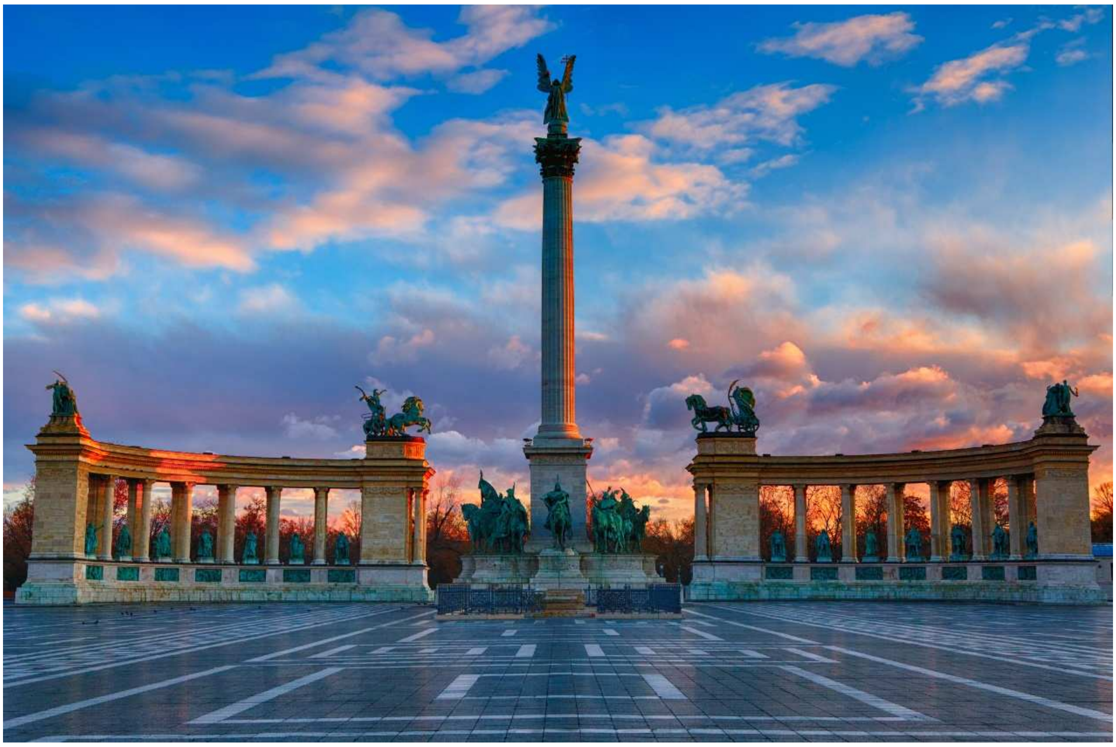
DOING BUSINESS IN HUNGARY

This document describes some of the key commercial and taxation factors that are relevant on setting up a business in Hungary.



Prepared by Gyarmathy & Partners Auditors, Tax and Business Consultants Ltd.

www.gyarmathy.hu
+36 1 349 2954

BACKGROUND

Country overview

Hungary is about 93,000 square km and consist of 19 counties. Its population is 9,718 million. Budapest is the capital and the largest city with its 1,7 million inhabitants. The official language is Hungarian.

Economic overview

Hungary is a member of the European Union (EU) since 2004 which comprises of 28-member states. The local currancy is Hungarian Forint (HUF).

Foreign investors are often faced with more paperwork while doing business in Hungary than they are used to in their home country. The Government is aiming at decreasing the mandatory administration for businesses in several steps in the following years.

Hungary places no restrictions or controls on payments for or proceeds from current transfers, real estate transactions or repatriation of profits. The Republic of Hungary applies the principle of free access to all sectors of economy. No investment permit of any kind is needed in Hungary for foreign investors, but business entities must in general be registered with the local court.

Transport infrastructure

Hungary has a good motorway and rail network. As a result of intensive construction works major motorways reach national borders, ensuring faster and safer transportation. The railway network covers the whole country and is an integral part of the international railway network, thus providing easy access by international express trains from the neighbouring and numerous other European countries.

