statements need to include a reconciliation of the owner's equity due to differences between the equity structure under the Act and EU IFRSs. Entities reporting under EU IFRSs shall also prepare a Business Report in accordance with the provision of the Act.

Entities reporting under EU IFRSs use their EU IFRS annual financial statements as their basis of taxation.

Simplified Annual Financial Statements

Companies which meet any two of the three criteria detailed below in the preceding 2 years are permitted to prepare Simplified Annual Financial Statements if:

- total assets at year-end do not exceed HUF 1,200 million;
- annual net sales do not exceed HUF 2,400 million;
- the yearly average number of employees does not exceed 50.

Public limited companies (Nyrt.s), parent companies, public interest entities, and any entity whose debt or equity securities are publicly traded on the stock exchange (including those in the progress of authorization of such public trading) are not permitted to prepare Simplified Annual Financial Statements. A subsidiary, which is not itself a parent company, may prepare a Simplified Annual Financial Statements if it can separately provide the information its parent needs to prepare the consolidated annual financial statements.

Simplified Annual Financial Statements consist of a balance sheet and an income statement simplified to show only certain headings and simplified supplementary notes (for example, this need not include a statement of cash flows or a movement schedule of the tangible and intangible assets). Companies presenting Simplified Annual Financial Statements are not required to prepare a Business Report.

With some exceptions, companies which meet any two of the three criteria below in both of the preceding 2 years

are permitted by Decree 398 of 2012 on Simplified Annual Financial Statements for Micro Enterprises to prepare a Simplified Annual Financial Statements for micro enterprises whose:

- total assets at year-end do not exceed HUF 100 million;
- annual net sales do not exceed HUF 200 million;
- yearly average number of employees does not exceed 10.

Companies qualifying as micro enterprises are only required to prepare a balance sheet and an income statement; no supplementary notes are required. In addition, qualifying companies do not have to follow normal accounting rules in respect of asset impairments, fair value adjustments and certain other matters. The requirements applicable for Simplified Annual Financial Statements for Micro Enterprises constitute a compliance framework (i.e. departure from the requirements is not permitted).

Consolidated Annual Financial Statements

In addition to their separate annual financial statements, companies which have a majority holding in or control one or more subsidiaries must prepare consolidated annual financial statements unless they have met any two of the following criteria during the preceding 2 years:

- total unconsolidated total assets of the group do not exceed HUF 6 billion;
- total unconsolidated annual net sales revenue of the group does not exceed HUF 12 billion;
- the yearly average number of employees of the group does not exceed 250.

This exemption does not apply to banks, financial enterprises, insurance companies, and parent companies whose debt or equity securities are publicly traded or parent companies with a consolidated subsidiary whose debt or equity securities are publicly traded on the stock exchange (including those in the progress of authorization of such public trading).

A parent company which has one or more subsidiaries is not obliged to prepare consolidated annual financial statements if it is itself a subsidiary of a company which prepares consolidated annual financial statements under the Act, EU requirements or an equivalent financial reporting framework (and its parent has included the parent company and its subsidiaries in its own consolidated annual financial statements). This exemption does not apply to the issuers of publicly-traded debt or equity securities (including those in the progress of authorization of such public trading).

A Hungarian parent company that chooses not to prepare its own consolidated financial statements is required to publish the Hungarian translation of the consolidated financial statements of its parent company within 60 days of the date of their authorization. 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 financial statements consist of a consolidated balance sheet, income statement

and supplementary notes. A consolidated business report must also be prepared.

Listed companies must, while other companies may, prepare and present their consolidated financial statements in accordance with EU IFRSs. Any parent that prepares its annual financial statements in accordance with EU IFRSs and that is required to prepare consolidated annual financial statements in line with the Act is required to prepare and present its consolidated annual financial statements in accordance with EU IFRSs. The Act sets out additional disclosure requirements to those required by EU IFRSs with respect to these consolidated financial statements.

A company exempted from preparing consolidated accounts and having control, significant influence or joint control over another company must record its investment 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 in the value of an investment is shown under financial expenses in the income statement.

5.5. ACCOUNTING RULES OF THE ACT

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 the merger or transformation of a company from a Kft. to an Rt.). Contributions in kind are recorded at the value set forth in the Deed of Association.

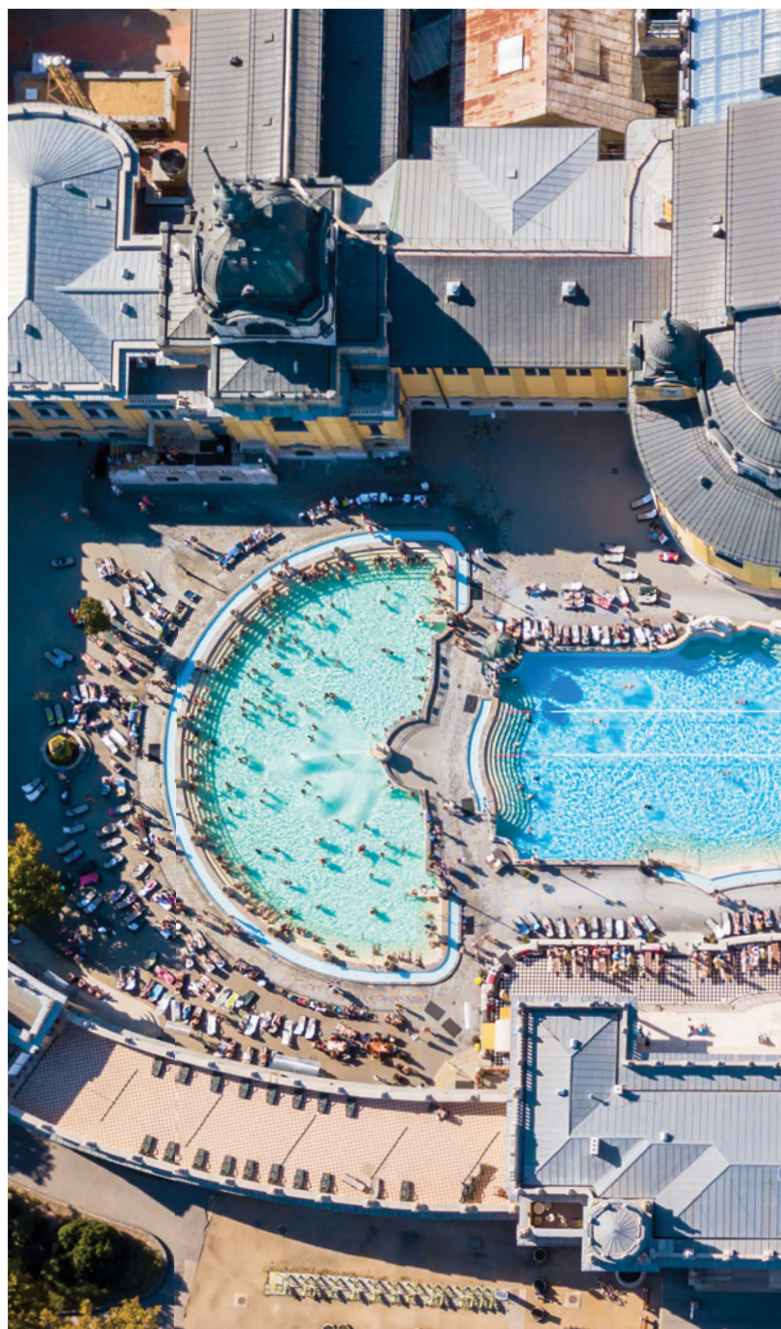
Foreign currency translation

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 revalued at the year-end rate. The unrealized foreign exchange gains and losses derived from year-end revaluations are netted. The net foreign exchange gain or loss is generally recognized in the income statement.

The applicable exchange rates include the average of the buying and selling rate of a selected credit institution or the official foreign exchange rate published by the Hungarian National Bank or the European Central Bank.

There are special rules for unrealized losses on foreign currency loans taken out for the purpose of acquiring fixed assets or current assets. The loan amount is reported in the balance sheet at the current year-end rate, but the unrealized loss can be deferred and amortized to the profit or loss in annual instalments over the repayment period of the loan.



On partial or full repayment of the loan, or on sale or disposal of the related fixed asset, the corresponding previously deferred unrealized losses must be charged to the profit or loss immediately. Any unrealized foreign currency gain arising on the loan should be netted against the deferral.

Fixed assets

Tangible and some intangible fixed assets may be recorded at cost, less depreciation and impairment, or at a revalued amount. Borrowing costs (including exchange differences) 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, non-current financial assets except for shares and other equity interests, goodwill, capitalized foundation, restructuring and development costs



may not be revalued upwards. The revalued amount of assets must be reviewed annually.

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

The depreciable amount of most tangible and intangible assets (other than land, assets not yet put into use and works of art, and those assets whose value does not diminish through use) must be depreciated or amortized over their expected useful lives, as determined by management. If the market value as at the closing date for the preparation of the balance sheet is considered to be permanently and significantly less than the carrying amount of a fixed asset (including securities and shares), then an impairment loss must be charged to profit or loss to reflect the devaluation of the asset to its market value. Impairment losses must be reversed if no longer appropriate due to a subsequent increase in market value, except in the case of goodwill.

