



Investment in Hungary

KPMG IN HUNGARY

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Investment in Hungary

Preface

Investment in Hungary is one of a series of booklets published by KPMG to provide information to those considering investing or doing business in various countries. This publication has been prepared by KPMG in Hungary to assist those contemplating investment or commencing operations in Hungary. KPMG in Hungary provides audit, tax and advisory services for Hungarian and multinational companies, government entities and inward investors.

The information in this booklet is of a general nature and should be used only as a guide for preliminary planning purposes. *Because of the continually changing legislative environment in Hungary, the complexity of Hungarian corporate, tax and social laws and regulations and the steadily evolving nature of the Hungarian economy, comprehensive professional advice and assistance should always be obtained before implementing any plan to invest in or immigrate to Hungary.* KPMG and its several hundred professionals in Hungary can render such assistance and would be pleased to provide more detailed information on matters discussed in this publication.

Every care has been taken to ensure that the information presented in this eighth edition is correct and accurate as of 1 January 2007.

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Chapter 1

General Information

Geography and Climate

Hungary is located in the Carpathian Basin of Central Europe, within easy reach of Western Europe. It covers 93,000 square kilometers (36,000 square miles). About two thirds of its territory is flat and lies less than 200 meters above sea level. The highest peak, Kékestető, rises to a height of 1,015 meters.

Hungary has two important rivers, which also serve as waterways – the Danube and the Tisza – and three major lakes – Balaton, Velence and Fertő. The greater part of Fertő belongs to Austria. Lake Balaton, with a surface area of 598 square kilometers and its surroundings are a popular destination for both Hungarian and foreign tourists.

In addition to rivers and lakes, the country is rich in thermal and medicinal waters and springs. The continental climate, the high annual proportion of sunshine and the quality of the soil ensures favorable conditions for agriculture.

A truly Central European country, Hungary has borders with Austria, Croatia, Romania, Serbia and Montenegro, Slovakia, Slovenia, and Ukraine.

Hungary is expected to join the Schengen accord at the end of 2007, taking full responsibility for EU borders.

Population and Language

Hungary has a population of approximately 10 million. Population density is about 100 persons per square kilometer. This population is expected to decline as a result of the low birth rate and the high death rate.

The capital, Budapest, has approximately 2 million inhabitants.

The population of the other 10 major cities ranges from 100,000 to 200,000 people.

The official language is Hungarian, but English and German are also used frequently in business.

Infrastructure

The transportation infrastructure is currently undergoing major reconstruction. In government-supported projects additional highways are being built, while the widely used, state-owned domestic railway system is also under reconstruction

Hungary has an extensive road system, centered around Budapest, with highways extending in most directions. Public transport in Budapest is well developed and consists of a comprehensive network of trams, buses, a subway system and railways.

Ferihegy airport handled 8.3 million passengers in 2006, a growth of 4.2 percent compared to a year earlier. Almost 2.2 million of those air travelers used one of the 11 budget airlines flying to and from Budapest in 2006. Major Hungarian cities have modernized their airports, a sign of an increasing importance of domestic air services.

The electronic communication sector is undergoing further rapid changes. Competition is growing and prices are decreasing on all fields – a trend likely to continue. Broadband Internet has been growing rapidly, while the mobile market is almost saturated. Majority of the operators offer double or triple play converged products. On the fixed-line market consolidation of the players has continued by Hungarotel acquiring Invitel and thus forming a strong competitor to Magyar Telekom. The Government accepted the digital switchover strategy aiming to implement a so called strong multiplex model and switchoff by 2012.

Labor Force

The Hungarian labor force is highly skilled and highly educated, particularly in engineering, IT, pharmacy, economics, mathematics, physics and professional services. Around two-thirds of the work force has completed some form of secondary, technical or vocational schooling. Foreign investment has brought know-how and technology into the country. Thus increasing the productivity of the labor force considerably.

The unemployment rate is slightly lower than the European Union average. The unemployment rate is higher in the eastern and southern regions and lower in the central and western areas.

Wages still lag behind those of Western Europe. The minimum wage is currently HUF 65.500 per month, approximately EUR 260 per month.

The Political System

The President is the head of state, elected by Parliament and serves a largely figurehead function. Parliament is the dominant source of power in Hungary and is comprised of elected representatives in a single chamber. The Prime Minister is elected by a simple majority of the members of Parliament.