The main International Airport in Hungary is the Liszt Ferenc International Airport in Budapest. Budapest is serviced by numerous major international airlines and also accessible by several low-cost airlines.

www.gyarmathy.hu
+36 1 349 2954

CHOICE OF LEGAL FORM

Hungarian Law allows four company types that can be founded in Hungary. The most common company types used by international businesses are the company limited by shares (Rt) and the limited liability company (Kft). The general partnership (Kkt.) and the limited partnership (Bt) require the unlimited legal liability of the members. The latter forms are more common for family businesses.

Private individuals may carry on a business as sole traders. While there are no specific regulations for civil law partnerships under Hungarian Law, foreign companies can set up a branch in Hungary. A foundation may be established for public interest and may carry on business additionally to its primary activity.

Limited Liability Company

The legal characteristics of an LLC are similar to the US limited liability company. This form is suitable to coordinate the co-operation of a small number of shareholders, where the members are actively participating in the company's affairs. An LLC can be founded as a single-person company as well. The minimum founding capital is HUF 3,000,000 (approx. USD 10,700).

The members have limited liability, which means that – under normal circumstances – they are not liable for the obligations of the company. The Company Act (Act IV of 2006), however, determines certain cases when the corporate veil can be lifted.

The supreme body of an LLC is the members' meeting, which must be convened at least once a year and where all members are entitled to participate. The members' meeting decides on the most important strategic business issues, elects and removes the managing director(s), the auditor and the members of the supervisory board and it may alter the Articles of Association. The members' meeting has a quorum if – unless the Articles of Association otherwise provide – at least half of the subscribed capital or the majority of the eligible votes are represented. The members' meeting passes its resolution by the simple majority of the votes cast.

The day-to-day operations of an LLC are headed by one or more Hungarian or foreign managing directors, who may be the members or employees of the company as well as outsiders.

General Partnership

The general partnership (Kkt.) has at least two members. The responsibility of all partners is unlimited and universal. Although the law does not require a minimum subscribed capital for the establishment of the company, all partners are liable for unpaid debts on the assets of the company. This responsibility cannot be limited or excluded. Under the joint and several liability of the partners, the creditor of the company may claim the total amount of debt from any partner. General partnerships are typically small, often family-owned businesses with low-risk activities.

Limited Liability Partnership

DFK INTERNATIONAL Gyarmathy & Partners
www.gyarmathy.hu
+36 1 349 2954

The limited partnership (bt.) is a popular company form for small businesses in Hungary. The limited partnership can be incorporated by at least two partners, with at least one general partner (beltag) and one limited member (kültag). General partners are jointly and severally liable with the other general partners for the debts of the company while limited partners are only required to provide a deposit, but are not liable for the company's debts.

Branch

A branch is considered a legal entity where the foreign head office bears joint responsibility with the establishment. A branch may only perform activities that comply with the laws of both Hungary and of the headquarters.

Sole Trader

Private individuals may carry on a business as sole traders after obtaining a registration number and registering with the tax authorities.

Company Limited by Shares/Public Limited Company

This corporate form is mostly suitable for large business entities with several investors. The minimum initial capital is HUF 5,000,000 that may be contributed in the form of cash or in kind contributions.

The company limited by shares can be operated as either a private or a public company. The shares embody membership rights and may be issued as several classes of shares. Classes of shares are namely ordinary shares, preference shares, employee shares and interest shares. It is the only corporate form that may issue securities, as stipulated in The Company Act: convertible bonds that guarantee the right of conversion to shares upon the request of the bondholder and another kind of bonds that grant subscription rights upon the issue of new shares.

Foundation

A Foundation may be established for public interest and may carry on business additionally to its not-for-profit primary activity.

Setting up an organization

The registration of business associations is a must in Hungary. The Articles of Association or the Deed of Foundation, respectively, must be drafted and countersigned by a Hungarian registered attorney.

The registration application must be filed with the competent Hungarian Court of Registration within 30 days from the conclusion of the Articles of Association. If the applicable laws require for the establishment of the company any official license, it must be attached to the application form.

www.gyarmathy.hu
+36 1 349 2954

The Court of Registration must decide on the registration of the company within 15 days the latest. If the company wishes to use the standard articles of association laid down in the Companies Act which is to be filled out as a form, registration of the company can take place as quickly as within one hour.