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

Development expenses and foundation or reorganization expenses are permitted, but not required, to be capitalized and written off over a period of up to 5 years. Recognition criteria for capitalization of development costs are less restrictive than under IFRSs.

Neither goodwill nor a bargain purchase gain may be recognized separately in the separate financial statements when the entity acquires an equity interest in another entity. Goodwill and a bargain purchase gain can only arise in the separate financial statements, if the acquisition is realized

through item-by-item recording of assets and liabilities (i.e. an asset deal). Subject to certain conditions, goodwill might also be recognized when a subsidiary merges with/ into its parent company.

Goodwill shall generally be amortized over 5 to 10 years, if its useful life cannot be estimated.

A bargain purchase gain shall be deferred as deferred income and shall generally be amortized to profit or loss as other income over 5 to 10 years from the acquisition date.

Inventory

Inventory is valued at the lower of cost or net realizable value. Cost can be calculated on a first in, first out or average cost basis. Inventories must be written down to the net realizable 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-downs must be reversed if no longer appropriate due to a subsequent increase in net realizable value.

Securities

Equity securities and debt securities with a maturity of longer than 1 year should be valued at cost unless the market value has permanently and significantly decreased below cost. (See the *Financial instruments* section for an alternative measurement of securities at fair value).

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

Equity

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

Liabilities

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

Loans and borrowings are measured at the amount received less repayments. Costs directly related to taking loans and borrowings that are not capitalized as part of the cost of an asset may be deferred. The deferred expense is released to profit or loss over the term of the loan but not later than its full repayment.

Provisions

Provisions are required to be made for obligations arising from past events and contracts including specified kinds of liabilities such as legally enforceable guarantees (such as warranties), contingent liabilities, commitments, early retirement pensions, severance payments and environmental protection obligations. It is also possible to record provisions against certain other losses that are likely or probable to occur and can be estimated with reasonable certainty.

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

Deferred taxation

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

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

Income statement presentation

The principle of completeness (grossing up) means that some related items are presented separately in the income statement. For example, the proceeds of fixed asset disposals and the write-back of the prior-year impairment of assets are reported under *Other income*, whereas the carrying amount 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 reporting date (at the annual General Meeting or Members' Meeting) are recognized as liabilities and a reduction in retained earnings at the date of a resolution on dividend distribution. Similarly, dividends receivable shall be recognized as dividend income in the financial year in which any resolution on such dividends is made.

Revenue

Revenue is recognized for the sale of goods and services and is generally measured at the amount of consideration less invoiced trade discounts and value added tax. Non-invoiced volume rebates given to customers are recognized as other expense. The recognition and measurement



principles are different from IFRS 15, therefore, the timing of revenue recognition may differ.

Extraordinary items

Extraordinary items are not recognized as separate line items in the income statement.

Prior-year material errors

Significant errors detected from prior years must be adjusted directly against retained earnings and presented in a separate column of the financial statements. Companies may determine the threshold that they consider significant, but it cannot exceed the higher of 2% of the total assets for the year in question or HUF 1 million. This amount could be below what is considered material under IFRSs. There are detailed rules defining what a significant error is and how the calculation of the total of significant errors is to be made. Errors increasing and decreasing profits cannot be netted in arriving at this total.

Financial instruments

Entities can opt to present financial instruments at fair value and to apply hedge accounting. If fair valuation is applied, the classification of financial instruments and the recognition requirements are similar to those of IAS 32 and IAS 39, however, there are some differences, for example, in terms of measurement. Accordingly, the classification and measurement requirements for financial assets are different from those under IFRS 9. The Act is not expected to be amended to reflect changes implemented by IFRS 9 as compared to IAS 39.

Disclosure

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



5.6. FILING AND PUBLICATION REQUIREMENTS



All legal entities which are registered in the Trade Register and maintain double or single-entry books must file and publish their Annual Financial Statements and the related Auditor's Report (if any) by the end of the 5th month after the reporting date. A shorter 90-day deadline applies in some special cases (e.g. when the company changes its legal form or merges with another company). The managing director(s) of the entity must sign the Annual Financial Statements. The Annual Financial Statements should be accompanied by the Auditor's Report, where an audit is required, as well as a 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 Financial Statements must be filed by the last day of the 6th month after the reporting date. Many Hungarian companies still tend to regard their separate annual financial statements as their primary financial reports and treat the preparation and issuance of their consolidated accounts as less important.

Companies listed on the Budapest Stock Exchange must issue their audited separate and consolidated financial statements within 4 months of the year-end.

The filing and publication requirement must be satisfied by filing the information electronically at the Company Information Office of the Ministry of Public Administration and Justice.

Public interest entities reporting under EU IFRSs must also publish their separate Annual Financial Statements, consolidated Annual Financial Statements and the respective business reports on their own website.

Branch offices of foreign companies are not required to publish their Annual Financial Statements if the foreign company is established in the European Union or in a state outside the European Union where the national legal requirements on the preparation, audit, deposit and

publication of annual accounts are in conformity with the relevant regulations of the European Union. The Annual Financial Statements of such foreign companies must be filed and published in Hungarian within 60 days following their authorization. Branch offices of financial institutions are also subject to additional filing requirements with respect to some aggregated data of their operations.

A branch office that satisfies the above conditions is required to ensure that the Annual Financial Statements on its own activities and statements for tax purposes prepared according to the Accounting Act and the relevant Government Decree is available upon request for review and for making copies.

5.7. AUDITING



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

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

- their average annual net sales over the past 2 years do not exceed HUF 300 million; and
- the yearly average number of employees over the past 2 years on average does not exceed 50.

This exemption is not available for some entities including branch offices of foreign companies, consolidated subsidiaries, banks and insurance companies, and public interest entities, all of which must always be audited. However, branch offices of foreign companies (excluding branch offices of financial institutions and insurance companies) established in the European Union, or in a state outside the European Union where the national legal requirements on the preparation, audit, deposit and publication of the annual accounts are in conformity with the relevant regulations of the European Union, are not required to appoint an auditor.



Business entities with unpaid tax debts – as defined in the Act on the Rules of Taxation – in excess of HUF 10 million overdue by more than 60 days at the end of a financial year, may not apply the threshold-based Audit Exemption Provision in the subsequent financial year.

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.

Any company that prepares its separate or consolidated annual financial statements in accordance with IFRSs must appoint a registered statutory auditor or audit firm holding an IFRS qualification. KPMG Hungária Kft. holds this qualification.

Only specifically qualified individuals and firms are authorized to audit the financial statements of regulated entities including financial institutions, investment enterprises, insurance companies, issuers, and health and pension funds. KPMG Hungária Kft. is one such firm.

Under the Act, the purpose of an audit is to establish that the separate or consolidated Annual Financial Statements (or the Simplified Financial Statements) have been prepared in accordance with the Act and provide 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 request that management take actions needed for the shareholders to make a decision if circumstances justify this, including any change in the entity's net assets that endangers the settlement of the entity's liabilities and circumstances that entail the responsibility of the management or the supervisory board. The auditor must attend the General Meeting of the company approving the financial statements audited by the auditor.

Registered auditors, the Chamber of Auditors and the Audit Public Oversight Authority are regulated under Act LXXV

of 2007. The Act allows the Chamber of Auditors to fulfil certain responsibilities under the supervision of the Audit Public Oversight Authority. These include the registration and regulation of auditors, quality reviews, the development of national auditing standards, and forming opinion on the IFRS accounting treatment of transactions included in tax ruling requests. The Chamber of Auditors has adopted International Standards on Auditing ("ISAs"). All auditors are expected to comply fully with ISAs (adapted as necessary to deal with particular local issues). Auditors and audit firms responsible for statutory audits of public interest entities are subject to quality reviews performed by the Audit Public Oversight Authority.

5.8. OTHER MATTERS



Specific rules and legislation apply to certain types of entities such as the following.

Banking and other financial institutions are legislated for under Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises 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 reporting date (i.e. any specific provisions should be reflected in the reported value of the asset).

Insurance companies are legislated for under Act LXXXVIII of 2014 on the Insurance Business.

