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COUNTRY

Doing Business in
Hungary

Preface

This guide has been prepared by Baker Tilly Hungária Audit Kft., an independent member of Baker Tilly International. It is designed to provide information on a number of subjects important to those considering investing or doing business in Hungary.

Baker Tilly International is the world's 8th largest accountancy and business advisory network by combined fee income, and is represented by 145 firms in 110 countries and over 25,000 personnel worldwide. Its members are high quality, independent accountancy and business advisory firms, all of whom are committed to providing the best possible service to their clients, both in their own marketplace and across the world.

This guide is one of the series of country profiles compiled for use by Baker Tilly International member firms' clients and professional staff. Copies may be obtained from Baker Tilly Hungária Audit Kft. or any of our independent member firms.

Doing business in Hungary has been designed for the information of readers. Whilst every effort has been made to ensure accuracy, information contained in this guide may not be comprehensive and recipients should not act upon it without seeking professional advice. Facts and figures as presented are correct at the time of writing.

Up-to-date advice and general assistance on Hungarian matters can be obtained from Baker Tilly Hungária Audit Kft.; contact details can be found at the end of this guide.

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1 Fact Sheet

Geography

Location	East of Central Europe
Area	93,036km ²
Land boundaries	Austria (west), Slovakia (north), Ukraine (north-east), Romania (east), Serbia and Croatia (south), Slovenia (south-west)
Coastline	None (landlocked)
Climate	Temperate
Terrain	Mostly flat to rolling plains; hills and low mountains in the north and west
Time zone	GMT +1

People

Population	10 million
Ethnic groups	Roma, Germans, Slovaks, Croats, Romanians, Serbs and Slovenes
Religion	Roman Catholic, Presbyterian/Calvinist, Lutheran, Greek Catholic, Orthodox and Jewish
Language	Hungarian

Government

Country name	Republic of Hungary
Government type	Republic
Capital	Budapest
Administrative divisions	19 counties
Political situation	Parliament consists of 386 members; members are elected for a four-year term. The prime minister is elected by the members of parliament. The President of the Republic is elected by parliament for a five-year term. Hungary is a member of the EU and NATO

Economy

GDP – per capita	HUF2.4m
GDP – real growth rate	2% (2007)
Labour force	6.5 million (March 2008)
Unemployment	7.5% (July 2008)
Currency (code)	Hungarian forint (HUF)

2 Business Entities and Accounting

2.1 Company Forms

Act IV of 2006 on Business Associations (the Companies Act) regulates company structures.

Since 1 July 2008 it is possible to apply electronically for the registration of a company at the Court of Registration. If no issues arise, registration can be completed within a week.

The registration application must be filed with the Court of Registration within 30 days of the conclusion of the Articles of Association. Once the registration is submitted the company may start its operations as a pre-company until registration is finalised (or refused). A pre-company may pursue business activities, but may not conduct activities requiring an official licence.

The Companies Act permits the following corporate forms:

- Company limited by shares
- Limited liability company
- Joint enterprise
- Limited partnership
- Unlimited partnership.

Companies limited by shares and limited liability companies are the most popular structures among foreign investors (see sections 2.1.3 and 2.1.4).

Two additional types of business entity foreign investors may choose in order to establish a presence in Hungary, are:

- A representative office, which can be useful if a foreign company intends to familiarise itself with local business conditions before embarking on an investment. Representative offices may perform normal liaison functions, including assisting with contract negotiation, advertising and exhibiting products and other forms of marketing on behalf of the parent company, but are not allowed to pursue core business activities
- A branch office, an organisational unit of a foreign company authorised to carry out normal business activities independently.

New forms of corporations have appeared following Hungary's accession into the EU, namely European Economic Interest Groupings (EEIG), European companies (European joint stock companies) and European co-operative societies.

Hungarian law may prescribe that certain business activities can only be carried out in a particular corporate form. For example, banks can only be established and operated as companies limited by shares.