It has to be noted that the above deadlines can be delayed by 8-45 days should the court of registration require the modification of the articles or further documents to be submitted before the company is registered.

A newly registered company must also register with the local municipality, State Taxation Office and Central Statistical Office. Branch offices and commercial representation offices must also be registered by the Court of Registration and may start their activities only after the registration.

If the company intends to build a relationship with a taxpayer(s) in an EU Member State, the company must apply for an EU tax number upon registration with the tax authority if it did not apply for one when submitting the application for incorporation (the EU tax number must be indicated on all documents related to EU trading, such as correspondence, orders, etc.).

FINANICAL AUDIT REQUIREMENTS

Based on the Hungarian Act on Accounting all companies are required to undergo financial audits if their net sales exceed an average of HUF 300 million (approx. USD 1,071,000) and the average number of employees is over 50 in two consecutive years. Financial auditing is also mandatory for companies which are consolidated.

TAXATION

Corporate Income Tax

Business entities (including companies as well as local branch offices of foreign companies) – with the exception of private entrepreneurs – doing business in Hungary are subject to corporation tax based on Act LXXXI of 1996.

Tax rate is 9% of the positive tax base.
Minimum tax: this so-called tax was introduced in 2007 with the aim of imposing tax on business organizations even if they are loss-makers. The rate of the minimum tax is 9%, its base being 2% of the total turnover less cost of goods sold, and the income of the place of business abroad plus the 50% of the difference between the average daily volume of liabilities against owners and the amount of liabilities against liabilities as of prior year end. Minimum tax is to be paid in case the corporate income tax base of the business organization does not reach the base of the minimum tax, calculated as described above.

Companies may be exempted from the minimum tax if they can prove that they in fact did not have any taxable income. For such cases however the law prescribes an increased probability of a detailed tax audit.

The deadline for corporate tax returns is May 31 of the year following the tax year.

Branch Profit Tax

The profit of branches in Hungary are subject to Corporate Income Tax (9%).

Personal Income Tax

Residents of Hungary are taxed on their worldwide income (unlimited tax liability), while non residents are taxed only on Hungarian source income or income to which under a double taxation treaty tax may be levied (limited tax liability). Foreign source income may be taxed even if it is not transferred to Hungary.

Under Hungarian law Hungarian nationals are deemed to be tax resident. A foreign national is tax resident, if he has permanent home or habitual abode or the centre of his vital interests is in Hungary. Residence status may also be affected by the terms of a double taxation treaty. Tax treaties override the local legislation.

Hungary operates a system of advance payments of tax, whereby employers are required to deduct personal income tax at the source.

The tax year for individuals is the calendar year, the deadline of tax return is May 20, in the year following the tax year.

Tax Rate
Most of the incomes (income from employment and independent business activities, other income) are aggregated and the tax rate is 15%. This is an important change compared to former years, when tax rates were progressive.
It is possible to reduce the aggregated tax base by the family allowance which depends on the number of dependents and months of eligibility.

Real Estate Capital Gain Tax

Net capital gains realized by nonresident individuals on sale of real estate are taxed at a flat rate of 15%. Acquisition costs and related expenses, improvement costs, and cost of transferring the property can be deducted from the revenue to arrive at the net capital gains. If the deductible expenses are not documented and if the acquisition costs are not substantiated, the 15% rate will be applied to 25% of the gross proceeds.The taxable gain is reduced by 10% every year after the fifth year, so that in the fifteenth year after acquisition, the taxable gain is reduced to zero.

Value Added Tax (VAT)

VAT is the most significant indirect tax in Hungary. Its major characteristics are as follows: besides the general tax rate of 27%, there is a preferential rate of 18% for internet and certain food products. A rate of 5% applies to certain medications and medical accessories. Banking services and certain other business activities “inter alia” insurance, real estate leasing, and general education are tax exempt. Businesses, other than banks and others with turnover tax exemption, can generally recover the amount of input VAT in excess of output VAT or it may be transferred for the next tax return period.

