DOING BUSINESS
in Hungary



TREUHAND
20 YEARS IN HUNGARY

ABT Treuhand Group
Adr.: H-1037 Budapest, Montevideo u. 3/a **Tel.:** +36 1 430 3400 **E-mail:** abt@abt.hu **Web:** www.abt.hu

AB T

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DEAR INVESTORS, FRIENDS, LADIES AND GENTLEMEN,

We are pleased to present you with our updated, 3rd edition of the brochure DOING BUSINESS IN HUNGARY.

Our brochure is intended as a simple, yet comprehensive overview of the Hungarian circumstances. Should you wish to explore the topic in greater depth or are perhaps even interested in establishing part of your operations in Hungary, we are ready to assist you at any time, backed by our many years of experience.

Best Regards,

JÓZSEF LÁNG
Tax Consultant
Co-Owner and CEO

INTRODUCTION

2013 was a year of recovery after recession for the whole European Union, and optimism also characterises the Hungarian economy.

- Our relations with the European Union have been consolidated, and the pressure has eased on Hungary.
- After falling in 2012, Hungary's GDP grew by over 1% last year, exceeding expectations. For 2014, economic analysts predict growth of around 2%.
- Inflation has reached a record low of four decades, which could significantly boost household consumption.
- Employment data also reflect an improving tendency, mainly due to measures aimed at creating jobs that have been introduced in recent years.
- As regards investments, the Hungarian National Bank is optimistic for 2014, based largely on the expected success of the Credit for Growth Programme, which facilitates investments by enterprises.

That does not mean that Hungary can sit back, since it is facing challenges in several areas:

- increasing the level of employment is still among the priorities,
- the education and health care systems are struggling with severe lack of funds,
- Hungary is lacking an appropriately developed small- and medium-sized enterprise sector by international standards and
- the geographic distribution of investments is uneven.

These challenges, however, also represent opportunities for investors. Currently the country is working to develop a stable legal system and tax stucture which will be highly attractive to foreign investors. It may be positively noted that a number of features attractive to investors are already in place today in Hungary:

- the best infrastructure in the region (some one thousand kilometres of motorways and main roads, unparalleled in the Central and Eastern European region),
- more than 200 industrial parks with fully developed utilities and

- hundreds of thousands of skilled and highly motivated workers who are educated and possess experience in a variety of fields (from assistant labourers to multilingual research scientists); and last, but not least,
- a 10% tax on capital gains[1] and a 16% personal income tax, which are among the lowest for both businesses and private individuals across Europe.

Prominent corporations from overseas countries which have chosen Hungary as the site of their investments in recent years include the following: America's Alcoa, Korea's Hangkook and Samsung, Japan's Suzuki and Sanyo, Germany's Daimler, Audi and Bosch; Austria's Wienerberger; Switzerland's Nestlé and Stadler Rail, a leading manufacturer of suburban rail cars. As a result of their presence, numerous suppliers have also set up business in Hungary.

1 The 10% capital gains tax applies to profits up to HUF 500 million (approx. EUR 1.7 million); for profits exceeding that level the rate is 19%.

1. HUNGARY'S PLACE IN THE WORLD

1.1. HUNGARY IN NUMBERS

Area: 93,030 km2
Capital: Budapest
Official language: Hungarian
Languages of business communication: Hungarian, English, German
GDP 2013: EUR 97.5 Mrd
Currency: Hungarian forint (Ft, HUF)
Government type: Republic
Population: 9,906,000 people
Road network: total 32,000 km; motorways: 1,300 km

1.2. GEOGRAPHY AND CLIMATE

Hungary is a country located in Central Europe, in the Carpathian basin, with no coastline. The country is bordered by Slovakia to the north, Ukraine to the northeast, Romania to the east and southeast, Serbia and Croatia to the south, Slovenia to the southwest, and Austria to the west.

Almost the entire Carpathian basin belongs to the catchment area of the Danube. The axis of Hungary's water system is the Danube. Its length is 2850 km, of which the length of its main branch in Hungary is 417 km. The country's largest tributary river is the Tisza. The largest rivers lend themselves to transportation purposes.

Hungary is not only rich in fresh water but also in thermal water – in fact, the country is the richest area of Europe for thermal water.

1.3. HISTORICAL OVERVIEW

For over 1,100 years, since the late 800s, Hungary has been present on Europe's political, economic and cultural map. This makes Hungary one of the longest existing nations in Europe, even if the country has undergone changes in terms of size and form.

Up to 1301, the end of the Árpád dynasty, and during the Anjou dynasty, medieval Hungary flourished almost without interruption. In the 15th century King Matthias made renaissance Hungary the cultural centre of Europe, and it served as an example for other countries as well. In the following centuries Hungary lost its independence for a prolonged period, falling under Turkish, and later Habsburg influence. Suppression eased after the Compromise of 1867, when the Austro-Hungarian Monarchy was formed. The agreement was highly favourable for the Hungarians – the economy soared, and Hungarian GDP grew substantially up until the beginning of the 20th century. The country developed into an agricultural and industrial power, while Budapest emerged as one of the leading cities of Europe with a new, unique cityscape, and several innovations such as the first metro line on the continent.

After the flourishing years of the Austro-Hungarian Monarchy, the 20th century brought hard times upon Hungary. The First World War led to the collapse of the Monarchy and the tragic Trianon Peace Treaty of 1920, when Hungary lost 72% of its territories. In the Second World War, Hungary's objective was to recover its lost territories, though this was to no avail. Hungary came under German occupation in 1944, followed by Soviet troops entering the country.

With the weakening of communist rule in the 1970s, Hungary was the first socialist state to join GATT (in 1973) and it also became a member of the World Bank and the International Monetary Fund in 1982.

In the 1980s, the Soviet influence eased. The most important domestic political event of the regime change in 1989 was the proclamation of the Third Hungarian Republic in Budapest on 23 October 1989.

Since 1990, Hungary has been working toward western (Euro-Atlantic) integration. In December 1991, the country became party to the European Union Association Agreement; this contributed, in addition to closer economic ties, to stronger financial, legal and political cooperation.

Hungary became a member of NATO in 1999 and, following lengthy negotiations, a member of the European Union on 1 May 2004, together with nine other countries. Hungary has been a member of the Schengen Area since 21 December 2007, marking the end of permanent border checks on Hungary's borders with Austria, Slovenia and Slovakia.

The European Parliament currently has 22 Hungarian members.

We are proud that EU member states voted unanimously on 18 June 2008 to make Budapest the seat of the European Institute of Innovation and Technology (EIT). The aim of the EIT is to increase the EU's innovative capacities by coordinating educational, developmental and scientific fields.

In the first six months of 2011, Hungary for the first time held the rotating presidency of the Council of the European Union, one of the principal bodies of the EU. Together with Spain and Belgium, Hungary formed a presidential trio as president of the Council of the European Union.

1.4. POLITICAL ENVIRONMENT, HUNGARY'S NEW FUNDAMENTAL LAW

Hungary's new Fundamental Law entered into force on 1 January 2012, replacing the constitution originally drafted and adopted during the communist era, in 1949, and modified several times since.

In its new Fundamental Law, Hungary declares that the family, order, home, work and health are what it considers its most important values.

1.4.1. Key Regulations of the Fundamental Law

Fundamental rights (the issue of freedom and responsibility)

The new Fundamental Law expresses Hungary's commitment to the common constitutional values and traditions of the European Union, spells out the individual and collective rights of the citizens of the country (regardless of nationality), and defines fundamental freedoms in keeping with the spirit of the EU's Charter of Fundamental Rights.

Constitutional order and the separation of powers

The new Fundamental Law elaborates on the precise separation of powers, the roles of key state figures (the president of the republic, the government, the courts, the Constitutional Court, the Office of the Prosecutor, the Hungarian Defence Forces and the police), as well as the scopes of authority of local governments.

Debt ceiling and the protection of public funds

As a new feature, the Fundamental Law includes an important chapter on public funds: it ensures that Parliament only be allowed to adopt a central budget that does not lead to growth in state debt. In fact, it requires that this drop to a level below 50% of GDP.

1.4.2. Rule of Law Framework

In terms of political system, Hungary has been a parliamentary representative democracy since 1990. The three primary tasks of the state are lawmaking, the implementation of legal regulations and ensuring that these are adhered to. The three branches of power are institutionally separate in Hungary: the Fundamental Law also declares the independent functioning of the various branches of power.

Lawmaking

Hungary's legislative body is the National Assembly; its operations are governed by the Fundamental Law as well as its house rules. Members of Parliament are elected for four-year terms. Parliament generally adopts laws with a simple majority; some laws require a qualified majority.

The Executive

The implementation and execution of laws and regulations is the task of the government and various public administration bodies (e.g. the National Tax and Customs Administration).

The government represents the highest level of the executive branch in Hungary. The prime minister and the government are elected by Parliament. A constructive motion of no confidence allows for the removal of the government.

The current prime minister, Viktor Orbán, has been in office since 2010. The next parliamentary elections will be held on 6 April 2014.

The Judiciary

If laws or regulations are violated, the plaintiff or victim (or even the State) may turn to relevant authorities and the various forums of the judiciary, including the independent courts.
A fifteen-member Constitutional Court operates completely independently of regular courts and with a different scope of authority. The role of the Constitutional Court is to provide preliminary or ex post facto examination of the constitutionality of laws, to protect fundamental rights provided for in the Fundamental Law and to review constitutional complaints. Decisions of the Constitutional Court may not be appealed.