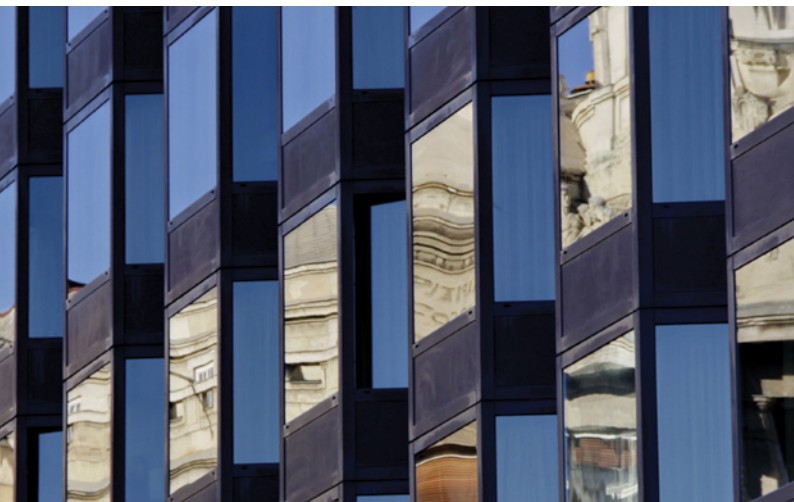
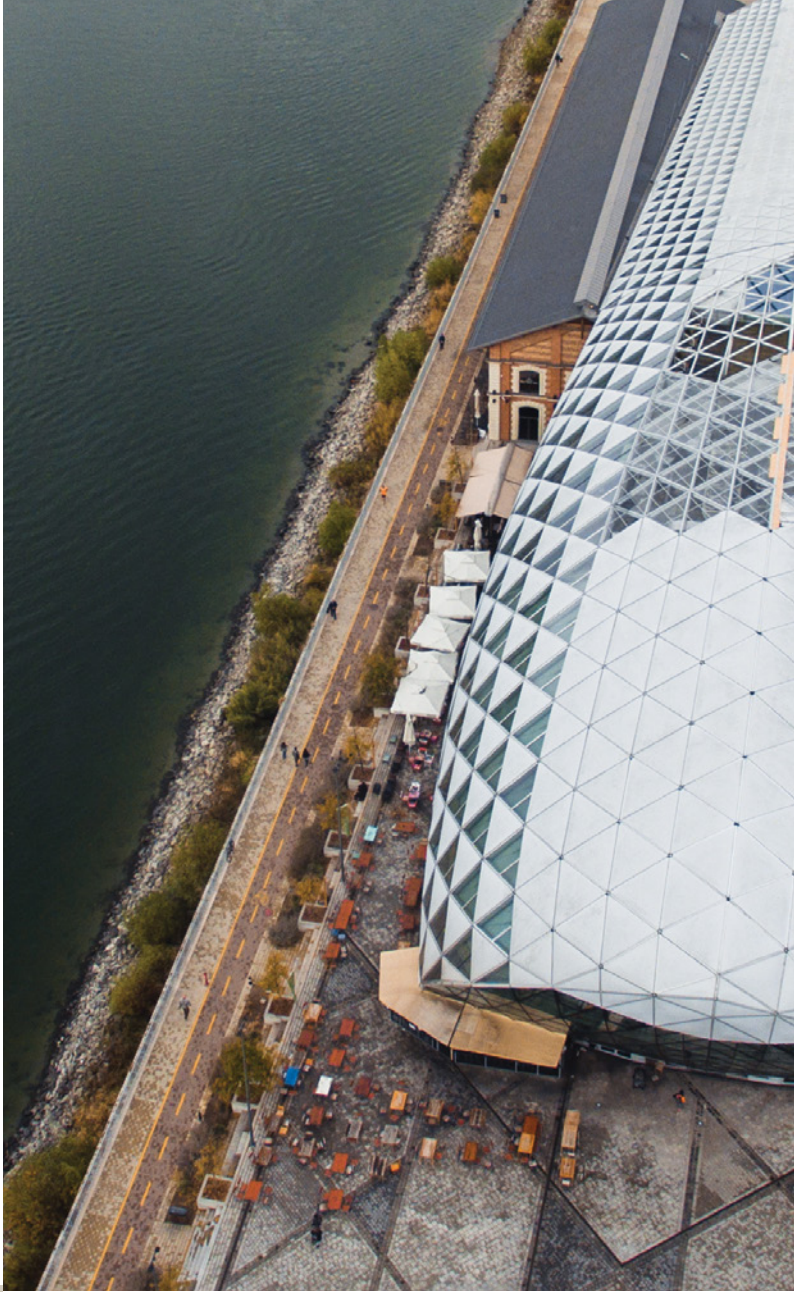
Brokerage firms are regulated by Act CXX of 2001 on Capital Markets. Brokerage firms must also comply with the rules and regulations established by the Budapest Stock Exchange.

Investment Funds are legislated for under Act XVI of 2014 on Collective Investment Forms and their Managers.

6.

TAXATION

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Taxation



6.1. CORPORATE TAX



A company, being a domestic tax resident limited or unlimited liability company, is subject to corporate income tax ("CIT") liability in Hungary and to the provisions of the Hungarian CIT law.

The basic principles for taxing business profits are detailed in the CIT law but, in general terms, the profit before tax of the taxpayer, adjusted with certain items (non-deductible expenses, and non-assessable income items), is the tax base for CIT purposes.

According to the prevailing rules, the tax rate is a flat 9% starting from 2017.

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

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 taxpayers for investigation. Using risk analysis software, the Authority selects companies for tax audits where it is assumed that the low or negative profit of the business activity could be the result of hiding revenues or accounting fictitious costs. During

an investigation, the taxpayer must support any transactions challenged by the Tax Authority and show that the costs (expenditure) were incurred in the interests of the business activity. The Tax Authority is also permitted to estimate the tax liability; or

2. The revenue (profit) minimum is regarded as the tax base, and the corporate income tax should be calculated and paid on this basis.

According to the Act, the income (profit) minimum is 2% of total revenues adjusted by items decreasing and increasing the taxable base as described by the law.

From 2015 the number of decreasing items has been significantly reduced. So the revenue (profit) minimum tax base will almost equal to 2% of the total revenue.

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.

Group taxation registration

As of 1 January 2019, the concept of group taxation under corporate income tax has been introduced. It can be applied by at least two associated Hungarian tax resident companies (including a non-resident person whose effective place of management is located in Hungary and is treated as a resident taxpayer, the permanent establishment of a foreign entity whose head office is not located in Hungary), with at least 75% direct or indirect majority interest in each other (based on voting rights).

Group taxation can be opted by those taxpayers who have the same balance sheet date, and furthermore, the financial report of these companies is prepared either according to Chapter 3 of the Act on Accounting, or is based on IFRS. Registration can be claimed in each year (if the tax year is equal to the calendar year) from the Tax Authority between 1 and 20 November, which is a mandatory (forfeit) deadline.

Members of the group need to determine their tax base, as if they were separate taxable persons for each tax year. These members shall prepare stand-alone declarations – equivalent to the tax return – about their tax base to the Tax Authority, for each tax year.

An appointed representative of the group is obliged to submit a group tax return. The tax base of the group is the sum of the individually-identified, non-negative tax bases of the member companies, which can be decreased – within certain limitations – by the losses carried forward from previous tax years as well as the negative tax base of each member in the given tax year.

The taxable group will be considered as a stand-alone taxable person from a tax allowance point of view; it can utilize a tax allowance only if the relevant conditions of the allowance were undertaken and effectively fulfilled by one of the members of the group.

The rate of corporate income tax under group taxation remained 9%, and the payable tax in the tax year is allocated among the group members in proportion to the individually-specified positive tax bases.

Any member of the group is jointly and severally liable with the other members for the fulfilment of the tax liability of the group taxpayer, during its membership and in the preceding period as well.

Determination of taxable income

The assessment base 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 prescribes special rules, treating, amongst others:

- Non-business expenses
- Development reserves, provisions
- Depreciation
- Impairment
- Forgiven receivables
- Interest limitation rules (previously thin-capitalization rules)
- Own research and development expenses
- Reported intangible assets
- Sale of real estate
- Transfer pricing
- Loss carry-forwards
- Royalties
- Capital gain participation exemption
- Investments in start-ups

Non-business expenses

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

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

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

Goods, services, financial assets, etc. provided without consideration (with the exception of samples of goods as defined under the "Act on Value Added Taxation") qualify as expenses incurred for business purposes unless granted to foreign individuals, or to a taxpayer whose place of business is not in Hungary, or who does not have a declaration stating that the pre-tax profit of the beneficiary would have been positive, even without said receipt.

Development reserves, provisions

Taxpayers are permitted to deduct a development reserve, i.e. amounts expected to be spent on capital expenditure in the 4 years following the creation of the reserve. However, such a reserve can only reduce pre-tax profits by up to 50% (with an upper limit of HUF 500 million). In the tax return, development reserves may not be utilized for an investment or a purchased asset, which may not or should not be depreciated (e.g. land) based on accounting regulations. Development reserves reported in the taxpayer's financial statements as of 31 December 2008 can be utilized over a 6-year period.

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

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



Any tax relating to the part of the development reserve which is not utilized by the given 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 specifies depreciation rates according to the expected useful life of the asset. The exact text is as follows: "the absolute amount of depreciation

shall be planned with regard to the expected use of the individual asset, its duration arising therefrom, its physical deterioration through use and obsolescence, as well as to the circumstances typical of the entrepreneurial activity concerned". The criteria clearly include not only physical but also useful economic life.

The corporate tax depreciation rates must be used to determine the permitted deduction for tax purposes. The main maximum rates for corporate tax purposes at present are set out below:

Machinery and equipment, breeding stock	14,5%
Computers	33%
Vehicles	20%
Buildings	2% / 3% / 6% (depending on type)
Intangibles	Useful life
Leased assets:	
Buildings leased out	5%
Equipment in leased buildings and other leased tangible assets	30%

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

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

As of 2012, taxpayers are free to apply a tax depreciation rate lower than the rate specified directly by the tax law, nevertheless this cannot result in tax depreciation that is lower than the accounting depreciation.