VAT is levied by self-assessment. Tax returns must be filed monthly, quarterly, or annually, depending on the amount of VAT paid in the previous year.

Recovery of VAT is allowed within a tax return period if the amount of tax difference reaches or exceeds 1 Million Forints relating to monthly tax filers, 250 Thousand Forints relating to quarterly tax filers and 50 Thousand Forints relating to annual tax filers. VAT is only reclaimable if it relates to financially settled invoices.

The VAT Act allows residential associated enterprises to form a VAT group creating a further taxpayer status. In this case transactions between group members do not fall under VAT obligation, the members of the group are considered to be a single taxpayer.

The VAT group can be established and terminated with permission of the tax authority provided that there is a prior written agreement also serving as a common petition between all the members. The possibility of participating in the VAT group is reserved for associated companies resident in Hungary. The group must appoint a representative to act before the tax authority. The group has a single tax number, the so-called group identification number. In case of default in VAT payments the members of the group have joint and several liabilities for the outstanding VAT.

Tax Treaties/Avoidance of Double Taxation

Hungary has been a member of the European Union (EU) since 2004. It has entered into several bilateral and multi-lateral investment protection treaties with strategically important investor countries. These treaties provide a detailed description of the applicable legal guarantees granted to foreign investors.

Up to now, investment protection treaties have been established with the following countries:

Albania	Indonesia	Russia
Armenia	Iran	Romania
Australia	Ireland	San Marino
Austria	Israel	Saudi Arabia
Azerbaijan	Italy	Serbia and Montenegro
Bahrein	Japan	Singapore
Belgium	Kazakhstan	Slovakia
Belarus	Korean Republic	Slovenia
Bosnia and Herzegovina	Kosovo	South Africa
Brazil	Kuwait	Spain
Bulgaria	Latvia	Sweden
Canada	Liechtenstein	Switzerland
China	Lithuania	Taipei
Croatia	Luxemburg	Thailand
Cyprus	Macedonia	Tunisia
Czech Republic	Malaysia	Turkey
Denmark	Malta	Turkmenistan
Egypt	Mexico	Ukraine

Estonia	Moldavia	United Arab Emirates
Finland	Mongolia	United Kingdom
France	Morocco	United States
Philippine Islands	Netherlands	Uruguay
Georgia	Norway	Uzbekistan
Germany	Oman	Vietnam
Greece	Pakistan	
Hong Kong	Poland	
Iceland	Portugal	
India	Qatar	

ALLOWANCES

Depreciation

For corporation tax purposes tax depreciation adjustment is done as follows:

The following assets may be amortized for tax purposes in accordance with the method used in the financial statement:

- Buildings depending upon their construction: 20%, 30% or 60%.
- Machinery, equipment: 14.5% or 33%. Computers, film and video making equipment may be amortized within two years.
- Vehicles: 20%
- Land is not subject to amortization
- Fixed assets rented or hired out: buildings 5% other assets 30%.

The arm's length principle

Just like in most international taxation systems, Hungarian tax law provides that in case related parties do not apply the arm's-length market price in their business transactions, they have to adjust the corporation tax base. An entity qualifies as related, if the controlling majority share in one company is held by the other or a third person holds the controlling majority in both of them. A controlling majority – which may also be indirect – means a voting right in excess of 50%, or the right to appoint or dismiss the majority of leading office-holders and supervisory board members.

The economic entity – except small enterprises – prior to the tax return, has to determine the method of fixing the usual market price. Taxpayers may choose between the comparable uncontrolled price, the resale price and the cost-plus methods as defined by OECD. If none of the three methods are appropriate, the taxpayer may choose another justifiable method. If the actual price is not the normal market price, the corporation tax base has to be adjusted.

EMPLOYMENT

Social Security

Compulsory social security applies to employees, including contracted work, as well as other

legal relationships involving the performance of work by individuals.
The following social security amounts are paid by the employer as based on the income of the employee:

- social contribution tax: 19,5%
- vocational training contribution: 1,5%

The following social security amounts are deducted from the employees gross salary:

- pension fund contribution 10%
- health care contribution 7%
- labour market contribution 1,5%.

These amounts are paid by the employer to the National Budget.