The President of the Republic

The president of the republic performs ceremonial duties, as well as playing a role in the legislative process and signing laws enacted by Parliament. In the course of this process, the president may return each law one time for further consideration to Parliament, or may submit it to the Constitutional Court for a preliminary review. It is also the president who authorises the formation of the government and who appoints ministers; the president may also exercise clemency.

Other state authorities

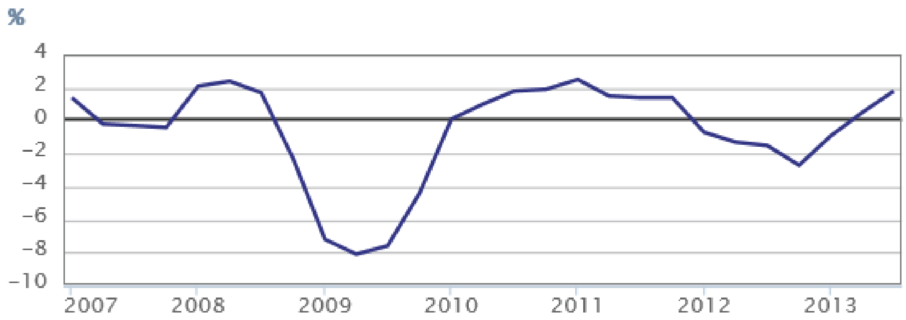
- The State Audit Office is responsible for the financial oversight of any institution receiving funds from the central budget. It reports to Parliament.
- The Central Bank of Hungary is the country’s official national bank; it issues the official currency (the forint) and determines the direction of the country’s monetary policy.
- The finances of the state are managed by the Hungarian State Treasury. Specifically, the Government Debt Management Agency is responsible for tasks related to debt management.

2. ECONOMIC SITUATION

Hungary has long traditions in agriculture and industry, with the latter primarily including machinery manufacturing and processing. In recent years, several major foreign corporations have established manufacturing bases in Hungary, which have also attracted large-scale supplier networks. Tourism and financial services are among the drivers of the services sector. Several companies, including Vodafone and IBM, have chosen Hungary as the site of their shared service centres.

2.1. ECONOMIC DATA

2.1.1. Hungary's Gross Domestic Product (GDP)



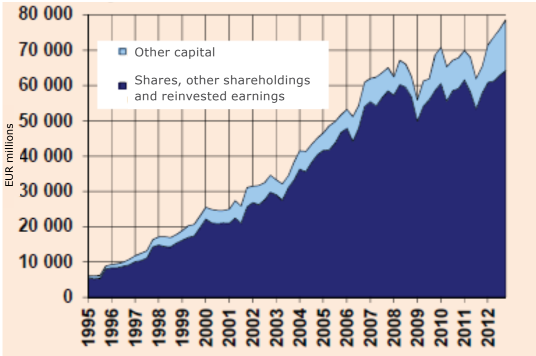
Source: Hungarian Central Statistical Office (KSH)

After a decrease of 1.7% in 2012, 2013 brought stronger-than-expected growth of over 1%, and professional analysts predict growth of 2-2.5% for 2014.

Hungary's economy is driven by industrial exports, as well as by agriculture and the processing industry. Household consumption has decreased continuously since 2006, but it is an encouraging sign that 2013 saw a slight increase in this respect. Economic experts anticipate further strengthening from 2014 on.

2.1.2. Foreign Direct Investments (FDI)

VOLUMES OF FOREIGN DIRECT INVESTMENT



Source: www.kormany.hu

Foreign direct investments have played a key role in the successful structural transformation of the Hungarian economy since 1990. The continuous inflow of foreign direct investment has contributed (and still contributes) decisively to the increase in productivity, technological modernization, the development of export capacities necessary for a healthy growth structure and to the creation of new jobs. The value of foreign direct investments in Hungary was EUR 78.5 billion at the end of 2012; Hungary had the highest FDI to GDP ratio (80.3%) in the Central European region.

The majority of these investments flowed into the service sector and into competitive processing-industry sectors (vehicle manufacturing, computer, electronics, manufacturing of optical products).

According to year end data for 2012, 78% of foreign direct investments realised in Hungary came from the European Union, with 29.7% from Germany.

In the last two years, *car manufacturing* has experienced a sharp increase in terms of investments. **Mercedes-Benz** opened its new – and, by its own assessment, its most modern – plant in Kecskemét in 2012. In addition, **Audi** in Győr and **Opel** in Szentgotthárd, both of which have been operating in Hungary for years, also expanded their manufacturing capacities. These developments have also brought about an expansion in production by car industry supplier companies.

Chemicals companies supplying the auto industry have also implemented significant investment projects. **BorsodChem**'s new EUR 200-million plant in Kazincbarcika is among the largest, together with the expansion of South Korean tyre manufacturer **Hankook**'s plant in Rácalmás.

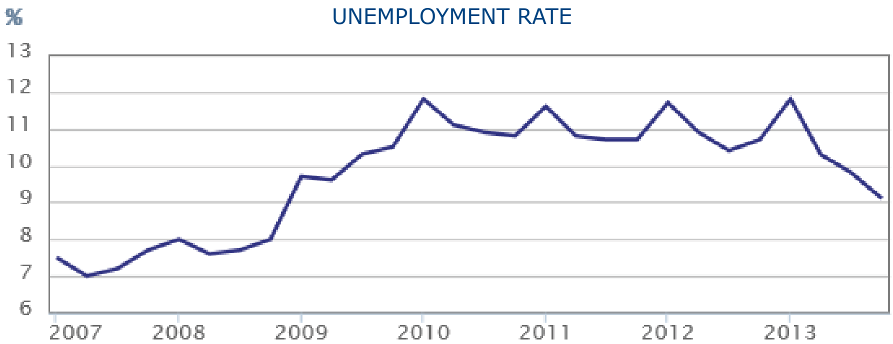
Renewable energy resources also represent a rapidly growing sector in Hungary; companies manufacturing solar cells and solar collectors have carried out especially significant developments in recent years. Parliament's decree on the National Energy Strategy, adopted in October 2011, is in line with these developments and includes specific proposals for the period until 2030. With the transformation of the sector's subsidies, decentralisation, sustainability and efficiency are going to be in the forefront.

2.1.3. Further Macro Data

Unemployment rate

Hungary continues to be near the European Union average as regards unemployment. In 2013 the unemployment rate stood at 10.4%, while the employment rate – which presents a more serious challenge for Hungary – barely exceeded 50%.

The October 2013 and January 2014 data of the Hungarian Central Statistical Office indicate a promising trend, since the number of employed people in this period exceeded 4 million (corresponding to an unemployment rate of below 10%), and the employment rate reached a record high of 52.9%.

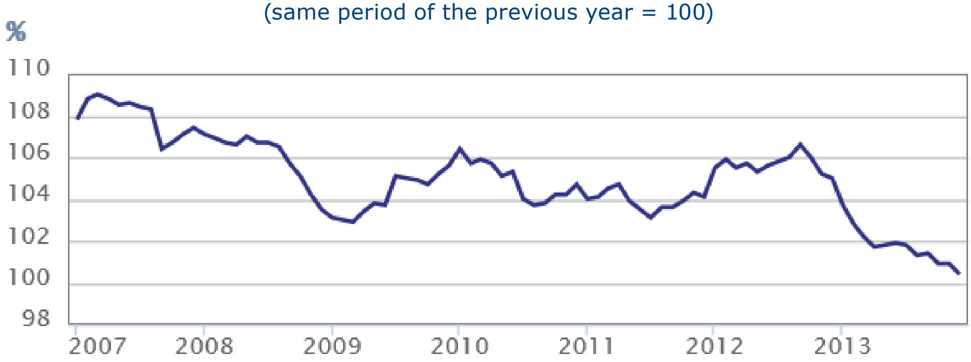


Source: Hungarian Central Statistical Office (KSH)

Inflation

In 2013, consumer prices rose by 1.7% on average compared to the previous year, which was mainly due to the government's program to reduce household utility bills. Overall, it can be noted that low inflation and the decrease in burdens on households increase available income, which could boost households' willingness to consume as the employment rate improves.

CHANGES IN CONSUMER PRICES (INFLATION)
(same period of the previous year = 100)



2.2. ENCOURAGING FOREIGN INVESTMENTS

2.2.1. Free Enterprise Zones

From 2013, the state is hoping to boost the economy of 47 regions, primarily located in Eastern Hungary, through the establishment of free enterprise zones. Businesses are offered several types of incentives in these largely disadvantaged areas with significant unemployment, in order for them to carry out as many new manufacturing investments as possible and to increase the level of employment. Such incentives include the following:

- for investments of at least HUF 100 million (approx. EUR 350,000), businesses are entitled to 80% tax breaks for five years following establishment of the project;
- for new hires, employers are required to pay only a part of employers' public contributions (amounting to 28.5% of the gross salary);
- in addition to numerous other types of subsidies, employers are eligible for HUF 400,000 (approx. EUR 1,350) in support for each new employee hired.