From 2015, a new option is available, one which allows companies to book 10% tax depreciation per year on goodwill, provided that the circumstances of accounting and retirement of goodwill were in line with the principle of legal practice.

Receivables

Expenditure accounted for due to written-off receivables is not deductible for tax purposes, unless it is construed as an irrecoverable debt for accounting purposes. Twenty per cent of the amount of outstanding receivables not settled within 365 days is also considered irrecoverable up to the write-off recorded for the respective receivable for tax purposes.

Expenditure from receivables forgiven towards related parties is not eligible for tax deduction purposes.

Interest limitation rules (previous thin-capitalization rules)

As of 1 January 2019, in compliance with a corresponding Directive of the European Union (ATAD), the new interest limitation rules replaced the previous regulation related to thin-capitalization.

Based on the new rules, a taxpayer's exceeding of borrowing costs will be tax deductible up to 30% of the tax base (calculated as follows), or up to HUF 939,810,000 (serving as an upper cap).

From this perspective, tax base otherwise calculated shall be increased:

- by the exceeding of borrowing costs (recorded in the P&L),
 - the amount of tax depreciation and
 - the amount of the unused interest deduction capacity from previous tax year, which is used in the current tax year,
- and decreased
- by non-deductible exceeding borrowing costs.

The aforementioned cap of HUF 939,810,000 is applicable on a group basis for a group taxpayer. Therefore, a member the group -calculating its individual tax base can take into account this cap in proportion to its own exceeding of borrowing costs as compared to the total exceeding of borrowing costs arose at the group taxpayer.

Borrowing costs mean interest expenses on all forms of debt, other costs economically equivalent to interest and expenses incurred in connection with the raising of finance.

The aforementioned provisions is applicable for financing contracts concluded or modified after 17 June 2016 – in accordance with the requirements of the Directive.

Exceeding borrowing costs which could not be utilized in the tax base in a given tax year, can be carried forward to subsequent tax years. The remaining interest deduction capacity in a given tax year can also be carried forward for 5 years and used in accordance with the order of origin.

The 50% limit of utilization of losses carried forward is applicable to the tax base calculated before the correction item(s) related to interest deduction.

However, these rules are not applicable to those taxpayers who comply with certain statutory capital requirements and for insurance companies, banks and other financial undertakings.

R&D expenses

Direct costs of own research and development activity are tax deductible. Potentially, a triple deduction can be claimed for R&D expenses with an upper limit of HUF 50 million if the research and development activity is carried out according to an agreement with an institute of higher education, the Hungarian Academy of Sciences, or with a centrally-funded research institute. The same applies if an agreement is signed with research institutions working under the central budgetary authority or with research institutions operating in the form of a business organization directly or indirectly owned by the state. Nevertheless, only deductions from an accounting perspective apply to R&D activities supported by governmental subsidies (to the extent of the subsidies).

Direct costs of R&D projects performed by related parties in the framework of their own research and development activity could be used by other Hungarian parties of a group for corporate income tax purposes provided that the R&D expenses relate to the business activities of the respective related party.

That said, the direct cost of R&D activities is not considered as a tax deductible business expense if it is not incurred in the interests of the business activity.

Since 2014, direct costs of R&D activities carried out by related parties are also deductible, provided that the taxpayer possesses a declaration issued by a related party that the related party did not decrease its tax base by the respective R&D costs and the R&D activity is linked to business activities of the company applying a resultant item that decreases their tax base.

The National Agency of Intellectual Property issues – in a similar system as for binding ruling requests – resolutions on taxpayer requests as to whether the activity performed qualifies as own R&D activity or not. The resolution may be used in relation to tax allowances and to verify R&D content. The Tax Authority may call upon the Agency to act as an expert in certain cases.

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 a non-cash contribution, for decreases of registered capital and in-kind withdrawals in the event of termination without legal succession, and non-cash dividends, if provided by or 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 based on a regulation partly amended as of 2012.

This documentation should be prepared by the deadline for submitting 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 any subsequent Tax Authority investigation.

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

To harmonize the Hungarian legislation with the Resolution of the Council of the European Union, taxpayers are now able to choose between preparing simplified documentation on inter-company services with low added value, or stand-alone documentation, or EU transfer pricing documentation regarding inter-company transactions. The documentation can be prepared in languages other than Hungarian and from 2012 the Tax Authority cannot oblige taxpayers to translate into Hungarian transfer pricing documentation or other related documents (contacts, invoices) prepared in French, English or German.

Exemption is available if the value of the transaction does not exceed HUF 50 million, or if all cost recharged is originally invoiced by third parties.

As of 2015, the range of related parties has been broadened as companies having the same representatives responsible for business and financial decisions are also considered as related parties.

From 2017, taxpayers shall possess the other party's statement declaring that the aforementioned party applies the amount of the difference (the sum determined under the principle of fair market price provided for in the national law of the other party) in determining the amount of corporate tax or any taxable amount that is considered equivalent.

In accordance with the Base Erosion and Profit Shifting (BEPS) Action Plan, the EU also introduced the Anti-Tax Avoidance Package (ATAP), the most important part of which is the harmonized introduction of a country-by-country report.

Based on this, Directive 2016/881/EU was adopted as regards mandatory automatic exchange of information in the field of taxation. Through the amendment, entered into force on 31 May 2017, the automatic exchange of information in a country-by-country report is transposed into domestic law. The primary objective is to facilitate information exchange between tax authorities, and thereby support transfer pricing audits and improve efficiency.

Regarding submission of a country-by-country report, only those multinational enterprises are obliged that have achieved

annual consolidated group revenue of EUR 750 million or more in the fiscal year preceding the fiscal reporting year.

In accordance with group taxation rules, for transactions between members of a group, the transfer pricing modifications otherwise applicable to associated parties is not applicable when the corporate income tax base is determined. The preparation of supporting documentation requirement, based on Ministerial Decree, shall be performed by a representative of the group.

Loss carry forwards

According to the tax law changes, a general, 5-year time limitation is introduced in the case of tax losses arising in 2015 or later. Tax losses arising until 2014 could be utilized by applying the rules in force on 31 December 2014 until the end of the tax year beginning in 2030 at the latest.

Under the legislation in force, losses arising in 2004 and thereafter can be carried forward without any time limitation. From 1 January 2009, taxpayers are no longer required to obtain permission from the tax authorities to carry tax losses forward in certain prescribed circumstances.

From 1 January 2012, the provisions on loss carry-forwards changed significantly.

Losses carried forward will only be deductible for up to 50% of the tax base. In the case of corporate transformations or restructuring, previous losses can only be utilized if the new owner (or its affiliated company) of the legal successor previously exercised a significant influence over the legal predecessor, and if income is realized from the latter's activity for two consecutive tax years. Should, however, the successor terminate its business within 2 years, or if the activity of the predecessor related only to asset management, the latter "revenue-condition" does not have to be met. Change in ownership restrictions may apply to loss carry-forwards in the case of acquisitions. If the new owner has not previously been an affiliated member, loss carry-forwards can only be utilized if certain activity criteria and income criteria are met, or if the company is listed on a stock exchange.

As of 2015, for a transformation utilization of losses generated before the transformation is capped based on a ratio determined as the revenue realized by the legal successor from the activities carried out by the predecessor and the revenue realized by the predecessor from the same activity in the last three tax years before the transformation. This provision may be ignored if the predecessor's sole business was asset management. Loss carry-forwards were available for the first time to financial institutions in respect of their 2009 liabilities.

If a taxpayer has availed an R&D-related tax benefit previously, only a certain proportion of its losses may qualify as so-called loss carried forward.

In accordance with the group taxation registration rules, the tax losses of these groups would be the sum of the negative tax bases of the group members. The loss carry forward is only deductible for up to 50% of the group's tax base together with the members' positive tax base.



Capital gains participation exemption

As an incentive for establishing holding companies in Hungary, domestic or foreign participations are considered a “reported participation”, if they are reported to the Tax Authority within 75 days of the acquisition. The capital gain on such participations held for at least 1 year is exempt from corporate taxation. Any loss on write-offs, foreign exchange or losses incurred when cancelling from the books (except during transformations) should be added back to the corporate income tax base.

An investment cannot be treated as a reported participation, nor can the special rules be applied, if it is in a controlled foreign company (“CFC”).

In order to be compliant with the European Union Directive (ATAD), the definition of a CFC would be modified as of 1 January 2019, but the basic concept remains unchanged.

A foreign entity or permanent establishment may still qualify as a CFC, if a domestic taxpayer (by itself, or together with its associated companies):

- holds a direct or indirect participation of more than 50% of the voting rights, or
- owns directly or indirectly more than 50% of capital, or
- is entitled to receive more than 50% of the profits of that entity

in a tax year in which the amount of tax paid by the foreign entity or permanent establishment is less than the half of

the tax that would have been paid on the same income in Hungary.

The concept of real economic presence will be replaced by the genuine arrangement method.

A foreign entity or permanent establishment is not considered a CFC in the given tax year, if:

- its income arises from genuine arrangements (which must be verified by the taxpayer);
- its accounting profits do not exceed HUF 234,952,500, while its non-trading income does not exceed HUF 24,395,250; or its accounting profits do not represent more than 10% of its operating costs for the tax year in question.