2.1.1 Capital requirements

No minimum capital is required to establish and operate an unlimited partnership, a limited partnership, or a joint enterprise. For other company forms, the Companies Act determines the following minimum amounts of subscribed capital:

Company Form	Minimum Share Capital HUF'000
Limited liability company (Kft.)	500
Private company limited by shares (Zrt.)	5,000
Public company limited by shares (Nyrt.)	20,000

Subscribed capital may be contributed in cash, contributions in-kind, or a combination of the two.

2.1.2 Company limited by shares (Rt.)

The Rt. is similar to the German AG or the English plc and is the most strictly regulated corporate form. It is particularly suitable for large business entities with several investors, but it is also possible to establish such an entity as a single member company. The Rt. may either be a public company (Nyrt.) or a private company (Zrt.).

The Rt. may issue several classes of shares, namely ordinary, preference, employee and interest bearing shares. Each share class confers identical rights on its holders. In general, shareholders' voting rights are in proportion to the sum of the nominal value of the shares they hold, but the statutes of the company may provide otherwise by creating different share classes.

The Rt. is ultimately controlled by its shareholders via shareholders' meetings. The administrative duties are handled by the board of directors, consisting of a minimum of three and a maximum of 11 members, all natural persons. The election of a supervisory

board is mandatory for public companies. In the case of private companies, it is mandatory only in special cases described by relevant legislation.

The Rt. is the only corporate form that may issue securities. The Companies Act specifies two types of bonds that a company limited by shares may issue. A convertible bond guarantees the right of conversion to shares upon the request of the holder of the bond. The other bond form grants subscription rights upon the issue of new shares.

2.1.3 Limited liability company (Kft.)

The Kft. is the most widely used form of business entity among investors due to the minimum capital requirements, the simplicity of the corporate governance system and few operational administrative procedures. However, the transfer of shareholdings, capital increases or decreases etc are less flexible than those of companies limited by shares.

The legal characteristics of the Kft. are very similar to those of the German GmbH or the US limited liability company, while its nearest British equivalent is the private limited liability company.

The Kft. is suitable for a small number of shareholders (single member companies are permitted) who actively participate in the operations of the company.

Members have limited liability; under normal circumstances they are not liable for the obligations of the company. The Companies Act, however, determines certain cases when the corporate veil can be lifted.

Ultimate control of the Kft. rests with the members via members' meetings. The daily operations are led by one or more managing directors who may be either the members of the company or third parties. The Kft. is not required to appoint a supervisory board.

2.2 Auditing, Accounting and Filing Requirements

2.2.1 Reporting

Act C of 2000 on Accounting has been brought into line with the EU accounting directives and International Financial Reporting Standards (IFRS).

All companies, public and other organisations registered in Hungary, are obliged to prepare financial statements according to one of the following methods:

- Annual financial statements, comprising a balance sheet, income statement, cash-flow statement, notes to the financial statements and a business report

- Simplified annual financial statements. In this case, the balance sheet, income statement and notes to the accounts are less detailed and a business report is not required. Companies are entitled to present simplified financial statements if they fulfil at least two of the following three criteria in two consecutive years preceding the financial year:
 - Total assets not exceeding HUF150m
 - Annual sales revenues not exceeding HUF300m
 - Average number of employees not exceeding 50 persons.

Companies limited by shares, consolidated companies and branch establishments of foreign companies are not permitted to prepare simplified financial statements even if they meet two of the three criteria listed above

- Consolidated annual financial statements must be prepared by companies acting as a parent company. The parent company does not need to prepare a consolidated annual report for the financial year if on the balance sheet date in the two consecutive years preceding the financial year, two of the following three criteria are met:
 - Total assets not exceeding HUF2.7bn
 - Annual sales revenues not exceeding HUF4bn
 - Average number of employees not exceeding 250 persons
- Simplified statements, comprising a simplified balance sheet and a simplified income statement. These may be prepared exclusively by companies with a single-entry bookkeeping system.