FREE ENTERPRISE ZONES IN HUNGARY

GeoX Kft. 2013. Source: ArcMagyarország 6.2, Ministry for National Economy

2.2.2. Industrial Parks

Industrial parks have existed in Hungary for over ten years and have become an integral component of the country's economic processes. There are 210 industrial parks in Hungary, hosting some 4,200 companies, which employ over 200,000 people. These companies account for 30% of industrial output, making their economic and infrastructural stability and expansion a cornerstone of the development of Hungarian industry. An industrial park portal was launched on 1 January 2013, providing information in English and Hungarian on, among other things, the features of the industrial parks, their results and the services offered:

www.ipariparkokmagyarorszag.hu

2.2.3. Spin-Offs and Start-up Businesses

The establishment of technology- and knowledge-intensive start-up businesses has become increasingly more significant in Hungary since the start of the twenty-first century. More and more researchers and students at universities and research institutions began working on the practical implementation of some aspect of their research area and on bringing that to market. Since the mid-2000s, several large tender announcements have been issued, each providing up to EUR 5 to 10 million in support for joint research projects involving universities and industry. Smaller tenders, providing under EUR 1 million in resources for supporting research, development and innovation, have also become regular. With the launch of the Jeremie program, a total of EUR 300 million was invested and is being invested by venture capital investors in spin-off and start-up businesses promising growth.

2.3. SUBSIDIES[2]

In the middle of March 2014, Hungary submitted the partnership agreement representing the framework for the use of EU funds to arrive between 2014 and 2020 to the European Commission, and it is expected that from the autumn the publication of tenders may start with regard to funds allocated to 2014-2020. In the new EU funding programming period Hungary may use HUF 7,480 billion from the structural funds and cohesion funds, including domestic co-financing.

The allocate amounts of the seven Operative Programs are as follows:

1. Operative Program for Economic Development and Innovation (GINOP): HUF 2,720 billion
2. Operative Program for Regional and Settlement Development (TOP): HUF 1,160 billion
3. Operative Program for Integrated Transportation Development (KOP): HUF 1,034 billion
4. Operative Program for Environmental and Energetics Efficiency (KEHOP): HUF 1,120 billion
5. Operative Program for Human Resources Development (EFOP): HUF 885 billion
6. Operative Program for Public Administration and Public Services Development (KÖFOP): HUF 300 billion
7. Operative Program for a Competitive Central Hungary (VEKOP): HUF 270 billion

A minimum of 15 percent of the total financial allocation will serve to bolster small and medium enterprises. Fifteen percent of the total funds will go to creation of jobs, which is one and a half times as much as between 2007 and 2013. Eleven percent of the total allocation will go to research and development, three times as much as in the previous EU funding programming period. Nine percent of the allocation will go towards energy efficiency, which is twice as much as previously, and about 4 percent of the total funds, likewise double the previous amount, will go directly to development of the info communication sector.

It is a significant change that HUF 736 billion, almost 10 percent of the total allocation, will be made available through financial means.

2 www.kormany.hu

3. LABOUR MARKET OVERVIEW

Currently, one of the biggest challenges in Hungary is how to improve the highly unfavourable employment situation of the country and how to create hundreds of thousands of new jobs. Unemployment is at over 10% and it presents a serious problem that masses of people have exited the labour market in recent years. Returning these individuals to the group of active citizens presents a major challenge for both the education system (re-training programs have been launched) as well as for businesses (financial incentives are being used to encourage them to raise employee numbers).

3.1. PROFESSIONAL TRAINING

The year 2012 brought about a significant change in Hungary's education system. The law on professional training adopted in December 2011 is designed to align the system of professional training with the actual expectations of the labour market; focusing on the practical component of training has become a key consideration.

The new law has placed the focus on practical training based on a dual system (involving both schools and businesses together), along with the provision of expert oversight for practical training and improvement in its quality. Beginning with the academic year starting in September 2012, three-year vocational training has become the norm. The law also set out the transformation of the role of vocational secondary schools, enabling young people to obtain a vocational certificate concurrently with their school-leaving examinations, allowing them to fill specific jobs. These regulations have all served to establish a layer of skilled workers as soon as possible, meeting the most pressing needs of businesses.

Simultaneously with the changes above, reforms in higher education were also brought about, starting with the 2012 application period. The government adjusted the number of state-funded student positions according to the demands of the labour market, allowing technical, IT and natural science departments to train more students than before. According to research findings, these are the very areas of the competitive sector where a significant increase in demand for labour is expected in the short term.[3]

3 www.gvi.hu

3.2. EMPLOYMENT, WAGES

Employment increased in 2013: in Q4 of 2013 the number of people employed was 4,015,000, representing a 2.7% year-on-year increase. Expansion of public employment was the principal reason for this increase.

Hungary's employment indicators show significant regional discrepancies, which are also reflected in differences in average wages. Hungary is highly centralised: employment and average wages are highest in the region of Central Hungary, i.e. in Budapest and surroundings. At the same time, the continued improvement in infrastructure and targeted regional support mechanisms is leading more and more foreign-owned companies to choose locations further from Budapest for their activities.

The figure below shows the latest data for average salaries from the National Employment Service:

Region	Average personal basic pay (per person/month)	Average of total earnings (per person/month)
Central Hungary	EUR 779	EUR 926
Central Transdanubia	EUR 575	EUR 708
Western Transdanubia	EUR 551	EUR 664
Southern Transdanubia	EUR 538	EUR 664
Northern Hungary	EUR 514	EUR 623
Northern Plains	EUR 499	EUR 596
Southern Plains	EUR 509	EUR 603
TOTAL	**EUR 622**	**EUR 603**

We see similarly significant discrepancies in earnings when the data are broken down according to the sectors of the national economy. People working in IT and other information service areas earned the highest wages. High average wages are also found in the energy industry, pharmaceuticals manufacturing and financial and insurance services.

From 2014, the government increased the minimum salary to HUF 101,500 (gross) per month and set the minimum salary for jobs requiring specialised training at HUF 118,000 per month. In the case of part-time employment, the relevant monthly, weekly and daily wage amount is to be reduced in proportion to the hours worked.

3.3. CONCLUSION OF EMPLOYMENT CONTRACTS, PROBATIONARY PERIOD

Employment contracts may only be concluded in writing. The mandatory content that they must contain includes the following:

- the basic pay;
- the job description;
- the term (if not specified, the employment contract is concluded for an indefinite duration);
- the workplace (if not specified, the place where work is normally carried out);
- the day of the commencement of the employment relationship (if not specified, the day following the conclusion of the employment contract).

Either party is entitled to cancel the employment contract in the event of substantial changes to the circumstances of either party between the date of conclusion of the employment contract and the day of the commencement of the employment relationship if carrying out the employment relationship is no longer possible or would result in unreasonable injury.

The duration of the probation period may not exceed 3 months; if a shorter probationary period has been stipulated, it may be extended once but its duration may not exceed 3 months.

3.4. WORKING HOURS AND SCHEDULES, SPECIAL CASES

The standard daily working time in full-time jobs is 8 hours (the minimum is 4 hours, except for part-time work. The daily working hours together with overtime may not exceed 12 hours).

The rules relating to work schedules (working arrangements) are laid down by the employer, but in view of the individual organisation of work, the employer may transfer this right in writing to the employee (flexible work schedule).

Work is to be scheduled for five days a week, from Monday to Friday. Where working time is defined within the framework of working time banking or payroll period, working time may be determined irregularly for each day of the week or for certain days only.

The work schedule has to be prepared for at least one week and notification must be given at least 7 days in advance in writing.

If the daily working time exceeds 6 hours, 20 minutes of break-time must be provided.

The employer's activity is:

a) continuous: if the stoppage time on a given day is less than 6 hours or if operation is suspended in any year only for the reasons and for the duration required by the technology employed and

- the employer is engaged in the provision of basic public services on a regular basis, or
- if economic or proper operations cannot be ensured otherwise for objective reasons related to the production technology.

b) shift work: if its duration reaches 80 hours a week.

A total of 250 hours of overtime work may be ordered in a given calendar year.

The base holiday is 20 working days; according to the age of the employee further days are added as extra holiday (e.g. 1 working day over the age of 25, 2 working days over the age of 28 etc.). Further days off are also available if the employee has children, until they turn 16 (two days for one child, four days for two children, and seven days for three or more children).

3.5. WAGE SUPPLEMENTS

Entitlement to supplement	Supplement	Details
night work	15%	if it exceeds 1 hour, the employee is not entitled to a shift premium
afternoon and night shift	30%	work in shifts, between 6 p.m and 6 a.m; the time of starting work varies
overtime work	50% or time off	
overtime work on a rest day	100% or 50% and another rest day	
stand-by duty	20%	
on-call duty	40%	if work is performed, according to the general rules; if its duration cannot be measured: 50%
on Sundays	50%	it is only possible in the case of work in shifts or stand-by jobs
on public holidays	100%	in the case of overtime work, 100% or 50% and another rest day

3.6. TERMINATION OF EMPLOYMENT RELATIONSHIPS

In line with international practice, employment relationships may be terminated in three ways: by *mutual consent*, by *notice* or by *dismissal without notice*.

3.6.1. Mutual consent

The parties may agree at any time on the termination of the employment relationship by mutual consent; in that case they may deviate from the non-mandatory rules of the Labour Code.