However, a non-resident permanent establishment is exempted from CFC status, if it is located in a country outside the EEA with whom Hungary has concluded an international treaty that provides for exemption on the attributable income of such a permanent establishment from corporate taxation, as long as it qualifies as a permanent establishment based on the international treaty.

The income to be included in the tax base of the taxpayer will be the profit after tax (on the last day of the fiscal year of the CFC) reduced by the approved (distributed) dividend arising from non-genuine arrangements of the CFC in proportion to the extent the significant people functions (necessary for generating income at the CFC) are carried out by the controlling company. The attribution of CFC income shall be calculated in accordance with the arm’s length principle.

Non-resident companies

Branches and permanent establishments

In most cases non-residents are 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 in the same way 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 had to be scaled back.

Development allowance

The Ministry for National Economy grants tax incentives for a maximum 12-year period in respect to investments executed within the framework of a development programme introduced by the Government. The Corporate Income Tax law specifies the following investments, which can provide entitlement to a development tax allowance:

1. For investments of at least HUF 500 million at present value by a small or medium-sized company or investments in certain special regions of at least HUF 1 billion (present value), which meet the following requirement:

- the average number of staff (not including the staff of a foreign permanent establishment) in the 4 consecutive tax years following the claim of the tax allowance must not be less than the average staff number of the 3 tax years prior to the tax year of the investment.

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

- projects bringing an existing food facility producing foodstuffs of animal origin into compliance with the requirements laid down in legal regulations concerning food hygiene (permit of the European Council required since 1 June 2007);
- independent environmental protection or rehabilitation projects;
- broadband Internet service projects (permit of the European Council required since 1 June 2007);
- motion picture and video production;
- investments serving basic research, applied research or experimental development;
- investments launched within 3 years of the date when shares issued in the course of an equity increase are listed on the Hungarian or another EU stock exchange;
- investments put into operation in so called "free-entrepreneurial zones" as stipulated by the Government.

3. For investments creating new jobs, an investor could now be eligible for tax allowances via the creation of new jobs.

The tax allowance can be utilized if the project is to create a new facility, expand an existing one, involves a significant improvement in a product that is manufactured or in production technology.

To become eligible for the tax allowance, requests should be submitted to the appointed minister and the Government grants authorization in a decree if 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 commencing the investment. As of 2013 a new pre-condition for the application of development tax allowance is that the date of completion of the investment must be communicated to the minister responsible for taxation within 90 days after the investment is put into operation.

The decision must be adopted within 90 days of the date when the application was submitted or 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 investment starts.

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



6.2. LOCAL TAXES



There are a number of local taxes that may be imposed at the discretion of various local authorities.

Local business tax

Enterprises pay local business tax on all business performed on a permanent or temporary basis in municipal areas. In general, the basis of this tax is the enterprise's gross sales revenue less cost of goods acquired for re-sale, material costs, the value of mediated services, and subcontractors' fees. Direct costs of R&D are fully deductible. Accordingly, service providers get very limited relief and are required in essence to compute their local tax based on gross revenues.

As of 2013, a restriction on the amount of allowed cost of goods sold and mediated services has been introduced. As per the new rule, over HUF 500 million net sales revenue, the tax base is reducible only with a limited value of cost of goods sold and mediated services, depending on the value of the revenue considering certain thresholds. As a result, the restriction adversely affects those who realize less than a 30% gain on the aforementioned items.

In addition, a consolidated local business tax base establishing method has been introduced concerning taxpayers qualified as related parties for corporate income tax purposes, whose aggregated amount of cost of goods sold and mediated services exceeds 50% of their net sales revenue. The net sales revenue and the cost of goods sold data of the related parties need to be taken into account proportionally based on the period of the existence of the related party status when determining the local business tax base.

The maximum rate of tax is 2% of the tax base, which can be lower depending on the particular municipality where the company carries out its business. Enterprises have to pay local business tax for all the municipalities where they perform a business activity. The tax base should also be allocated to foreign locations, but such cases are not subject to local business tax. As the national law provides no minimum levy, it is up to each municipality to determine whether it will impose local business tax and, if so, the rate it will charge. There are still some municipalities that do not charge this tax at all. The law sets special allocation rules on certain activities (e.g. telecommunication services, energy providers). In addition, the local municipalities are allowed to determine tax allowance or tax exemption in relation to certain investments carried out by companies located on their territory.

As of 1 January 2019, the national Tax Authority is entitled to collect the tax returns of companies in connection with the local business tax and transfer the information indicated on these tax returns to local municipalities.

Real estate investment trusts (REIT) are exempt.

If a taxpayer hires new employees it is possible to obtain a local business tax base decrease of HUF 1 million for each

new individual (provided employees are taken over from unrelated parties). However, if the number of employees decreases by more than 5%, the tax benefit must be repaid.

6.3. INNOVATION CONTRIBUTION



The innovation contribution is payable by every entity subject to the Act on Accounting, with the exception of micro- and small enterprises. As of 1 January 2019, all rules of the SME Act should be taken into consideration in relation to these business forms. Certain information of all group members is relevant to determine the SME status.

The basis of the contribution is the same as for local business tax less the amount of local business tax base that is attributable to the foreign permanent establishment. The applicable tax rate is 0.3%

6.4. PERSONAL INCOME TAX

Residence

Under Hungarian domestic law, individuals with Hungarian citizenship (apart from dual citizens without a permanent or habitual residence in Hungary), individuals having an EEA residence permit who stay more than 183 days in Hungary, foreign nationals with a valid settlement permit and stateless persons are treated as residents for income tax purposes. For other natural persons, residence status can be determined firstly by permanent home, 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 applying the 183-day rule, but in practice it is understood to be a physical presence test. In the event 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 taxation treaties or reciprocity. The same taxation rules are applicable as for residents (i.e. the same tax rates). For tax purposes, Hungary means the territory of the country. Hungarian resident individuals are subject to personal income tax on their worldwide income.

Income derived from Hungarian sources is, particularly, the income that originates, according to the place of gainful activity, from Hungary, e.g.:

- for dependent income, the regular place of employment is in Hungary;
- income earned by executive officers and supervisory board members of legal persons and other organisations, if the legal person or other organisation is established in Hungary;

- interest income, dividend income paid by a Hungarian entity;
- income from disposing or renting out real estate located in Hungary.

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

Income

Individuals are subject to tax 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. Income is defined as „any increase in wealth or value obtained in any manner or form”.

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

Rates

The consolidated personal income tax base contains income deriving from dependent, non-dependent activities and other income.

The tax rate is 15% of the tax base.

Flat 15% rates are applicable for income taxed separately, such as interest, dividends, capital gains, etc.

Relief from tax – elimination of double taxation

Under its double taxation treaties, Hungary mainly gives relief by way of exemption. The wording of each double taxation treaty should be considered on its own merits.

6.5. SOCIAL SECURITY CHARGES AND CONTRIBUTIONS

Social security

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

Social security contribution

The employee obligations are called social security contributions. While the social tax is payable by the employer and is a tax type burden, it does not constitute any rights for a service or benefit funded by state sources for the employee. On the other hand, the above rights are granted upon the payment of social security contributions by employees.

Employees must pay a 10% pension contribution. Private pension fund payments can only be made voluntarily, because



all mandatory social security (both pension and health) payments are made to the state fund from 2012.

A summary of employee contribution rates for 2019 is presented in the table below:

Employees	Contribution is withheld by employer from gross salaries or wages
Pension contribution	10%
Health contribution for pecuniary services	3%
Health contribution in kind	4%
Contribution to Unemployment Fund	1.5%
Total	18.5%

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 EEA company. Individuals, not subject to, but wishing to benefit from the Hungarian social security system, are allowed to contribute to the system on a voluntary basis – under certain circumstances.

Individuals assigned from an EEA country are exempt from Hungarian social security contributions provided that they are in the possession of an A1 certificate.

Third-country nationals not having an EEA residence permit are not subject to Hungarian social security if they have a non-Hungarian employer and are assigned or seconded to Hungary for a period not longer than 2 years.

Social tax

The employer obligation is called social tax, the rate of which is 17.5% in 2019.

Certain social tax allowances can be applied, including:

- employees without a special profession and agricultural workers;
- young employees entering the labour market;
- employees arriving back from maternity leave;
- employees with certain levels of disabilities;
- employees in public projects and employees who are dismissed civil servants aged 60 or above, under certain conditions;
- highly qualified professionals for research and development activity; in addition, a separate allowance can be claimed for the research and development activity itself;
- mothers raising four or more children.

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

Social tax of 19.5% must be taken into account when calculating tax advances on income which is part of the consolidated income tax base, if no social security contributions or social tax were paid on the income.

There is a 19.5% social tax payable on the following forms of income taxed separately:

- income withdrawn from enterprises;
- income from lending securities;
- dividends not derived from securities on an EEA exchange market;
- income from capital gains.

The 19.5% social tax payment is capped at a value of 24 times the monthly minimum wage (on aggregate: HUF 3,576,000) per annum (including the income from dependent, non-dependent and other income which is subject to social tax and the 19.5% social tax liability on the above types of income).

Other

The monthly health service contribution has been raised to HUF 7,500 in 2019.