Hungary has been politically stable since the transformation process began in 1989. The political arena is bipolar, dominated by the center-right FIDESZ-MPSz and the center-left Hungarian Socialist Party (MSZP). Two further minor parties, the conservative Hungarian Democrats (MDF) and the liberal Alliance of Free Democrats (SZDSZ) are also active players in the political arena. The Socialist party (MSZP) won the 2006 general elections and together with the liberal SZDSZ formed a coalition government. Socialist party president Gyurcsány Ferenc is serving as Prime Minister.

International Memberships

Hungary has been a member of the United Nations and some of its associated institutions (ILO, UNESCO, FAO, WHO, etc.) since 1955.

Hungary became a member of the IMF, the World Bank and the IFC (International Finance Corporation) in 1982. Additionally, Hungary is a signatory to the GATT (General Agreement on Tariffs and Trade), a member of the WTO (World Trade Organization) and of the OECD, as well as of the International Bank for Reconstruction and Development (IBRD), the World Intellectual Property Organization (WIPO) and the Central European Free Trade Association (CEFTA).

Hungary became a member of NATO in 1999 and a member of the European Union in 2004.

Hungary and EU Accession

As of May 2004, Hungary is a full member of the European Union. In 1994, Hungary was the first of the Central and Eastern European countries to apply for EU membership. The negotiation process was launched in 1998, and since then, Hungary has met the economic requirements of the accession and brought its legal system in line with the *acquis* of the EU.

With the EU's financial assistance, Hungary aspires to close the gap between its level of development as a new member country and the EU average. The Hungarian government has been working on the establishment of the physical and legal infrastructure, which will enable the country to most effectively channel the EU sources, as well as to complement these sources with domestic funds.

The Economy

The table below presents key indicators of the Hungarian economy from 2003 to 2007

ECONOMIC INDICATORS

	2003 actual	2004 actual	2005 actual	2006 estimate	2007 forecast
GDP growth	4.1	4.9	4.2	4.0	3.0
Of which:					
Industry	5.9	3.9	4.3	7.0	6.0
Construction	-4.2	3.9	2.0	4.0	5.0
Agriculture	-0.7	54.4	-2.4	-5.0	2.0
Transport and telecommunication	3.3	5.3	4.4	5.0	4.0
Services	4.0	1.9	4.7	3.0	1.0
GDP domestic absorption	6.1	4.2	1.4	1.5	1.0
Of which:					
Individual consumption	7.8	3.2	3.8	2.5	0.5
Accumulation of tangible assets (investment)	2.1	7.7	5.6	5.0	6.0
Foreign trade					
Exports	8.8	18.4	10.8	15.0	12.0
Imports	10.1	15.2	5.3	11.0	9.0
Consumer price index (previous year = 100)	4.7	6.8	3.6	3.9	5.8
Combined balance of the current account and the capital account					
– in billions of euros	-6.4	-6.7	-5.3	-5.3	-4.8
– as a percentage of GDP	-8.6	-8.1	-6.0	-6.2	-5.3
Unemployment rate	5.9	6.1	7.2	7.5	8.0
Consolidated general government deficit as a percentage of GDP (according to EU methodology, excluding pension fund contributions)	7.1	6.6	7.5	9.5	6.0

Source: GKI Economic Research Co. 2007

Hungary has seen successful transformation from a centrally planned economy to a free, fast-growing and robust market economy in the past 17 years.

The privatization process has been completed in most sectors, bringing foreign strategic investors as well as know-how, technology and best international practice into the country. As a result, the private sector accounts for over 80 percent of the GDP today.

Hungary has made significant progress in recent years in creating sustained economic growth – the growth rate was around four percent in each year in 1997-2006. Through the downturn in the global economy in the past years, Hungary achieved a GDP growth of 4.1 percent in 2003, 4.9 percent in 2004 and 4.2 percent in 2005.

Last year the economy lost momentum, Hungary achieved a GDP growth of 4,0 percent. This year – as a result of the austerity package of the government – the economy is expected to grow by 3.0 percent. (In 2006 the new elected socialist government passed an ambitious austerity package. The aim of the package is the consolidation of the Hungarian budget.) From 2008 the economy will gear up, predict analysts, as a result of the consolidation of the budget, the continuing capital inflow and the incoming EU funds.

Inflation has declined continuously over the past years – from about 30 percent in the mid-90s, the inflation rate fell to 3.9 percent in 2006.