3.6.2. Notice

The employer is required to justify its dismissal of an employee; it may be based on a reason connected with the conduct of the employee in relation to the employment relationship, the employee's abilities, or the operations of the employer.

In certain circumstances the employer may not terminate the employment relationship (e.g. during pregnancy if the employee earlier informed the employer of being pregnant).

The right of dismissal may be excluded for a period of up to 1 year from the beginning of the employment relationship.

The employer may terminate a fixed-term employment for example during liquidation or bankruptcy proceedings or for reasons related to the employee's ability.

The period of notice is 30 days, which is extended according to the period of employment at the employer (e.g. by 5 days after 3 years). By agreement of the parties the notice period may be extended to a maximum of 6 months.

The notice period normally begins on the day following the date when notification is given of the dismissal (but, for example, on the day following the end of the incapacity for work in the case of sick leave).

The employer is required to exempt the employee from work duty for at least half of the notice period, in two parts at most, according to the wishes of the employee.

In the case of dismissal by the employer, the employee is entitled to severance pay (e.g. the absence pay for 1 month if the employment relationship lasted for at least 3 years), unless the reason for the dismissal was the conduct of the employee related to the employment relationship or his/her inaptitude.

3.6.3. Dismissal without notice

Any party may terminate the employment relationship without notice if the other party wilfully or by gross negligence commits a grave violation of any substantive obligations arising from the employment relationship or otherwise engages in conduct that would render the employment relationship impossible.

The right of dismissal without notice may be exercised within a period of 15 days of gaining knowledge of the grounds for dismissal, but within at most 1 year of the occurrence of such grounds.

The right of dismissal without notice may be exercised without giving reasons by either party during the probationary period or by the employer in the case of fixed-term employment relationships. In that case the employer is required to pay the absence pay due for 12 months to the employee or, if the time remaining of the fixed period is less than 1 year, the absence pay due for the remaining time period.

4. WORKING AND RESIDENCE OF EXPATRIATES IN HUNGARY

The Treaty of Rome of 1957 establishing the European Economic Community (hereinafter: Treaty of Rome) was designed to provide for the free movement of workers inside the Community, that is to ensure the right of free entry and residence in the territory of another Member State and to gradually abolish discrimination based on nationality between workers of the Member States with regard to employment, remuneration and other working conditions. Similarly to the other Member States of the Union, Hungary complied with its obligations undertaken in the Accession Treaty and provides the same treatment to citizens of the Member States of the European Union and the EEA countries as to its own citizens.

Pursuant to the Article of the Treaty of Rome on the right of residence, Hungary abolished all restrictions related to the residence of Community enterprises and citizens, thus according to the principle of national treatment Hungary provides the same conditions for residence and operation to natural persons from other Member States and the agencies, branches or subsidiaries founded by those persons.

4.1. RESIDENCE OF EXPATRIATES IN HUNGARY FOR ECONOMIC PURPOSES

In Hungary the investments of foreigners and residence for economic purposes enjoy full protection and security. In Hungary, foreign citizens may freely found businesses and other associations and public-benefit organisations whose purpose is an activity aiming at or resulting in the acquisition of income and profit. In Hungary, an enterprise registered abroad may establish a branch office or commercial representation through company registration or found an independent enterprise or subsidiary.

Certain economic activities specified by law may be performed without a branch office or the foundation of an independent enterprise, such as:

- educational activities in educational and training institutions or higher education institutions;
- performing arts;

- activities requiring expertise (with the exception of auditing, accounting and bookkeeping services and legal services);
- business activities if they may be performed in Hungary without the presence of the foreign person and his/her permanent equipment.

According to the freedom of services the foreign persons may supply cross-border services in Hungary without establishment in Hungary for an economic purpose, within the limits of EU law and international agreements.

4.2. RESIDENCE AND EMPLOYMENT OF EXPATRIATES IN HUNGARY

As in EU law, domestic immigration rules classify foreign citizens into two groups: EEA nationals with the right of free movement and residence and third-country nationals.

4.2.1. The entry and residence of EEA nationals enjoying the right to free movement and residence

EEA nationals may enter the territory of Hungary and stay there for a period not exceeding three months with a personal identification document or a valid travel document.

An EEA national has the right of residence for a period longer than three months if he/she:

- is residing in the country for the purpose of gainful employment;
- has the necessary financial resources to keep himself/herself and his/her family members during the period of residence and certifies that he/she has insurance or ensures cover for the use of health-care services;
- arrives for the purpose of following a course of study and satisfies the conditions in the previous point.

The EEA national is required to register in person with the relevant regional immigration authority according to his/her future domicile within 93 days of the time of entry and provide his/her personal data. The applicant must certify compliance with the conditions of residence by presenting the necessary documents to the immigration authority. The immigration authority may only exempt the applicant from being present in person on the basis of his/her health condition. The EEA national receives a registration certificate (card) certifying registration and the date of registration.

An EEA national who has resided legally and continuously within the territory of Hungary for five years receives permanent residence status. Such status is certified by a permanent residence card issued by the relevant regional directorate of the Office of Immigration and Nationality according to the domicile of the EEA national. Under certain conditions an EEA national engaging in gainful employment is entitled to permanent residence before the end of the five-year residence period (e.g. upon reaching the age of the old-age pension or in the case of incapacity to work due to accident or illness).

4.2.2. Third-country nationals

Third-country nationals may enter the territory of Hungary for the purpose of residence for a period not exceeding three months with a personal identification document or a valid travel document according to the conditions set out in the Schengen Borders Code [4]. Compliance with the conditions of entry and residence must be certified at the time of crossing the border. A third-country national holding a valid residence visa or national visa is authorised to remain in the territory of Hungary after the period of residence authorised in the visa expires with a residence permit.

The most common purposes of residence exceeding three months are: studies, research, official purposes, visits, medical treatment, humanitarian purposes. A residence permit for the purpose of gainful employment issued by the Hungarian immigration authority is necessary for the employment of a third-country national in Hungary.

In addition to personal identification documents, the following documents, among others, must be attached to the application for the residence permit:

- a work permit issued by the competent labour authority;
- the work contract;
- a document certifying accommodation in Hungary;
- certification of the qualifications required for the job etc.

The period of validity of the residence permit for the purpose of gainful employment is a maximum of three years and it may be extended for another three years. In the case of activities requiring a work permit, the period of validity of the residence permit corresponds to the period of validity of the work permit.

4 Regulation (EC) No. 562/2006 of the European Parliament and of the Council

4.3. BASIC RULES OF TAXATION

Hungary has concluded bilateral conventions for the avoidance of double taxation with more than 70 states. These conventions establish the tax residence of individuals and the applicable law according to the different types of income. Foreign nationals must pay taxes and prepare tax returns according to the principles set out in the bilateral conventions and the Hungarian laws and regulations. Persons with Hungarian tax residence have full tax liability in Hungary, i.e. they have to submit a tax return to the Hungarian tax authority on all of their income. Persons with foreign tax residence have restricted tax liability: they have to submit a tax return and pay tax only on their income arising in Hungary or taxable in Hungary according to the given tax convention.

Individuals pay quarterly advances on their income that is taxable in Hungary: the deadline is the 12th day of the month following the relevant quarter. The tax return must be submitted to the Hungarian tax authority once a year by 20 May of the year following the relevant year. The tax authority may verify the data of the return and the underlying income certificates up to 5 years from the submission of the return. Individuals may correct inaccurate returns through self-assesment during the 5-year period of prescription.

4.3.1. Request for a tax identification number from the Hungarian tax authority (NAV)

In order to fulfil their tax liability, foreign individuals need to register with the Hungarian tax authority. The first step to register is submitting the application form for a Hungarian tax registration number to the tax authority by post or electronically. The data required for registration are as follows: nationality, full name, birth name, place and date of birth, mother's name, foreign address, Hungarian correspondence address.

4.3.2. Notifying the Labour Centre and the tax authority

The Hungarian employer (receiving enterprise) has to notify the relevant Labour Centre (based on the place of employment) of the employment of foreign workers. The receiving enterprise must inform the Hungarian tax authority of the tax liability of the foreign individual in Hungary.

4.4. SOCIAL SECURITY

The rules on social security related to the free movement of workers as harmonised by the coordination regulations apply to the Hungarian insurance system, which provides the following to workers and their families:

- the aggregation of the insurance, employment and residence periods in different Member States, which is important for determining pensions and annuities due in the case of old age, incapacity to work or death and for determining the provision of benefits, and
- the payment of benefits in cash to persons residing in the territory of Hungary.

4.4.1. Registration in the Hungarian social security system

If the foreign individual does not have a certificate attesting his/her entitlement to social security abroad (EU/EEA: A1 certificate, third countries: other documents), he/she belongs under the Hungarian social security system and must pay a social security contribution (18.5 %) on his/her income. The domestic or foreign employer of the individual must pay in the social contribution tax (27 %) in Hungary on the gross income. In order to fulfil the obligation of the foreign individual to pay the contribution, a social security identification number is required (called TAJ) which, is issued to the individual by the relevant county health insurance fund based on location of the workplace.

The Hungarian tax authority must be notified of the first day and the last day of the foreign individual performing work in Hungary.

4.4.2. Health insurance

The healthcare of persons with the European Health Insurance Card is free of charge in Hungary. Like Hungarian citizens, the foreign individuals may make use of supplementary and basic health services provided by health institutions operating in the private sector and may conclude individual insurance contracts with the Hungarian branches and subsidiaries of insurance companies known across Europe.