Employment of foreign staff

Compulsory social security also applies to expatriates (both EU and non EU citizens) employed by a Hungarian employer.

Employees on secondment employed by a non resident employer usually underlie the social security of their own country, whereby:

- EU rules (Council Regulation 1408/71) apply to EU nationals assigned to Hungary. Provisions of reciprocal agreements have to be applied to citizens of countries with which Hungary has entered into such agreements. (non-EU member successor states of Yugoslavia, CIS countries, Canada).
- Compulsory social security does not apply to expatriates (citizens of "third countries") employed by non resident employers.

Medical

It is obligatory for employees to pay health insurance. The compulsory rate is 7% and it is deducted from their monthly gross salary. Medical services and basic hospital services are covered by the compulsory health insurance without any further contribution by the insured person. Employers can make extra payments to Voluntary Health Funds, within the framework of the so-called cafeteria system, in this case employees can receive health services on a higher level at Private Medical Centers.

WITHHOLDING TAXES

Interest

The withholding tax rate on bank deposits, investment gain on securities is 15%.

Dividends

If an individual receives dividends, the amount will underly 15% personal income tax and 14%

health care contribution liability. The threshold limit for paying the 14% health care contribution is HUF 450,000. Above this amount, the individual has to pay only personal income tax.

MISCELLANEOUS

Distance selling of goods

Distance selling occurs whenever goods or services are sold without any face-to-face contact between the supplier and the buyer. Distance sales include any made by mail order, through TV shopping, over the phone or ordered on the internet.

In the case of a company registered in another EU member state making sales to Hungarian non-taxable customers, the distance sales threshold is EUR 35,000. Thus, if its total net sales to these customers in Hungary exceeds this threshold in the current tax year and also in the previous tax year, the foreign company must register for Hungarian VAT.

VAT Registration

Normally, the Tax Office generates VAT number for all new entities founded in Hungary.

It is possible for foreign EU member companies to apply for a Hungarian VAT number if they are planning to have a business activity in Hungary. The documents contained in the list below must be sumbitted in original to the Hungarian Tax Office. The date of issuance may not be earlier than 30 days before the date of application:

- Certificate of incorporation issued by the local Court of Registration + Hungarian translation
- Certificate form that your company is a taxable entity (issued by the local Tax Office) + Hungarian translation
- Original notarised signature sheet of the legal representative of the company
- Personal document for the general Manager of the Company (for example passport)
- Power of Attorney (PoA) for a Hungarian tax advisor

Invoicing Rules

VAT subjects are required to issue invoices in accordance with the specifications of the tax law regarding form and content. The taxpayer is obliged to issue an invoice within 15 days from the date of supply. This strict deadline does not apply to summary invoices. On 1st July 2018, the so called „real-time" invoicing has been introduced in Hungary. It applies only for domestic B2B transactions where the amount of VAT exceeds HUF 100,000.

Invoices issued on a simple letter head are generally legally unacceptable and result in fines by the tax authorities.

www.gyarmathy.hu
+36 1 349 2954

If the parties have a prior written agreement they are entitled to issue the invoice in a language other than Hungarian. In this case the tax authority may ask for a certified Hungarian translation of the invoice.

If the tax base is determined in a foreign currency the tax payer must convert the amount into Hungarian Forints on the basis of the rate specified by the Hungarian National Bank or the bank where the tax payer carries a bank account. The amount of VAT has to be determined in HUF in this case, as well.

Tax payers may issue summary invoices of performances within one tax period provided that there is a prior written agreement between the same creditors and debtors.

This document is provided as a general overview of matters to be considered when setting up an overseas business in Hungary. It is essential to take advice on specific issues. No liability can be accepted for any action taken or not taken arising from the information provided.

Prepared by: Julia Toth-Keszei, Gyarmathy and Partners

Created: June 2017

Amended: June 2019

For further information on the services available from the DFK International Member firm in Hungary please contact:

Dr. Gyarmathy and Partners Ltd.
Auditors and Tax Advisors, Law Office
Tel: (36-1) 349-2954
E-mail: julia.keszei@gyarmathy.hu

www.gyarmathy.hu
+36 1 349 2954