Financial statements must be prepared in Hungarian and figures must be in HUF'000. The annual financial statements must be lodged at the Company Court of Registration and a copy sent to the company registration and information office of the Ministry of Justice.

Any enterprise conducting operations in its principal business environment in a currency other than HUF may prepare its annual report in the currency defined in its deeds of foundation, provided that at least 75% of its income, expenses and costs, and financial assets and financial liabilities for the previous and the current financial year are denominated in that currency.

2.2.2 Audit obligations

An audit of the financial statements is compulsory for all companies keeping double-entry books unless both of the following conditions are satisfied:

- Annual sales income does not exceed HUF100m on the average for the two financial years preceding the financial year under review
- Average number of employees for the two financial years preceding the financial year under review does not exceed 50 persons.

If the relevant data is not available or not complete, calculations should be made using estimates.

3 Finance and Investment

3.1 Exchange Control

There are no exchange controls on inward or outward investment. Foreign currencies can be bought and sold freely and there are no restrictions on the maintenance of foreign currency bank accounts in Hungary.

3.2 Banking and Sources of Finance

The National Bank of Hungary (NBH) is responsible, inter alia, for setting base interest rates. The government makes decisions on the exchange rate system in agreement with the NBH. The current exchange rate system is classified as a band exchange rate system. The centre and edges of the exchange rate band, as well as the official exchange rate of the forint in relation to the euro, are set by the NBH.

The activities of commercial banks are subject to statutory regulation; supervision of commercial banks is the responsibility of the Hungarian Financial Supervisory Authority.

Banks offer short, medium and long-term loans, as well as overdrafts. To obtain bank financing a business must provide adequate security and, in most cases, financial statements and a business plan.

3.3 Securities Market

The Hungarian Stock Exchange opened in Budapest in 1864. In 1948, the Budapest Commodity and Stock Exchange was dissolved, the assets of which were nationalised. Following the change of regime in 1990, the Budapest Stock Exchange (BSE) was reopened. Since the integration of the activities of the BSE and the Budapest Commodity Exchange in 2005, commodity trading also takes place on the BSE.

3.4 Insurance System

Insurance activities are subject to statutory regulation. The supervision of insurance activities is administered by the Hungarian Financial Supervisory Authority.

3.5 Foreign Investment Incentives

Various tax incentives are currently available, the main ones being:

- Tax incentives for investments. Discounts of corporate income tax are available under certain conditions for companies undertaking:
 - Environmental protection
 - Research
 - Production of films or video
 - Creation of new jobs
- Regional tax incentives. In some regions, the rate of corporate income tax is reduced if the company meets certain strict requirements
- Tax incentives for small and medium-sized companies. If a small or medium-sized company purchases new fixed assets, the purchase value of the assets may be deducted from the corporate tax base in the year of the purchase
- Tax incentives for development. If companies decide to purchase fixed assets, they may set up a reserve for development and the amount of this reserve is tax deductible. The reserve may be set up for four years and must be utilised at the latest in the fifth year. The depreciation of the relevant assets should be added back for tax purposes.

Hungarian companies may also apply for EU funding for certain purposes.

4 Employment Regulation and Social Security

4.1 Work Permits

With limited exceptions as stipulated by law, a foreigner undertaking work in Hungary must possess a work permit.

Permits, however, are not required for:

- Recognised foreign refugees and foreigners possessing an immigration permit or settlement permit
- Citizens of EU member states, Norway, Iceland and Liechtenstein and their close relatives, who are authorised to reside in Hungary.

The request for a permit is submitted by the employer. The necessary application form can be obtained at employment centre offices.

The authorisation or denial of the permit request is decided upon by the regional employment centre. The permit can be granted for up to one year, but may be extended.

There are firms operating in Hungary which facilitate the work authorisation process for foreigners.

4.2 Labour Contracts

Employment and labour issues are regulated by Act XXII of 1992 of the Labour Code. It is important to emphasise that this regulation is unconditionally mandatory – in the absence of authorisation its provisions cannot be disapplied even with mutual consent.