5. FOUNDATION AND OPERATION OF BUSINESS ASSOCIATIONS

The rules concerning the foundation, operation, termination, as well as mergers and divisions of companies were last modified in March 2014, when the provisions, which were previously set out in a separate Act, were integrated into the Civil Code. Generally, company law resembles the Western European system; it is probably closest to the German legal system. The difference between the two legal systems is most apparent in relation to the taxation of business associations, as in Hungary all corporate forms including partnerships come under the scope of company taxation - for further details, see the section on taxation.

5.1. FOUNDATION OF COMPANIES

Business associations may be founded by non-resident and resident natural persons, legal persons and business associations without legal personality for the purpose of jointly engaging in business operations, and such persons may join these business associations as a member, or acquire participation (shares) therein.

With the exception of private limited liability companies and public limited companies, at least two members are required for the foundation of a business association.

Business associations may be established to engage in joint business operations for objectives other than for making a profit (non-profit business association). This is governed by a separate Act, rather than by the Civil Code.

5.2. TYPES OF COMPANIES

5.2.1. General partnership – "Közkereseti társaság (Kkt.)"

The members of the partnership undertake to jointly engage in business operations with unlimited and joint and several liability, and to put the capital contribution necessary for such activities at the disposal of the partnership.

The Kkt. is a partnership and has legal personality.

5.2.2. Limited partnership - "Betéti társaság (Bt.)"

Business association where the liability of at least one member (general partner) for the obligations not covered by the assets of the partnership is unlimited, and is joint and several with all other general partners, while at least one other member (limited partner) is only obliged to provide the capital contribution undertaken in the memorandum of association, and is not liable for the obligations of the partnership.

The Bt. also has legal personality.

5.2.3. Private limited-liability company - "Korlátolt felelősségű társaság (Kft.)"

Business association founded with initial capital consisting of capital contributions of a pre-determined amount. The liability of members to the company extends only to the provision of their capital contributions and to other possible contributions as set forth in the memorandum of association. With the exceptions set out in law, members are not liable for the liabilities of the company.

5.2.4. Limited company - "Részvénytársaság (Rt.)"

Business association founded with a share capital consisting of shares of a pre-determined number and face value. The obligation of the members (shareholders) to the public limited company extends to the provision of the face value or the issue price of shares. With the exceptions set out by law, shareholders are not liable for the obligations of a public limited company. Companies limited by shares may be established privately, and they may operate in the form of public or private companies limited by shares.

5.2.5. Grouping

Co-operative society vested with legal personality, founded by members in order to facilitate the success of their business activities and to co-ordinate such business activities, as well as to represent their professional interests. The purpose of a grouping is not to make profits for itself; its members bear unlimited, joint and several liability for debts in excess of the grouping's assets.

5.2.6. Simple comparison of the corporate forms

Corporate form	Legal personality	Number of members	Liability of members	Partnership or limited liability company	Minimum subscribed capital
General partnership	yes	minimum two	unlimited; joint and several	partnership	no
Limited partnership	yes	minimum two	general partner: joint and several limited partner: limited	partnership	no
Limited liability company	yes	minimum one	limited	limited liability company	HUF 3 million
Company limited by shares	yes	minimum one	limited	limited liability company	HUF 5 million

5.3. OTHER FORMS OF ENTERPRISE

5.3.1. Hungarian branch office of a foreign enterprise

The organisational unit of a foreign enterprise that pursues its activities independently but does not have legal personality. It is registered in the Hungarian registry of companies as a separate type of business association as the Hungarian branch office of a foreign enterprise.

The foreign enterprise is entitled to pursue business activities in Hungary through its branch office; in relation to the activities of the branch office, the branch office proceeds before the authorities and in legal relationships with third persons.

5.3.2. European Company ("SE")

According to the regulation of the European Council and the relevant Hungarian law, a European Company may be established by a founder whose registered seat is in Hungary.

5.4. PROCESS OF FOUNDING BUSINESS ASSOCIATIONS

A business association may be established subject to the conclusion of a memorandum of association, which is to be signed by all members (founders). The memorandum of association is to be drawn up in an authentic instrument prepared by a notary public, or in a private document countersigned by a solicitor.

Several other instruments must be signed and countersigned by a solicitor (e.g. declaration of acceptance of the managing director, declaration of the managing director on not being subject to a ban etc.).

The mandatory instruments specified by law must be submitted in 30 days to the court of registration, which decides on the registration within 15 days of the submission.

There is also a simplified procedure for founding a business association, which requires the template specified in the Annex attached to the law to be used as memorandum of association. In such cases registration of the business association is generally performed in one day and the registration duty is also lower.

5.5. MANAGEMENT OF BUSINESS ASSOCIATIONS

The executive officers or a board made up of executive officers conduct management of the business association pursuant to the provisions governing the specific forms of business associations. Management means the adoption of decisions other than those conferred by the memorandum of association to the competence of the supreme body or other company organ and which are necessary in relation to the company's operations.

The executive officer may be a natural person or a legal person. Executive officers must discharge their duties relating to the company's internal affairs and its bodies and other officers in person; no representation is allowed.

Executive officers must be elected for an indefinite or fixed term (maximum five years) and they perform their duties under an engagement contract or in an employment relationship.

The law specifies in detail the grounds for disqualification (e.g. a person who has been sentenced to imprisonment by final verdict for committing a crime may not be an executive officer).

The competence of executive officers covers in particular, but is not limited to the following tasks:

- direction of the business association, calling the members' meeting and keeping the registration of resolutions;
- ensuring the regular keeping and execution of the mandatory registers, data provision and accounting ledgers;
- exercising the rights of employer with regard to employees;
- notifying the court of registration of amendment of the memorandum of association of the business association and modification of the rights, facts and data registered in the register of companies and other data prescribed by law;
- preparation of the annual report (balance) of the business association;
- representation of and signing for the business association.

5.6. THE SUPREME BODY OF BUSINESS ASSOCIATIONS

The principal duty of the supreme body of a business associations is to adopt decisions on fundamental and strategic (personal and asset-related) issues. The matters that come under the exclusive competence of the supreme body are not defined by the Civil Code; these are entrusted to the members, within the bounds of the law.

The competence of the members' meeting of the private-limited liability company covers in particular, but is not limited to the following tasks:

- approval of the annual report prepared pursuant to the Accounting Act, including the decision on the division of the after-tax profits;
- order for and repayment of supplementary capital contributions;
- decision to pay interim dividends;
- the division of business shares, and order for the withdrawal of business shares;
- resolution for initiating the exclusion of a member;
- election and recall of the managing director and director and decision on his/her renumeration;
- election and recall of the auditor;
- decision on termination without succession or transformation of the company.

5.7. SUPERVISORY BOARD

For the purpose of supervising the management of the business association, the members may establish a supervisory board with a minimum of 3 members.

Its establishment is mandatory in cases specified by law (e.g. if the annual average number of full time employees exceeds 200 persons, and the works council has not waived the right of employees to participate in the supervisory board.).

5.8. AUDITOR

The auditor is responsible for carrying out audits of accounting documents as specified in the Accounting Act, including – first and foremost – determining whether the annual report that the business association has filed as prescribed in the Accounting Act conforms with legal requirements, and whether it provides a true and fair view of the company's assets and liabilities, financial position and profit or loss.

The business association may choose to elect an auditor or be obliged to do so, for example, if the average net sales revenue of the company in the two fiscal years prior to the given fiscal year exceeded HUF 300 million, and the number of its employees exceeded 50 people.

6. ACCOUNTING RULES

A number of statutes guarantee that business associations operate transparently and financial transactions are accounted for properly. The accounting rules in Hungary have essentially been developed according to the relevant international standards. However, there are a number of differences, which we will discuss in Section 6.2. The most important deviation from international rules is the requirement of strict compliance with the principle of documentation, which very often surprises foreign investors when they come to Hungary.

6.1. HUNGARIAN ACCOUNTING RULES

Business associations are required to prepare a financial report in Hungarian about their operation and their financial, property and revenue situation on the basis of bookkeeping records also prepared in Hungarian. The fiscal year is generally the same as the calendar year. However, if a foreign company uses a non-calendar fiscal year, its Hungarian subsidiary may choose to use the fiscal year of its parent company.

The monetary amounts in the bookkeeping documents and the financial report must be specified in HUF or in the foreign currency specified in the business association's articles of association. If the relevant conditions are met, the business association may change its bookkeeping and reporting currency from HUF to a foreign currency or vice versa.

Businesses may choose to do their bookkeeping and prepare their financial reports in EUR or USD at their own discretion and subject to no restrictions.

Business associations incorporated in Hungary must publish the approved financial report electronically (in a form also available through the Internet and freely accessible) by the last day of the fifth month after the balance sheet date of the relevant fiscal year. The report must also be deposited with the relevant authorities.

Hungarian branch offices of business with a registered address in a foreign country (including within the EU) publish and deposit the financial report approved by the foreign business.

The type of financial report depends on the size of the annual net sales and of the balance sheet total and also on the number of staff employed by the business. Businesses with financial figures below a certain threshold publish a so-called “simplified” financial report with limited data content.