6.6. CONTRIBUTION TO THE REHABILITATION FUND



This fund provides assistance for disabled employees. Disabled people should comprise a minimum 5% of an employer's headcount. Any employer not meeting this criterion is obliged to pay a contribution of HUF 1,341,000 /disabled person not employed per annum in 2018. The contribution is not levied if the total number of employees does not exceed 25.

6.7. CONTRIBUTION TO THE VOCATIONAL TRAINING FUND



Employers are required to contribute to this fund, which supports various vocational schools in Hungary. The contribution is set at 1.5% of the total annual base for the social tax considering certain contribution base adjustment items.

6.8. VALUE ADDED TAX



Hungarian VAT legislation is largely harmonised with EU VAT legislation. Recent major changes to EU VAT legislation have also been introduced into Hungarian VAT legislation.

Taxpayers

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

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

Group taxation

Group VAT taxation has been an option since 2008 for related entities established in Hungary for economic purposes. The members of a group stop being considered independent taxpayers from a VAT point of view and the group is regarded as a single taxpayer for 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

In general, VAT is charged on supplies of goods and services where the place of supply is in Hungary, on intra-Community acquisitions and on goods imports. Certain kinds of goods and services are exempt from VAT.

Following the EU VAT principles, Hungarian VAT law usually applies the destination principle to cross-border transactions, which means exports of goods and intra-Community supplies of goods are exempt from VAT (input VAT can be deducted). Most services when provided to foreign companies are outside the scope of Hungarian VAT with the right to deduct input VAT. In other words, these transactions are not subject to Hungarian VAT. Suppliers of such transactions can nevertheless claim input tax credits to recover the VAT paid on their own business-related purchases.

The exemptions from the destination principle include:

- Most supplies of services to non-taxable persons (see details below on the changes in relation to hiring means of transport);
- Supplies connected with immovable property;
- Passenger transport;
- Supply of admission to cultural, artistic, sporting, scientific, educational, entertainment or similar events supplied to a taxable person;
- Restaurant and catering services;
- Short-term hire of means of transport.

As from 1 January 2013, the place of supply when hiring a means of transport (other than short-term hiring) to non-taxable persons has changed to the place of establishment of the recipient/renter (i.e. where he has his permanent address or residence). For the hire of pleasure boats, the place of supply is the place where the pleasure boat is actually put at the disposal of the recipient.

In line with the amendments of the Community regulation, Hungary adopted special place of supply rules concerning telecommunications services, radio and audio-visual media services, and electronically supplied services rendered to non-taxable persons. As from 1 January 2015, similarly to the long-term hiring of a means of transport the aforementioned services shall be taxable in Hungary if the recipient is established in the country (having a permanent address or residence).

For the acquisition of goods from other member states and most services acquired abroad, the buyer and recipient of the services must self-assess VAT on the amounts charged. Most services must be treated as being subject to reverse charge VAT in Hungary, if the supplier has no Hungarian VAT establishment.

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

As from 1 January 2013, as a general rule no VAT payment liability arises in relation to the sale of a business as a going concern. The simplification only applies among domestic tax registered businesses and only if the business performs activities subject to VAT.

Registration for VAT purposes

Retroactive registration of foreign businesses for VAT in Hungary has been permitted since 1 January 2008, assuming these foreign businesses were conducting taxable activity in their home country. This enables companies to recover input VAT incurred from the commencement of business activities in Hungary (i.e. before the registration procedure is finalised). The registration procedure is relatively short: obtaining a tax number takes 2-4 weeks on average.

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 an 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 its 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 to declare the import and the subsequent intra-Community supply of goods in their own VAT returns.

Tax base

The basis for tax assessment is the sales value of the goods or services. However, if the sales value is significantly different from the market value, dependent parties may have to adjust the VAT base if this impacts on non-deductible VAT or the VAT deduction ratio of the seller. Both higher and lower prices can trigger adjustments between dependent parties.

For goods imports, the assessment basis is the value for customs duty purposes increased by the amounts of stamp duties and other tax-related payment obligations.

Taxpayers are obliged to keep a register for 5+ years to show and control the assessment basis and the taxes paid.

VAT rates

There are three VAT rates in Hungary:

- 27% – the standard VAT rate applicable to most products and services;
- 18% – the reduced VAT rate applicable to certain dairy and bakery products, hotel and other accommodation services, admissions to occasional outdoor events among specific circumstances;
- 5% – the super-reduced VAT rate applicable to pork, cattle, sheep, goats, poultry, eggs, fresh milk, books, newspapers, magazines, some pharmaceuticals, certain medical aids/equipment with 98 and 90% social security subsidy, central heating services, newly built residential properties and – as from 1 January 2018 – internet access, restaurant services with some restrictions, some fish.



Reporting obligations

Taxpayers are obliged to file VAT returns on a monthly, quarterly or annual basis depending on turnover.

Intra-Community transactions carry certain administrative obligations, such as Intrastat and EC Sales and Purchase List filings. Taxpayers are obliged to submit Intrastat reports monthly if the value of their dispatches or arrivals of goods exceeds the annual threshold determined by the Statistical Office. The threshold for arrivals is HUF 170 million and for dispatches HUF 100 million. Taxpayers must submit EC Sales and Purchase Lists monthly or quarterly on intra-Community supplies and acquisition of goods and services.

The obligation to submit special recapitulative reports on invoices was introduced on 1 January 2013. Both the seller and the buyer must prepare reports containing the details of each incoming/outgoing invoice involving more than HUF 1 million in VAT. Reporting liability also arises if purchase invoices from one supplier cumulatively reach the HUF 1 million VAT threshold within one reporting period. From 1 July 2018, on the side of the receiver, the HUF 1 million threshold will be lowered to HUF 100,000. On the side of the invoice issuer, the reporting liability will not be applicable from 1 July 2018 (as it will be replaced by real-time reporting). Pursuant of the adopted amendments all purchase and sales invoices can be disclosed voluntarily even if the above conditions are not met.

Invoicing

Invoicing systems, both in the case of paper and electronic invoices, have to meet uniform basic criteria regarding their authenticity, data integrity and legibility.

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 then have joint and several liabilities for the invoicing obligations.

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

In order to modify a previously issued invoice for any purpose, a document equivalent to an invoice must be issued. The obligatory items to be indicated in terms of format and content are simplified compared to those for ordinary invoices.

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

If the consideration is expressed in a foreign currency, not only the daily exchange rate of the National Bank of Hungary but any daily exchange rate for currency sales published by any domestic credit institution or, as from 1 January 2013, the daily exchange rate of the European Central Bank can be applied when converting into Hungarian forints provided this intention is communicated to the state Tax Authority in advance. The amount of VAT should be indicated in Hungarian forints on the invoice.

According to the changes that came into effect on 1 October 2014, all taxpayers with Hungarian VAT numbers are obliged to report details regarding the invoicing software they use to the Hungarian Tax Authority. Acquisition of new invoicing software or withdrawal from use of old software have to be reported to the Tax Authority within 30 days (pre-registration is required as of 2018 – see details below). A similar reporting obligation also applies to online invoicing applications and solutions.

Since 2016, there is a requirement under Hungarian law that the invoicing software used for issuing invoices under a Hungarian VAT number should be capable of exporting certain invoice data in a pre-determined format. This means that the invoicing software should be equipped with a 'data export function' for tax audit purposes (following SAF-T principles). Upon the request of the Tax Authority (i.e. during Tax

Authority audits only), the data export function should be able to provide the Tax Authority with invoicing data in a prescribed XML format. The purpose of the legislation is that the Tax Authority receives invoicing information in a standard format during tax audits enabling effective searches within the data.

With the help of the data export function, the Tax Authority should be able to filter the invoices by:

- invoice date (invoices issued within a certain period may be selected);
- invoice numbers (a specific range of invoice numbers may be selected).

As of 1 July 2018, invoicing information would need to be provided to the Tax Authority immediately following the issuance of invoices if the related VAT amount reaches HUF 100,000 (approx. EUR 330). Basically, the invoicing system of the taxpayer should be capable of immediate and automatic data provision, without manual intervention. Data provision has to be carried out in a pre-defined XML data format covering at least the compulsory invoice data as mandated by Hungarian regulations. Default penalty of up to HUF 500,000 (approx. EUR 1,500) per invoice could be levied by the Tax Authority, if a taxpayer does not fulfil this reporting obligation.



Electronic Road Transportation Control System (ERTCS/EKAER)

As a key element of the taxation regulations serving the whitening of the economy and the fight against corruption, the Electronic Road Transportation system was introduced on 1 January 2015. The purpose of the system is to assure that no goods are put into circulation in Hungary that were not previously reported to the Hungarian Tax Authority.

The transactions listed below can only be carried out by traders who possess a so-called ERTCS/EKAER number, which has been issued by the Hungarian Tax Authority:

- intra-Community (deemed or actual) supplies of goods where the goods are dispatched from Hungary;
- intra-Community (deemed or actual) acquisitions of goods where the goods are delivered to Hungary;
- the first supply of goods in Hungary to a certain business customer,

provided that the goods are delivered by road.

In cases of the supplies/acquisitions of certain goods falling within the category of so-called dangerous goods, a specific bond or equivalent bank guarantee must also be provided by/ for the seller/acquirer.