The employment relationship between employers and employees can exclusively be established or terminated via written labour contracts, and contracts can only be modified by mutual consent of the parties and in writing (official forms are available).

Labour contracts must contain the names and designations of the parties, information relevant to the work relationship, as well as:

- The scope of duties to be performed by the employee (in addition, a listing of the definite tasks must be recorded in a written job description)

- The place of work (referencing whether the workplace location varies)
- The employee's basic wage or salary.

Labour contracts must also contain all provisions regarding the legal relationship within the framework of the Labour Code of all parties, eg probation period, fixed-term employment relationship, etc.

Prior to or on the first day of employment, the employer is required to report information on the employee and employment conditions to the competent state tax authority of first instance. The employer is required to notify the tax authorities of the employment and its conditions.

4.3 Trade Unions

The Labour Code regulates the relationship between employer and employee as well as their relationships with trade unions and similar entities.

4.4 Social Security System

Social security contributions cover health, pension and unemployment insurance. Contributions paid by employers are:

Contribution	Rate (%)
Pension contribution	24
Health insurance contribution	4.5
Health contribution	0.5
Vocational education contribution	1.5
Employers' contribution	3

Contributions paid by employees are:

Contribution	Rate (%)
Employees' contribution	1.5
Health insurance contribution	6
Payments to state pension funds	1.5
Payments to private pension funds ¹	8
Itemised health contribution	HUF1,951/month

¹ There is a maximum limit of income for which this contribution is paid. For income above this limit, no pension contribution is paid but solidarity surtax is applied.

The rates stated above apply for income received from sources in Hungary. For income received from foreign sources different rates apply.

EU regulations generally state that individuals are subject to the social security system of the country where they perform their work activities. Therefore, if EU nationals perform their work activities in Hungary they are generally subject to the Hungarian social security system. However, there are certain exceptions to this rule. Third country nationals will not automatically fall under the EU social security provisions and will continue to be exempt provided appropriate criteria are met.

For social security purposes residents in Hungary are classified as follows:

- Hungarian citizens living in Hungary
- Individuals holding a permanent residence permit
- EEA citizens (and their family members) holding an EEA residence permit
- Fugitives and immigrants.

The following benefits are available to individuals participating in the Hungarian social security system:

- Daily compensation in the event of interruption of professional activities due to illness
 - Retirement pension
 - Family allowances
 - Accident and medical coverage.
- 

5 Taxation

5.1 Corporate Taxation

5.1.1 Corporate income tax

The standard rate of corporate income tax is 16%.

Tax losses may be carried forward indefinitely. However, in the five years following incorporation losses may be carried forward without special permission of the tax authority. Thereafter, an application to the tax authorities is required.

Companies are assessed on a calendar year or on a business year basis. The business year may only be adopted if the Hungarian company is a fully consolidated subsidiary or a branch of a foreign parent company that uses a tax year different from the calendar year.

Companies must file their corporate income tax returns and pay any balance of tax due by 31 May of the year following the tax year concerned, or by the 150th day following the end of the business year if it is different from the calendar year.

Advance payments of corporate tax should be paid:

- In 12 equal instalments for companies with a corporate income tax liability exceeding HUF5m in the preceding tax year
- Quarterly, for companies with a corporate income tax liability not exceeding HUF5m in the preceding tax year.

5.1.2 Solidarity surtax for companies

The solidarity surtax for companies was introduced on 1 September 2006. The surtax liability is calculated as 4% of pre-tax profit, subject to limited adjustments.

It is not possible to carry forward losses for solidarity tax purposes and taxpayers cannot utilise any tax allowance against solidarity tax.

Taxpayers are obliged to pay corporate income tax and solidarity surtax advances quarterly in equal instalments. The excess of 90% of the expected annual liability over the instalments must be paid by the 20th day of the last month in the tax year.