Chapter 2

Foreign Investment in Hungary

The Hungarian Act on Foreign Investment specifies that investments by non-residents enjoy full legal protection and security. Additional protection for foreign investors is guaranteed by bilateral treaties in force.

Foundation of New Companies or Acquisition of Shares in Existing Companies by Foreign Investors

Foreign individuals and legal entities may found new companies or acquire shares in existing companies in Hungary. Companies, which are wholly or partly foreign owned, can, in practice, operate in all business areas. Where the chosen activity requires a permit (e.g., for banking activity) the same rules apply regardless of whether the owners of the entity are resident in Hungary or abroad.

Returns payable to Foreign Investors

A foreign company may establish a registered company branch or a representative office in Hungary. Branch offices and representative offices are not separate legal entities but an organizational unit of a foreign company. Representative offices are relatively easy to administer and their activities may be stopped immediately without consequence or requiring deregistration.

Branches and Representative Offices

A foreign company may establish a registered company branch or a representative office in Hungary. Branch offices and representative offices are not separate legal entities but an organizational unit of a foreign company.

Representative offices are relatively easy to administer and their activities may be stopped immediately without consequence or requiring deregistration.

Branches

Non-residents can conduct business in Hungary through branches registered with the Hungarian Court of Registration.

After registration, branches can carry out most business activities in Hungary without limitation: the branch cannot pursue representation activity on behalf of its founder. Naturally, the same business licenses must be obtained as are required for Hungarian legal entities.

The assets required for the operation of the branch must be provided by the founder of the branch office and the founder has an unlimited obligation for the liabilities of its Hungarian branch. The branch must keep its books in accordance with Hungarian accounting law, and prepare annual financial statements. Branches of non-resident entities with a registered office in one of the member states of the European Union are exempt from auditing obligation. The same applies to non-resident entities having their registered office in the territory of the Republic of Ireland, Grand Duchy of Liechtenstein and the Norwegian Kingdom.

The acquisition of real estate by a branch is subject to the Act on Acquisition of Real Estate by Non-Residents, similarly to any other non-resident company. In all other respects, the same rules are applied to branches as apply to resident legal entities (e.g., they are subject to Hungarian VAT, corporate income tax, local taxes, etc.).

Representative Offices

Certain activities of a non-resident entity may also be conducted through a representative office, which can be used to provide information concerning the non-resident's products and services and to a limited extent to assist the non-resident entity in the conclusion of contracts. Tax consequences should be carefully considered.

Representative offices must be registered at the Hungarian Court of Registration. A representative office of a non-resident company is permitted to assist in the preparation of contracts and to supply advertising services on behalf of the entity it represents. They are not allowed to engage in any other kind of commercial activity. In particular, representative offices of foreign law firms may not provide legal services or legal consulting services.

Although the accounting for Hungarian representative offices is not governed by Hungarian accounting legislation, most of the rules (e.g. double-entry bookkeeping, valuation rules etc.) should be followed by these entities if they are subject to Hungarian corporate income taxes. For example, acting as an agent for a non-resident may subject a representative office to Hungarian corporate income taxes.

In other respects, the same rules apply to representative offices as apply to other domestic business entities. For example, the employment of foreign or Hungarian employees results in the same administrative, personal tax and social security obligations as for Hungarian corporations or branches.

Chapter 3

Company Law

The primary legislation governing the form and regulation of companies is Act IV of 2006 on Business Associations (hereinafter 'Companies Act'), which came into effect on the 1st of July, 2006. This Act is the successor to Act VI of 1988 and Act CXLIV of 1997.

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

As a result of the accession of Hungary to the European Union as of 1 May, 2004 new forms of business associations have also been integrated to the Hungarian company law legislation. Such forms are the European Economic Interest Grouping and the Societas Europea.

Based on Act XLIX of 2003 (the EGE Act) the European Economic Interest Grouping (EEIG; in Hungarian: Európai Gazdasági Egyesülés – EGE) having its seat in the Hungarian Republic is a legal entity, which shall be formed, organized and operated upon the terms laid down in the Council Regulation (EEC) No 2137/85 on EEIG except those aspects regulated otherwise by the EGE Act, when the regulations of the Companies Act shall be applied.

The EGE differs from a firm or company principally in its purpose, which is only to facilitate or develop the economic activities of its members to enable them to improve their own results, its purpose is not to make profits for itself. Its activity shall be related to the economic activities of its members and must not be more than ancillary to those activities.