Companies may choose to undertake an audit obligation even if their numbers are below the thresholds. However, businesses must engage an auditor if they meet either of the following two conditions:

- their annual net sales revenue exceeded HUF 300 million on average in the two fiscal years preceding the respective fiscal year, or
- the average number of staff exceeded 50 on average in the two fiscal years preceding the fiscal year under review.

6.2. COMPARISON OF IFRS AND HUNGARIAN ACCOUNTING RULES

A key development trend in the world today is globalisation, which connects the economies, cultures and societies of countries far apart.

In the course of harmonising Hungarian law with EU rules, the Hungarian Accounting Act has been amended a number of times, which means that today it conforms with the Directives of the European Communities regulating this field of law. International accounting principles were also taken into account during legislation. However, this does not mean that the IFRS standards have been fully introduced in Hungary.

Since 1 January 2005, listed companies have been required to prepare their consolidated financial statement in accordance with the International Financial Reporting Standards (IFRS); non-listed businesses may choose to follow the IFRS at their own discretion when preparing their consolidated financial statements. IFRS cannot be applied when preparing other (i.e. non-consolidated) reports.

At this time, there are quite a few differences between the primarily tax-oriented, itemised Hungarian rules (consisting of approximately 100 pages) and the IFRS, which is built on frameworks (and consisting of around 1,000 pages). A few examples of the differences between the two set of standards:

- the format/structure of the financial report under Hungarian rules is fixed, while the IFRS report only contains the main lines;
- leasing and securities transactions are handled differently in the two systems (operational leasing transactions, which do not even appear among assets in the Hungarian financial statement, must frequently be converted into financial leasing under the IFRS);
- while evaluation under the Hungarian system focuses on the historical cost, under the IFRS fair value is given more weight;
- in the Hungarian system, restrictions apply to currency revaluation as Hungarian accounting rules adapt to tax law by only allowing the application of bank-defined exchange rates and prohibiting the use of the parent company’s internal exchange rates according to the IFRS;
- in the applicable Hungarian legal regulations, businesses are not allowed to include any future liabilities related to environmental protection in the value of their fixed assets, not even if the cost of restoring any environmental damage caused must be covered from utilisation of the asset in the future;

- payment of dividends is quite different in the two systems: according to the Hungarian standards, the dividend appears in the profit and loss account of the period that the approval of the dividend payment applies to, while in a financial statement prepared according to the IFRS, the dividend appears in the profit and loss account of the period when the approval is given;
- IFRS offers more flexibility compared to Hungarian rules in connection with the accounting of deferred taxes, provisions and impairment.

In addition to differences of content, it should also be noted that much simpler and shorter notes need to be prepared for a Hungarian financial statement than for one prepared under the IFRS. Accordingly, the Hungarian notes to the financial statement only include details for information purposes and do not tend to present the figures concerning certain changes and risks.

In accordance with the current economic policy, preparation for the full implementation of reporting under the International Financial Reporting Standards (IFRS) has recently begun. A first step in this process will be the introduction of IFRS qualifications for both auditors and chartered accountants, which will make sure properly trained professionals are available for reporting in accordance with the IFRS. The drafting of Hungarian accounting standards has also started with the stated goal of adjusting Hungarian rules to the IFRS.

7. TAXATION IN HUNGARY

The Hungarian tax system has become one of the most competitive systems of the region; it is safe to conclude that it is one of the driving forces behind the Hungarian economy's competitiveness. The rate of direct taxes is the lowest in the region and also in European comparison (e.g. the corporate capital gains tax is only 10%). By contrast, Hungarian value added tax has the highest rate at 27%. However, the reverse charge mechanism, which is applicable in a number of areas including domestic transactions, lifts the burden of funding this high rate of tax temporarily in a lot of industries.

The rates of taxes on labour have been reduced significantly over the past few years. Private individuals pay a 16% flat rate tax. The total rate of employee's contributions is 18.5% and the rate of employer's contributions is 28.5%. This means that foreigners coming to Hungary to work now enjoy the double benefit of the flat rate tax and the social security system of the posting country.

Hungary has a double taxation convention in place with a large number of countries and has introduced the most important tax avoidance rules such as the CFC rules or thin capitalisation rules, and has implemented transfer pricing regulations. However, the tax system allows the carrying forward of losses subject to certain restrictions.

Hungary has levied special taxes in certain industries (e.g. on banks, financial service providers, telecommunication companies and retail chains), but in the near future these will be fully lifted.

Some particularly favourable tax allowances are available for certain activities, and these may be key factors in making a decision on investments.

Lastly, it should be noted that although nearly all types of tax-related administrative affairs can be managed electronically in Hungary, foreign investors may be surprised by how strict the rules for issuing invoices are. Tax audits of large companies are regularly conducted; penalties are levied in most cases at 50% of tax defaults, and late-payment interest at a rate double the central bank's base rate applies if the tax is paid late.

7.1. TAXES AND CONTRIBUTIONS OF PRIVATE INDIVIDUALS

The tax and contributions payable in Hungary on income provided on the basis of employment in Hungary should be assessed on the basis of the applicable treaties for the avoidance of double taxation, the bilateral social security conventions, as well as EU coordination regulations. If it is established that a private individual is liable to pay tax and contributions in Hungary, he/she is expected to pay the following types of tax:

7.1.1. Personal Income Tax

A uniform flat rate tax of 16% is payable on income types forming part of the consolidated tax base and taxable in Hungary (e.g. salary or engagement fee) and on income types taxed separately.

There is a family tax allowance, which amounts to HUF 10,000 per child per month per family for one or two children and HUF 33,000 per month per child for three or more children. The family tax allowance, with some restrictions, may also be claimed by employees seconded from a foreign country to Hungary, and individuals subject to the Hungarian social security system may also deduct the family tax allowance from the social security contributions payable, if the amount of their personal income tax is less than the above tax allowance for their children.

In Hungary, the tax advance is withheld by the payer (the employer) and the employer transfers the income tax to the tax authority's account. The tax return on withheld advance payments must be filed by the employer by the 12th day of the month following the relevant month. Private individuals must file their own tax return by 20 May of the year following the relevant year, and may settle at that date the difference between their annual tax liability and the advance tax payments withheld from them by the payer or paid by themselves during the year.

7.1.2. Health Insurance and Pension Contributions

Private individuals are required to pay a pension contribution (10%) and a health insurance and labour market contribution (8.5%) on the part of their income that is subject to contribution payments. The payer is required to withhold these contributions monthly from the income paid to private individuals, and to transfer them to the tax authority's account. The tax return on this also required to be prepared and filed by the payer by the 12th day of the month following the relevant month.

7.1.3. Taxes and Contributions Borne by the Payer

Depending on an employee's type of insurance relationship, the payer is required to pay either a social contribution tax of 27% or a health contribution of 27% on the provided income. Employers are eligible for significant allowances from social contribution tax if they employ members of certain employee groups (career starters, employees under the age of 25 or over 55, employees employed during or following maternity leave, researchers and developers, permanently unemployed persons etc.)

The payer is liable to pay a vocational training contribution of 1.5% on any income that forms part of the base of the social contribution tax. For the vocational training contribution, employers may also claim incentives when employing persons belonging to the special categories mentioned.

The deadline for filing a return on and paying the taxes and contributions borne by the payer is the 12th day of the month following the relevant month.

Employers employing more than 25 persons on average must also pay a rehabilitation contribution if the proportion of persons with disabilities or with impaired health within their staff does not reach 5% (mandatory level). The level of the contribution is based on the number of workers with disabilities required to reach the mandatory level (HUF 964,500 per person per year). The contribution is payable quarterly on the basis of the average headcount of the given quarter.

7.1.4. Fringe Benefits and the "Cafeteria" System

If a business also provides benefits (in kind) to its employees in addition to the net salary, these may be taxed at lower rates compared to those applicable to salaries. The employer bears the entire tax on benefits in kind; employees do not pay taxes or contributions on these benefits.

Fringe benefits fall into three categories according to how they are taxed:

Tax-free benefits:

- non-returnable support provided for housing purposes;
- tickets for sporting and cultural events, library registration fees;
- life insurance, accident insurance or health insurance premium up to 30% of the national minimum wage;
- the regular premium of a life insurance policy taken out for an indefinite period and only providing cover for death;
- vaccinations.

Benefits subject to the lower tax rate (35.7%)

- local travel pass;
- meal voucher;
- holiday/recreational/food allowance;
- "back to school" benefit for children;
- voluntary pension and health fund contributions by the employer;
- paying for the training costs of the employee.

Benefits subject to the higher tax rate (51.17%)

- any benefit (other than the above) if it is provided to all colleagues (or a pre-defined employee group), e.g. gift vouchers;
- gifts of small value (on maximum 3 occasions per year);
- taxable insurance premium paid for the benefit of a private individual.

Given the wide range of available items in the different categories and the various needs of employees, it is advisable for employers to set up a so-called cafeteria system. The cafeteria system is very much like a self-service shop: the employer first specifies which benefit types specified by law it will make available to its staff (i.e. it specifies the product range that can be chosen from), and employees select the items that best suit their personal needs up to an amount fixed by the employer in advance. Employers can save money by replacing some of the salary by an amount made available through the cafeteria system as the listed fringe benefit items are taxed more favourably than salaries.