Taxable persons who do not comply with the obligations above may be subject to penalties of up to 40% of the value of the goods transported. Alternatively, the goods may also be confiscated if they are found to have been transported without a valid ERTCS/EKAER number.

6.9. CUSTOMS DUTIES

Exporting to and from Hungary

As a member state of the European Union, Hungary is part of the Customs Union of the EU.

Customs duties are payable on non-Community goods imported from countries or territories that are not part of the EU's customs territory.

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

Import procedures

General procedures

All goods must be declared to the National Tax and Customs Administration upon import. The clearance procedure can be initiated at a border customs office, while non-Community goods may be transported to their final destination and cleared at a local customs office.



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The value, classification and origin of the goods and the purpose for which they are imported determines whether and how much duty is payable.

Customs agencies can assist companies with customs administration to ensure it is accurate and efficient. Some have an indirect customs representative license, which means they can obtain certain benefits (such as local clearance procedures, deferred payments, security relief, VAT self-assessment).

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

Valuation

Although there are six valuation methods 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's Combined Nomenclature (CN). This classifies all goods of international commerce so that each article is classified in one place and one place only, within the tariff. The classification determines the rate of duty applicable to the 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 a considerable influence on their duty liability. If they originate in and are directly dispatched from a country which has a preferential agreement with the EU, the duty rate is often reduced significantly, even to 0%. The EU has such agreements with other countries. 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 upon import

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

VAT is also charged or self-assessed at import. 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 directly to the importer of the goods every month, and in the case of traders with deferred payment terms. In other cases, invoices from a customs clearance agent are acceptable.

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

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

Customs duty relief and suspension procedures

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

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

Four of the most common reliefs are:

- Inward Processing Relief (IPR) – where goods are imported from outside the EU for processing and re-export, duty may be waived at import or refunded at export;
- Outward Processing Relief (OPR) – where goods are temporarily exported outside the EU for processing, a proportion of the import duty is waived on their return;
- Temporary importation – where goods should be re-exported in the same condition to a third country within a specified period of time;
- General Relief as defined in the EU customs legislation.

The customs warehousing procedure may allow for 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 placement in a customs warehouse shall trigger the application of measures normally attached to the export of such goods.

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

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

Export procedures

As with imports, goods must be declared to the Customs Authority upon 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 is VAT exempted, provided the exporter can produce the necessary evidence of exporting.

6.10. EXCISE DUTY



A new version of the Excise Law became effective on 1 April 2017. The legislation follows the concepts laid out in relevant EU legislation. Excise goods manufactured within the country and those imported are subject to excise duty.

Excise duty is charged on the following excisable goods:

- mineral oils;
- alcohol and alcoholic beverages;
- beer;
- fruit wine;
- sparkling wine;
- intermediate alcoholic products;
- tobacco products.



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

(Among exceptional circumstances, special rules apply. For example, alcoholic drinks and tobacco products are allowed to be sold free of excise duty on board airplanes heading towards third countries.)

Goods subject to excise duty should be produced in a tax warehouse; furthermore producers and traders have to possess relevant licences to carry out their activity. Excisable goods could either be under a duty suspension arrangement or in free circulation depending on whether the excise duty has been paid. In general, excise duty is related to quantity or weight rather than value (the latter is partly the case with reference to tobacco products).

6.11. PROPERTY TRANSFER TAX



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

- the general rate is 4% with certain exemptions and preferential rates (and applies also to apartments and houses for dwelling purposes);
- for acquisition of real estate or shares in real estate holding companies, the transfer tax rate is 4% up to HUF 1 billion per real estate, and 2% for the market value exceeding this threshold. The property transfer tax is capped at HUF 200 million per item of real estate (These transactions among related companies are exempt from transfer tax.);
- 2% on real estate if the buyer is a property trading or leasing company;
- real estate investment trusts (REIT) are subject to 2% real estate transfer tax;
- as of 1 January 2012, motor vehicles' transfer tax is determined according to the vehicles' horsepower and age.

The transfer of property as part of a preferential transaction under the corporate income tax law is not subject to property transfer tax.



7.

INVESTING IN PROPERTY

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Investing in Property



7.1. ACQUIRING REAL PROPERTY

Acquisition of real property by a company

Companies can acquire real property in two ways:

- if it is provided by an investor as an in-kind contribution;
- if it is purchased by the company.

Real properties in Hungary are registered in the land registry, which is open to the public. Anyone can access the registered data and pay for an official extract from the records.

Companies which own real properties in Hungary are generally allowed to make unrestricted use of their real property: they can sell it, utilize it (e.g. rent it out) or take out loans secured on it (e.g. mortgage it), or sell the rights associated with it.

Acquisition of real property by non-residents

According to Government Decree No. 251/2014 (X.2.) on the Acquisition by Foreigners of Real Estate Other Than Agricultural and Forestry Land, foreign individuals or legal entities may acquire Hungarian real property (with the exception of land used for agricultural or forestry purposes) provided that they obtain a permit granted by the Budapest or county government office, based on the location of the real property. No permit is needed if the acquisition occurs through inheritance/succession.

A permit is issued if the intended acquisition does not infringe local or public interests. The individual or the representative of the non-resident entity must request such permit from the competent government office. If the permit is denied, the decision can be appealed before the court.

From 1 May 2004, a citizen of a Member State of the Agreement on the European Economic Area ("EEA Member State") and business associations registered in an EEA Member State, or any other country similarly classified on the basis of an international treaty, may acquire property under the same conditions as domestic persons (i.e., no permit is required).

Also, no permit is required for the acquisition of a real property that is necessary for the business activities performed through the Hungarian branch offices of companies established in any state, other than an EEA Member State:

- in the cases defined by an international treaty, or
- if in this regard a state of reciprocity has been established between the country in which the foreign company is established and Hungary.

Long-term rental

Non-residents are allowed to rent apartments or houses in Hungary without a permit. During the rental period, the tenant has the right to use the real property in accordance with the lease agreement concluded between the tenant and the landlord.

Restrictions on the acquisition of agricultural land

No foreign person (legal or natural) may acquire the title or any other right of Hungarian arable land. This restriction also applies to Hungarian undertakings (including subsidiaries of foreign investors).

According to the Act CXXII of 2013 on the transfer of agriculture and forestry land, as amended, (hereinafter referred to as "Land Act"), EU and Hungarian natural persons, who do not qualify as farmers under the Land Act, may acquire land only up to one hectare (together with the land which is already possessed). This limitation does not apply in case of close relatives of the transferor.

EU and Hungarian natural persons qualified as farmers and their close relatives may not acquire and own agricultural land in excess of 300 hectares and may not possess more than 1,200 hectares with certain exemptions. The acquisition of agricultural land shall be subject to the prior approval of the agricultural authority.

Transfer tax issues with acquisitions

Those acquiring real property (or a quota – share – of a real property holding company) are generally required to pay a property transfer tax of 4% of the first HUF 1 billion (approximately EUR 3,250,000) of the commercial value of the

real property, and 2% thereafter, but no more than HUF 200 million (approximately EUR 650,000) per intangible property.

The transfer tax is reduced to 3% for enterprises whose core activity is either trading in real property and 50% of net revenue is achieved in the last tax year from such activity, or the enterprise conducts licensed financial leasing activity. The general rule is that such real property must be sold to a non-related undertaking by the enterprise within two years of acquisition. The transfer tax is reduced to 2% if the entrepreneur guarantees the fulfilment of the contract. Transfer of real property between related parties is exempt, if the core activity of the purchasing party is real property sale or own property rent.

7.2. TAX RULES ON EXISTING PROPERTIES (SALE OR USE OF PROPERTIES)

VAT

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

The general rule is that the sale and renting out of real property is exempt from VAT. This also means that the input VAT incurred in connection with properties cannot be deducted.

There are, however, some exceptions from the general rule, as follows:

- the sale of new real property is taxable – real property qualifies as a new property if it is sold before completion or within two years after being put into use;
- taxpayers may opt for VAT status in general prior to a given tax year for property transactions, or prior to the transaction if this is a new business activity enabling them to deduct the input VAT based on the general rules.

Where the transaction is subject to VAT, it is payable at the general rate of 27% on the use (sale or rental) of the properties.

Other taxes may be charged on property (e.g., building tax, land tax, local business tax and community tax).

Income Taxes and Other Tax Implications

Rules governing the taxation of income from the use or sale of property in Hungary are outlined below.

However, where there is a double taxation treaty in force, the terms of that treaty prevail the Hungarian tax provisions in case of contradiction between the two.



Personal Income Tax

Foreign individuals are taxed at 15% on income from the sale of property in Hungary. Documented costs of acquiring and developing a property allowed by Hungarian law may be deducted from sales proceeds. In case of residential property, the period for which capital gains are subject to tax is five years. Accordingly, income derived from the sale of residential property which was purchased more than 5 years ago is not taxable. In case of other types of real property, the exemption period is 15 years.