5.1.3 Transfer pricing

Hungarian transfer pricing legislation is modelled on OECD transfer pricing guidelines. Transfer pricing rules apply to related-party transactions where the relationship is determined on the basis of either direct or indirect majority control. The term “parties” (for transfer pricing purposes) includes resident and non-resident entities as well as branches and permanent establishments.

The basic transfer pricing rule provides for adjustments of pre-tax profit if prices stipulated between related parties differ from those applied between unrelated parties in comparable circumstances. The pre-tax profit must be increased by the price difference if this difference leads to a lower pre-tax profit. On the other hand, the possibility of decreasing the pre-tax profit, when justified by the arm's length price, is subject to further conditions.

All entities, with the exception of small and medium-sized enterprises subject to Hungarian corporate income tax, are required to prepare transfer pricing documentation with respect to all contracts concluded with related parties provided that transactions were carried out based on the contract in the respective tax year.

5.1.4 Local business tax

Local municipalities may impose taxes on land and buildings situated in their territory. They may also impose taxes on entrepreneurial activity carried out in the territory of the municipality. The most important and frequently introduced local tax is the latter – local business tax.

The amount of the local tax is deductible for corporate income tax purposes and is calculated by reference to trading profit.

The maximum rate of local business tax is 2% of the tax base. Within this limit, it is at the discretion of local municipalities to set the applicable tax rate.

5.1.5 Real estate transfer tax

In general, real estate transfers are subject to a 10% transfer tax levied on the transfer price or the market value of the property including the amount of VAT. The tax is payable by the transferee.

The rate is 2% for apartments and houses with a value not higher than HUF4m, and 6% on the excess of this sum. Companies purchasing, selling, or leasing real estate in the

course of their ordinary business are liable for a 2% preferential transfer tax when purchasing the property provided that the re-sale is completed within two years from the date of purchase, or the real estate is leased under such terms where the lessee automatically assumes the title to the real estate upon the expiry of the lease period.

5.1.6 Research and development (R&D) tax

The R&D tax rate is 0.3% based on trading profit. The amount spent on R&D is deductible from the R&D tax liability.

Newly-incorporated entities in the calendar year of their incorporation and small and medium-sized entities are not subject to R&D tax.

5.1.7 Company cars

Tax on company cars should be paid on all passenger cars owned by companies.

Monthly rates are:

Cylinder capacity	HUF
<1600cm ³	7,000
>1600cm ³	15,000

Tax is payable quarterly and if paid on time is deductible for corporate tax purposes.

5.1.8 Value added tax (VAT)

The standard rate of VAT is 20%. There are some goods and services which are subject to tax at a reduced rate of 5%, eg certain pharmaceutical products, daily papers. VAT is chargeable on the selling price plus the fees for related services and other related costs, but excluding discounts in most cases. Imports are subject to VAT on the sum of the customs value, customs duties, fees and other government levies.

Certain transactions carried out in Hungary are exempt from VAT, including: the sale, rental, or lease of real estate (with the option to pay tax under the general rules in the case of business property); the financial lease of residential properties; public radio and TV services; postal services; financial services; insurance; and the transfer of equities and credits. However, mediation of VAT exempt services is not always exempt from VAT. Businesses providing VAT exempt services are not able to recover input VAT in full. Small businesses may elect to be VAT exempt under certain conditions.

5.2 Individual Taxation

5.2.1 Personal income tax (PIT)

The law classifies income under different categories. Any revenue received by an individual should be classified on the basis of the relationship between the provider and the recipient, any third parties related to them and the actual circumstances of receiving the income. The categories are as follows:

Income from employment

In general, personal income tax is charged on annual taxable income at the following tax rates:

Income	Rate (%)
Below HUF1.7m	18
Above HUF1.7m	36

Certain items are excluded from taxable income and deductions are allowed for certain items, eg pension insurance premiums, charitable donations etc.