7.2. VALUE ADDED TAX

By 2008, Hungary managed to harmonise its value added tax system with the applicable EU VAT Directive. Therefore we will only mention a few key VAT rules in our summary below:

7.2.1. Tax rates

There are three VAT rates in Hungary:

- the standard rate: 27%;
- a reduced rate of 18% on dairy products, bread, district heating and commercial accommodation services;
- a reduced rate of 5% on specific medicines and medical aids, performing arts, books, magazines, newspapers and sheet music, as well as live hogs and half hogs from 2014.

7.2.2. Supplies exempt from VAT

Supplies exempt from VAT fall into the following categories:

- certain supplies of goods and services of public interest (e.g. postal services, certain health services, public service media, folk art products and events);
- certain special activities in accordance with the relevant EU Directives (e.g. insurance, financial institution services, gambling, the sale of land except for building plots etc.);
- optional exemptions i.e. supplies for which it is possible to choose VAT liability (e.g. letting of real estate, sale of real estate older than two years etc.).

7.2.3. Date of supply

The VAT liability usually arises at the time of supply, i.e. when all the elements of the transaction materialise. Special dates of supply apply in the following cases:

- in the case of advance payment, the date of supply is when the advance payment is received (the invoice on the advance payment must be issued by the supplier after receipt of the advance payment);
- in the case of regular supplies of goods or services (supplies settled periodically), the date of supply is the due date of payment, or from July 2014 the last day of the settlement period (e.g. rental fee or supply of goods from a consignment warehouse settled monthly);
- in the case of transactions with a reverse charge mechanism, the date of supply is whichever is earliest of the day when the invoice is received, the day when the price is paid or the 15th day of the month after the month of supply.

7.2.4. Invoicing rules

The requirements regarding the content of invoices conform to the principles specified in the relevant EU Directive. It should be noted that on invoices issued in a currency other than HUF

- the amount of payable VAT must always be indicated in HUF;
- the application of a special exchange rate for the calculation of the HUF equivalent is required by law (in general, it is the selling rate quoted by a domestic credit institution on the date of supply or, if advance notification is given, the medium exchange rate quoted by the Hungarian National Bank or the European Central Bank).

In certain cases, the VAT Act requires a pre-defined text to feature on the invoice (e.g. self-invoicing, reverse charge).

The issuer may comply with the obligation to issue invoices by issuing hard copy invoices with an invoice book (available in shops selling official forms), computer-generated invoices with the help of an invoicing program, or electronic invoices (based on prior written agreement with the purchaser). Special rules apply to issuing, forwarding and archiving of electronic invoices, which concern both the issuer and the receiver.

The invoicing software must meet the requirements set forth in a separate decree; most important are continuous numbering without omission or duplication (with a separate number range for foreign companies), and exclusion of the possibility of retroactive modification or deletion. The tax authority is authorised to check whether these provisions are met, and may require the software developer to declare that the software complies with the relevant Hungarian regulations and submit a detailed user's guide for the software.

If the parties agree in writing, the buyer may also issue the invoice.

Retail units are required to comply with the obligation to issue receipts using cash registers suitable for online data transfer that are directly connected to the tax authority.

7.2.5. Deduction, payment and refund of VAT

The deduction of VAT is specifically prohibited by law in the case of certain services and goods except if the item is resold or the purchased item is directly integrated into a new product or service to be sold. The most important types of services and goods in this category:

- passenger car fuel;
- services related to the maintenance of a passenger car (parking, road toll, and 50% of repairs and other services);
- food and drink, hospitality, entertainment and taxi costs;
- construction and renovation of residential property;
- 30% of phone bill.

Taxpayers with a Community VAT number file tax returns monthly or quarterly; the filing deadline is the 20th day of the month after the relevant month or quarter. In the return, the input VAT of purchases may be offset against the payable VAT. From 2013, it is required that a detailed description of any transaction with a VAT amount exceeding HUF 2 million be included in the tax return.

If on the basis of the tax return the taxpayer is entitled to a refund, according to a European Court of Justice judgement, the tax authority is required to transfer the amount to the taxpayer if the amount to be refunded exceeds HUF 1 million for taxpayers filing monthly returns or HUF 250,000 for taxpayers filing quarterly returns, regardless of whether the transaction has been settled financially. The transfer is generally made by the tax authority within 75 days but the taxpayer may request that the transfer be made within 45 days if all purchase invoices of the relevant period were duly paid by the filing date of the return.

Small enterprises may use a cash accounting scheme for VAT purposes.

7.3. CORPORATE TAX

The corporate tax rate and the allowances granted clearly show that Hungary is endeavouring to attract as much working capital investment to the country as possible. While favourable tax rates are naturally not among the most important factors when making investment decisions, it is still of significance how a country seeks to attract investors in this regard.

7.3.1. Tax rates

Up to a tax base (adjusted profit or loss) of HUF 500 million, the rate of corporate tax is **10%**. Over that it is 19%.

The Corporate Tax Act also sets out a minimum requirement as regards profit. If the company's profit before taxes or its tax base do not reach this minimum, the company can choose between two options:

- it either pays the corporate tax on the minimum profit requirement, or
- does not pay it but completes a statement about the reasons for the loss-making (or insufficiently profitable) business activity (this usually increases the chance of being selected for tax audit).

7.3.2. Items that adjust the tax base

The accounting pre-tax profit or loss can be amended by several items. There are items that simply do not allow certain costs and expenditures to be included in the tax base, while there are other items that remove certain revenues from it. We will summarise the most important such items below:

Items that increase the tax base (not recognised costs and expenditures):

- provisions for prospective expenses and obligations which are uncertain and cannot be defined exactly (contractual costs and expenditures that will be certainly incurred can be recognised as reducing the tax base);
- impairment loss claimed in connection with receivables providing that bad debts, the irrecoverability of which is verified by the liquidator, can be deducted from the tax base;
- fines and late charges;

- interest charged in addition to the undercapitalisation rules;
- fees paid to CFCs;
- costs and expenses that are not documented sufficiently or have not been certifiably incurred in the interest of business operations.

Items that can be deducted from the tax base and other allowances

- the tax base can be reduced by 50% by losses claimed in the previous years;
- by 50% of donations given to priority non-profit organisations;
- by the capital gains realised on notified shares (privilege of holding companies);
- by the revenues from the sale of notified intangible assets (e.g. royalties, licences, brand names);
- the amount placed into a reserve for development purposes, which must be used for investments in the following four years (essentially this functions as advance depreciation);
- accelerated 50% write-off rate in corporate tax for a wide range of assets (e.g. IT tools, furniture, other machines and equipment);
- the value of new asset investments acquired by small- and medium-sized enterprises, up to the amount of the pre-tax profit (not exceeding HUF 30 million).

7.3.3. Tax allowances

- Tax allowances are available for major investment projects, which may be valid for as long as ten years and extend to 80% of payable tax.
- Based on certification, a tax allowance is available of up to 70% of the total tax on the basis of amounts paid to support spectacular team sports (football, handball, basketball, water polo, ice hockey) and certain cultural institutions (in addition to being able to account for the same as an expense, though supplementary support must also be provided).

7.3.4. Transfer price rules

For a few years the Hungarian tax authority has paid special attention during tax audits to compliance with obligations concerning the documentation of transfer prices. The applicable methods are the following:

- comparative price method;
- resale price method;
- cost and income method;

- transactional net profit method;
- profit-sharing method;
- any other method (if justified).

The requirements relating to documentation have been greatly simplified in the recent past. In the case of transactions below HUF 50 million, the market price does not have to be documented. In the case of certain services within a company group (IT, accounting, administration) simplified documentation can be prepared if certain conditions are met.

The tax authority penalises violation of the rules on transfer prices with a higher than average fine.

7.3.5. Alternative Taxation Forms

Several types of taxation are available for small enterprises depending on the size and type of activity, e.g. revenue based flat rate (37%), simplified enterprise tax, or the cash-flow increase and personal expenses based flat rate small enterprise tax (16%), beyond which no other contribution obligations apply.

7.4. LOCAL TAXES

The revenues of local governments come from two sources: taxes levied by the local authorities and funds received from the central budget. Below we summarise the two most important tax categories that can be levied by local governments.

7.4.1. Local Business Tax

Companies that carry out their activities in the area of a given local government must pay local business tax to the local tax authority.

The base of the local business tax is the net sales revenues less the purchase value of the goods sold, material costs, the value of intermediated services and the value of subcontractors' performance. This means that, among other things, the following may not be deducted from the revenues: staff costs, services used, depreciation and financial expenditures. A stricter measure applies to large companies, according to which in the case of domestic revenues exceeding HUF 500 million, only 70 to 85% (depending on the size of the enterprise) of the deductible items (with the exception of material costs) can be taken into account.

The rate of local business tax is subject to the decision of the specific local government, but may not exceed 2%.

Companies that carry out taxable activities in the territory of more than one local governments simultaneously, distribute their tax base among the local governments concerned, using the calculation methods determined by law (based on the asset ratio and/or the staff costs ratio).

Activities that last no longer than one month (e.g. building and fitting by a foreign company) are exempt from local business tax, while temporary activities that last no longer than six months in the tax year incur a daily flat-rate tax (maximum HUF 5,000/day).