Corporate Income Tax

Hungarian Subsidiaries of Foreign Companies:

- Generally, Subsidiaries of Foreign Companies are subject to a corporate income tax of 9% as described in Chapter 6. The tax base is the profit before tax calculated based on the rules of the Act C of 2000 on Accounting, adjusted for specific items under the Act LXXXI of 1996 on Corporate tax.
- Capital gains derived from the sale of real property are taxed as ordinary business income.
- Income for investors selling property is the sales price of a property. Any accounting balance recorded as the value of a tangible asset may be included under cost of sales. If a seller and a buyer of a property are related parties, particular care must be taken to set an arm's length price.
- Generally, in case the selling price exceeds the tax book value, the difference is defined as profit and is subject to corporate income tax.
- Income calculations are based on nominal, historical forint (HUF) figures; there are no rules for relief from inflationary gains.

- The depreciation defined under the Act on Corporate Tax is deductible for corporate income tax purposes. For tax purposes, the maximum tax-deductible depreciation on industrial buildings and buildings in long-term use is 2%, while rental properties can be depreciated at a preferential rate of 6%. When calculating depreciation for accounting purposes, it is important to ensure that it corresponds to the anticipated useful life and residual value of the property, and is in line with the company's accounting policies.
- Dividend withholding tax was abolished with effect of 1 January 2006.
- Domestic or foreign participations (except participation in CFC) over 10%, acquired from 1 January 2007, are considered as "announced participations", which are reported to the Tax Authority within 75 days of the acquisition. Any losses on write-offs, foreign exchange or losses suffered when derecognizing from the books (except during transformations) is not tax deductible. The holding period to obtain exemption from corporate tax on capital gains for an announced participation is one year; the capital gain on such participations held for at least one year is exempt from corporate tax.

Branch Offices of Foreign Enterprises:

- General taxation rules apply for Hungarian branch offices and they are treated identically to Hungarian-registered companies, unless otherwise stipulated in an act of law or by a government decree issued pursuant to such a law. One such stipulation is a restriction on property acquisition as mentioned above.
- Thus branch offices are treated like domestic companies for corporate tax purposes. Business performed through branch offices is taxed in the same way as that conducted by legal entities. However, where there is a double taxation treaty, it may be possible to apply different principles to determine a branch's tax base.
- As of 1 January 2006, there is no withholding tax on profits that are withdrawn by foreign-registered enterprises from their branch office registered in Hungary.
- Certain business activities can be only carried out through a branch or a subsidiary, and since income related to real property is deemed to create a permanent establishment, a branch must be registered by law.

Transfer of Ownership of Property-holding Companies

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

Acquiring a real property holding company is subject to a 4% property transfer tax for the first HUF 1 billion (approximately EUR 3,250,000) of the commercial value of the property concerned, and 2% thereafter, but no more than HUF 200 million (approximately EUR 650,000) per property, where

the purchase results in the acquisition of at least 75% of the shares – calculated together with close relatives and/or related parties.

Furthermore, the alienation of the participation of a foreign corporate shareholder in a Hungarian property holding company may be subject to corporate income tax at 9% depending on certain conditions e.g. if there is an applicable double taxation treaty which allows the taxation of such capital gains. The tax is based on the selling price of the shares, decreased by the purchase price paid and other justifiable costs.

Transfer of Agricultural Land Reclassified as Real Property

Specific rules are applicable to the transfer of agricultural land reclassified as real property. As of 2012, such land is considered reclassified for a period of five years following the decision on reclassification, unless the land was acquired at least five years before the reclassification.

For private individuals, the usual yield upon the sale of a reclassified land is taxed at 15%; this 15% shall be calculated on three times the excess yield.

In case of companies, 9% shall be calculated on three times the excess yield (i.e. on the yield exceeding the usual yield).

The usual yield per day should be calculated as 0.3% of the costs incurred because of, and since, the acquisition. Usual yield should be calculated for the period of the possession.

For the sale of shares of a corporation owning agricultural land reclassified as real property, the (corporate or personal) income tax base of the (corporate or individual) shareholder is to be increased by twice the capital gain earned on the sale which is above the usual yield, if the value of such land exceeds 75% of the total of fixed assets and inventories (evaluated on the accounting date) in the books of the corporation. In this case the usual yield per day is 0.3% of the purchase value of shares. The usual yield is calculated for the period of possession in this case as well.

These rules are applicable both for single sales and in case of carrying out such activities on a routine basis.

Inherited agricultural land reclassified as real property is exempt from these rules.





Should you have any questions, please feel free to contact us!



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Disclaimer

PURPOSE OF THE GUIDE

This guide ("guide") has been prepared by us to provide information to our clients / potential clients on the main aspects and legal regulations relating to foreign investments in Hungary. The guide does not purport to be an exhaustive list of all issues which are in connection with the aforementioned topic. It is given for information purposes only.

RESTRICTIONS

In this guide we have focused only on those provisions that are important to understand the Hungarian regulations with respect to the main aspects of foreign investments in Hungary.

By its nature, our guide does not intend to provide a catch-all analysis of all aspects of the respective areas mentioned in it. We have highlighted only the most significant aspects that might arise in the case of investing in Hungary. This guide is not a legal opinion nor should it be considered any advice as to whether or not to proceed in any particular business case.

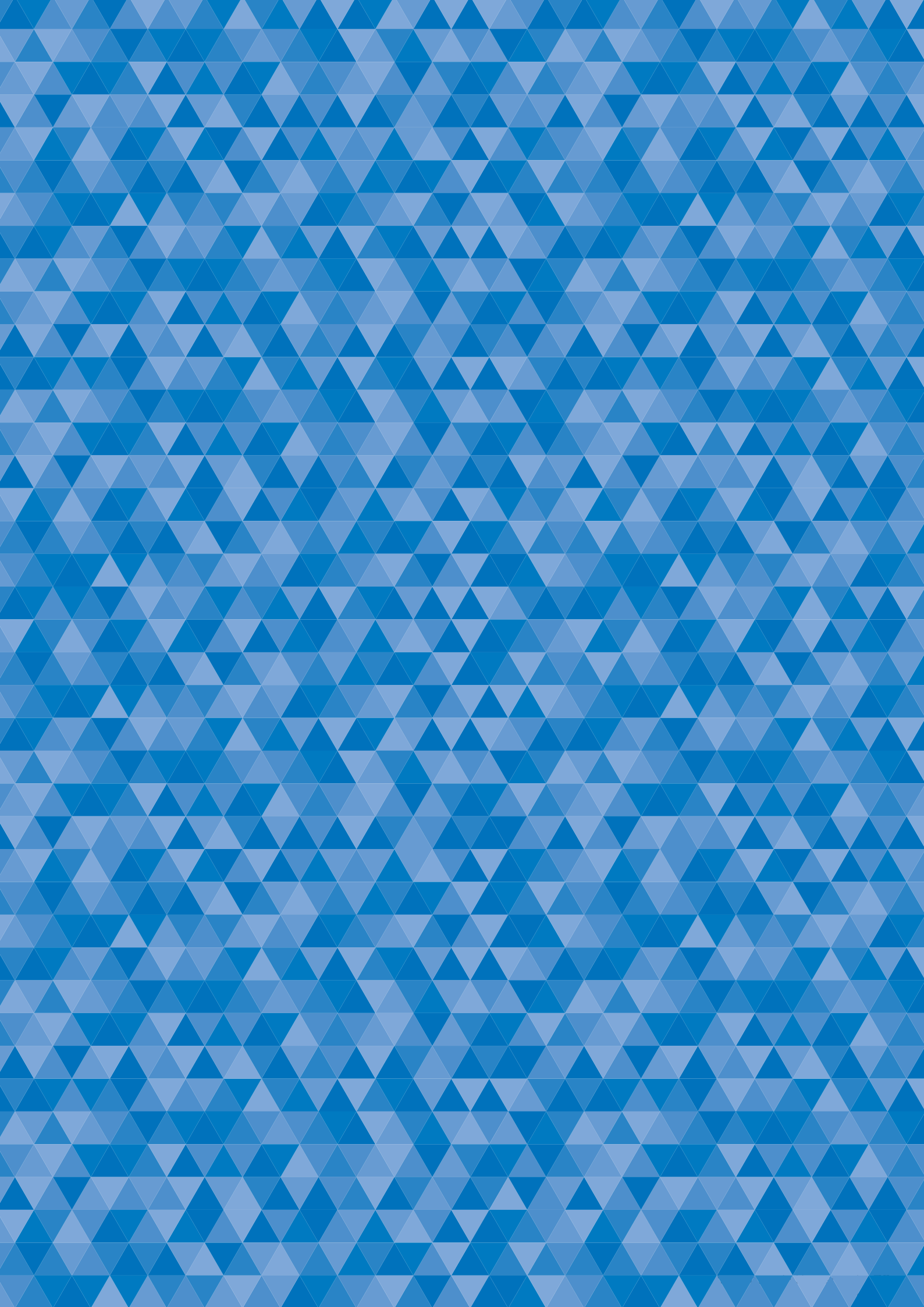
Naturally, if you are interested in any further details, we are happy to provide you assistance in the respective area.

Our work is based solely on Hungarian law as effective upon 1 January 2019.

The existing guide has been conducted on the following basis:

- it includes only the main and high-level aspects of the topic;
- it does not constitute a formal legal opinion and is subject to the various limitations set out herein;
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