The employer pays 54% personal income tax on benefits in-kind provided, but the individual is not subject to tax on benefits in-kind received. Further taxes and contributions on benefits in-kind:

- Employees: 24% pension contribution, 4.5% health insurance contribution, 0.5% health contribution, 3% employers' contribution, 1.5% vocational education contribution
- Third parties: 11% health insurance contribution.

Companies may provide certain tax-free benefits to their employees up to certain limits. The limits are specified by law according to the different types of contributions. Examples of tax-free contributions include monthly travel tickets, meal vouchers, holiday recreation vouchers, home internet usage, payments into private pension funds etc.

Directors' fees are subject to tax in the same way as employment income.

Income from independent activities

All activities that are not included in employment (dependent) activities are considered independent activities (eg the activities of private entrepreneurs, agricultural producers,

appointed auditors etc). The individual receiving income from an independent activity is entitled either to deduct a 10% lump-sum for their costs or to deduct the actual appropriately sustained costs incurred.

Investment income

Interest income from an Hungarian source is subject to 20% withholding tax. Tax on dividend income from an Hungarian source is withheld at 25%; an additional 14% health insurance contribution is payable up to an annual maximum limit of HUF450,000.

Dividends paid on stocks traded on the BSE or an accredited stock exchange of an EU member state are taxed at 10%.

Income from the letting of property is generally taxed at a flat rate of 25%. However, the taxpayer may elect to report the actual appropriately sustained costs incurred with respect to the property and pay tax at normal progressive rates.

Capital gains tax

Capital gains derived from transactions concluded on the BSE or the accredited stock exchange of other EU or OECD member states are taxed at 20%. All other capital gains are taxed at 25%.

Solidarity surtax

Individuals whose annual income exceeds the amount of the individual pension contribution cap (see section 4.4) are subject to 4% solidarity surtax. Solidarity surtax is levied on the consolidated personal income.

Appendix 1

Countries with which Hungary signed an agreement on the avoidance of double taxation are:

Arab Republic of Egypt	Republic of Finland
Australia	Republic of France
Canada	Republic of Greece
Channel Islands	Republic of Iceland
Czech Republic	Republic of India
Eastern Republic of Uruguay	Republic of Indonesia
Federal Republic of Germany	Republic of Italy
Federative Republic of Brazil	Republic of Kazakhstan
Grand Duchy of Luxemburg	Republic of Korea
Ireland	Republic of Latvia
Islamic Republic of Pakistan	Republic of Lithuania
Isle of Man	Republic of Moldova
Japan	Republic of Poland
Kingdom of Belgium	Republic of Portugal
Kingdom of Denmark	Republic of San Marino
Kingdom of Morocco	Republic of Singapore
Kingdom of Norway	Republic of Slovakia
Kingdom of Sweden	Republic of Slovenia
Kingdom of Thailand	Republic of South Africa
Kingdom of The Netherlands	Republic of the Philippine Islands
Macedonia	Republic of Tunisia
Malaysia	Republic of Turkey
Malta	Romania
Mongolia	Russian Federation
People's Republic of China	Socialist Republic of Vietnam
Principality of Andorra	Spain
Principality of Liechtenstein	State of Israel
Republic of Albania	State of Kuwait
Republic of Austria	Swiss Confederation
Republic of Belarus	Ukraine
Republic of Bulgaria	United Kingdom of Great Britain and
Republic of Croatia	Northern Ireland
Republic of Cyprus	United States of America
Republic of Estonia	

Member Firm Contact Details

Baker Tilly Hungária Audit Kft.

Zsolt u. 4.

H-1016 Budapest

Hungary

T. +36 1 225 34 90

F. +36 1 225 34 91

E. info@bakertillyhungaria.hu

www.bakertillyhungaria.hu

Notes



Notes



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WorldHeadquarters

2 Bloomsbury Street
London WC1B 3ST
United Kingdom

T. +44 (0)20 7314 6875

F. +44 (0)20 7314 6876

E. info@bakertillyinternational.com

www.bakertillyinternational.com