7.4.2. Building Tax, Land Tax

The local government may levy

- a building tax on buildings for housing or other purposes in its area, the maximum amount of which is HUF 1,100/m2/year or 1.8%/year of the market value and

- a land tax on land in its area, the maximum amount of which is HUF 200/m2/year or 1.5%/year of the market value.

The owners of public utility lines pay a public utility tax of HUF 125 per metre (the owners of telecommunications lines are granted an allowance depending on the length of the lines).

7.5. SPECIAL TAXES ON SPECIFIC SECTORS

The special taxes imposed by the government on the retail, telecommunications and energy sectors in 2010 were lifted in 2013; however, the special tax levied on the financial sector still remains. In the framework of the latter

- credit institutions pay an annuity that corresponds to 5% of the interest rate margin of their loan portfolio receiving state interest subsidies, and
- credit institutions pay a 30% special tax on their pre-tax profit, as well as a one-off contribution in 2014 of 19% of the 2013 risk provision transferred to retained earnings.
- Among financial institutions,
    - insurance companies pay tax based on the adjusted premium shown in their financial reports of the year 2009 as follows: 1.5% up to HUF 1 billion, 3% above that up to HUF 8 billion, and above that 6.4%,
    - credit institutions pay tax based on the amended balance sheet total calculated using the data of their financial reports for the year 2009 as follows: 0.15% up to HUF 50 billion and 0.53% above that (this is reduced by the amount paid as the 30% special tax),
    - other financial institutions (investment companies, stock exchanges, commodity exchange service providers, venture capital fund managers) pay a tax of 5.6 to 6.5% on the consolidated interest and commission income shown in their 2009 financial reports.

In connection with the fixing of the repayment exchange rates of foreign exchange loans, from 2013 50% of the amounts paid by the government will be paid by financial institutions in the form of an annuity.

Banks are subject to a so-called transaction duty on transfers, collections, cash deposits and withdrawals and other similar payment transactions, the general rate of which is HUF 0.3% (0.6% for cash withdrawals). The current practice is for banks to pass this duty onto their customers through their fees.

7.6. TAXATION RULES

With regard to tax returns, tax payments and audits performed by the tax authority, Hungary acts in accordance with European standards. Tax returns can only be filed in electronic form in most tax categories. In addition to tax audits, upon payment of a fee, consultation procedures are available, primarily in the field of transfer prices, but advance tax assessment may also be requested from the appropriate authorities.

7.6.1. Opening a bank account

Every company and branch office registered in Hungary must open at least one bank account in Hungary concurrently with founding the business (the bank automatically informs the court of registration and the tax authority of this).

Taxpayers obliged to open a bank account may not make cash payments among one another in excess of HUF 1.5 million gross per contract. (In the case of affiliated companies cash payments in excess of HUF 1 million must also be reported.)

7.6.2. Filing of tax returns, powers of attorney

Tax returns are filed electronically. For this purpose, the person appointed for filing the tax return (managing director, the company's own employee or the employee of a hired accounting firm) must be registered with the document office. Registration with the document office is only possible in person. In addition to the presentation of personal documents, it also requires the provision of an e-mail address, to which the office will send confirmation messages and other information relating to tax returns. (The managers and employees of consulting firms are usually registered with the document office.)

In practice, tax returns are mostly filed by the manager or an employee of a hired accounting firm, based on a power of attorney. In addition to the electronic filing of tax returns, powers of attorney can also be given on a case-by-case basis for dealing with certain tax matters, but there are also comprehensive powers of attorney (valid for dealing with all kinds of tax matters until revoked), which are registered by the tax authority. The power of attorney must always be granted to a specific private individual (for example, the company carrying out the bookkeeping cannot be given a general power of attorney as a legal person).

7.6.3. The role of tax advisers and tax experts

Tax returns can also be filed with the endorsement of a tax adviser or tax expert. In this case the tax authority fines the tax adviser or tax expert for any errors or omissions.

The law requires mandatory representation by a solicitor, a tax adviser or a tax expert in the following cases:

- application for a conditional tax assessment (ruling – the administrative fee for this is HUF 5 million for one-off transactions, and HUF 8 million for longer-term transactions effective up the end of the second tax year following submission, with an expedited procedure fee of HUF 3 million in each case);
- application for establishment of the fair market price (advance pricing agreement – the fee for this can range between HUF 500,000 and HUF 10 million);
- submission of an application for supervisory measures (ministerial review in addition to ordinary remedy, in the event of a measure that violates the law);
- submission of the tax returns of companies for which enhanced supervision by the tax authority was prescribed at the time of their foundation based on risk analysis (in such cases endorsement is also mandatory).

7.6.4. Legal consequences

After filing an incorrect return it is possible to correct the return subsequently (self-assessment) up until the commencement of the tax audit. If any additional tax payment obligation arises as a result, it must be paid plus interest corresponding to the central bank base rate (self-assessment supplement).

If an error is discovered later by the tax authority, several possible sanctions may apply:

- the default penalty that can be imposed upon companies for omissions of a formal or technical nature usually cannot exceed HUF 500,000 (however, in connection with the obligation to provide transfer price documentation it may be as high as HUF 4 million per register);
- in the case of tax arrears, the tax penalty can usually be maximum of 50% (for priority case types or intent the penalty may be several times that);
- late charges must also be paid, calculated from the original deadline, at double the current central bank base rate.

ABT TREUHAND GROUP - FOCUS ON TRUST IN HUNGARY

Anyone investing in Hungary should be familiar with the country-specific circumstances or take expert advice. As an active participant in Hungarian economic life, we are well acquainted with local conditions and methods, though we strive to represent the Western European approach, discretion and work ethic as well.

ABT TREUHAND – International Experience, in Hungary since 20 Years

The ABT Treuhand Group (consisting of the Hungarian trust company ABT Hungária Tanácsadó Kft. and the Hungarian audit company ABT Hungária Könyvvizsgáló Kft, both based in Budapest) was founded in 1993.

The company, which has a Swiss background, today employs a staff of more than 30 multilingual employees. The Hungarian ABT Treuhand Group initially aimed its services chiefly at investors and companies from the German-speaking world.

The company's personnel are well acquainted with the unique features of Hungarian standards, as well as the rules and requirements of international accounting.

NEXIA International — Profit From Our System of Contacts

In 2005, the ABT Treuhand Group became a member of NEXIA International. NEXIA International is a worldwide network of auditing and consultancy firms, which currently occupies 10th place in the global rankings. NEXIA International assists its customers in over 100 countries with more than 300 branch offices.

NEXIA offers its members — and thus the ABT Treuhand Group — both excellent international contacts and comprehensive technical expertise.

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20 YEARS
IN HUNGARY

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Start-up advisory services	Tax advisory	Accounting	Payroll accounting
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■ HR services (recruiting, search for managerial staff)	■ Expat services	■ On-site bookkeeping (at your location)	■ Audit of payroll and labour issues
	■ Tax due diligence	■ Online accounting	■ Online payroll accounting
Auditing	**IT and internal audit**	**Acquisition services with our associated partner**	**Legal services with our associated partner**
■ Audit (statutory audits)	■ Risk management	■ National and EU grants	■ Founding of companies
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■ Financial due diligence	■ SAP audit	■ Corporate finance	■ Property transactions
	■ Internal audit	■ Mergers & Acquisitions	■ Representation in and out of court

YOUR CONTACT PARTNERS

József LÁNG
Partner and managing director of ABT Treuhand Group

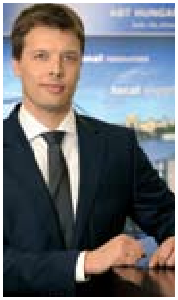
Tel.: +36 30 267 2689
E-mail: jozsef.lang@abt.hu

Mariann TÓTH
Partner

Tel.: +36 30 470 0721
E-mail: mariann.toth@abt.hu

Péter KARDOS
Head of Tax Division

Tel.: +36 30 610 8524
E-mail: peter.kardos@abt.hu



Ádám MILUS
Head of Accounting Division

Tel.: +36 30 633 8458
E-mail: adam.milus@abt.hu

Edina FAZEKAS
Head of Payroll Division

Tel.: +36 30 399 6616
E-mail: edina.fazekas@abt.hu

Ferenc SMOHAY
Head of the IT and Internal Audit Division

Tel.: +36 30 588 3513
E-mail: ferenc.smohay@abt.hu

ABT Treuhand Group in Hungary

ABT Hungária Tanácsadó Kft.
ABT Hungária Könyvvizsgáló Kft.

H-1037 Budapest
Montevideo u. 3/A
Tel: +36 1 430 3400
Fax: +36 1 410 3402
E-mail: abt@abt.hu
Web: www.abt.hu

ABT Treuhand Group in Switzerland

ABT Treuhandgesellschaft AG

CH-8134 Adliswil
Zürichstrasse 27 b
Tel: +41 44 711 9090
Fax: +41 44 711 9099
E-mail: abtadliswil@abt.ch
Web: www.abt.ch

CH-6330 Cham
Alte Steinhauserstrasse 1
Tel: +41 41 784 4500
Fax: +41 41 784 4509
E-mail: abtadliswil@abt.ch
Web: www.abt.ch

ABACOR Revisions AG

CH-6330 Cham
Alte Steinhauserstrasse 1
Tel: +41 44 318 9090
Fax: +41 44 318 9099
E-mail: abacor@abacorrevision.ch
Web: www.abacorrevision.ch

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