Consequently, an EGE may not: (a) exercise, directly or indirectly, a power of management or supervision over its members' own activities or over the activities of another undertaking, in particular in the fields of personnel, finance and investment; (b) directly or indirectly, on any basis whatsoever, hold shares of any kind in a member undertaking; the holding of shares in another undertaking shall be possible only in so far as it is necessary for the achievement of the grouping's objects and if it is done on its members' behalf; (c) employ more than 500 persons; (d) be used by a company to make a loan to a director of a company, or any person connected with him, when the making of such loans is restricted or controlled under the Hungarian laws governing companies. Nor must a grouping be used for the transfer of any property between a company and a director, or any person connected with him, except to the extent allowed by the Hungarian laws governing companies. For the purposes of this provision the making of a loan includes entering into any transaction or arrangement of similar effect, and property includes moveable and immoveable property; (e) be a member of another European Economic Interest Grouping.

Only the following may be members of an EGE: (a) companies or firms and other legal bodies governed by public or private law which have been formed in accordance with the law of a Member State and which have their registered or statutory office and central administration in the Community; where, under the law of a Member State, a company, firm or other legal body is not obliged to have a registered or statutory office, it shall be sufficient for such a company, firm or other legal body to have its central administration in the Community; (b) natural persons who carry on any industrial, commercial, craft or agricultural activity or who provide professional or other services in the Community.

A grouping must comprise at least: (a) two companies, firms or other legal bodies, which have their central administrations in different Member States, or (b) two natural persons, who carry on their principal activities in different Member States, or (c) a company, firm or other legal body and a natural person, of which the first has its central administration in one Member State and the second carries on his principal activity in another Member State.

The other new type of business association which may be founded as of October 8, 2004 in Hungary is the European public limited-liability company or Societas Europea (SE; in Hungarian: Európai Részvénytársaság). Based on Act XLV of 2004 (the SEAct) the SE having its seat in the Hungarian Republic has legal personality and shall be formed, organized and operated upon the terms laid down in the Council Regulation (EEC) No 2157/2001 on SE except those aspects regulated otherwise by the SE Act.

The capital of an SE is divided into shares, shall be expressed in euro, and must not be less than EUR 120,000. Employee involvement in an SE shall be governed by the provisions of Directive 2001/86/EC and Chapter II of the SE Act.

The capital of an SE is divided into shares, shall be expressed in euro, and must not be less than EUR 120,000. Employee involvement in an SE shall be governed by the provisions of Directive 2001/86/EC and Chapter II of the SE Act.

Act V of 2006 on company registration and voluntary liquidation is applicable for the registration and dissolution of business associations, branch offices, representative offices, EGE and SE.

Four legal forms of business associations are listed and governed by the Companies Act:

- Unlimited Partnership (Közkereseti Társaság – Kkt.)
- Limited Partnership (Betéti Társaság – Bt.)
- Limited Liability Company (Korlátolt Felelősségű Társaság – Kft.)
- Company Limited by Shares (Részvénytársaság – Rt.); a Company Limited by Shares can operate as a 'Closed Company Limited by Shares' (Zártkörűen működő részvénytársaság, in short 'Zrt.')
- if its shares are not put into public circulation (i.e., through a stock exchange) or as a Public Company Limited by Shares (Nyilvánosan működő részvénytársaság, in short 'Nyrt.')
- if its shares are put into public circulation.

The Kkt. and Bt. have elements which resemble partnerships in some ways but not to such an extent that they would be treated as such in all EU countries. The most important factor that separates Kkt and Bt. from Kft. and Rt. is that the members of Kkt. and Bt. have unlimited liabilities for the obligations of the company while the members (shareholders) of Kft. and Rt. have only limited liability. Another important difference is that the operation of Kkt. and Bt. is less formalized compared with Kft. and Rt. in respect of the decision making process, the increase or decrease of the registered capital, etc.

In practice, most foreign investors are likely to form or take a financial interest in either a limited liability companies (Kft.) or a company limited by shares (Rt.). These legal entity forms correspond to the company forms most commonly used by businesses in the European Union.

Foreign parties may found or become shareholders in a Kft. or Rt. if they are either a company under their domestic law or if they are individuals.

Specific rules applicable to Kft.'s and Rt.'s are discussed below following a summary of the rules applicable to all types of business associations, including the Kkt. and Bt.

Rules applicable to all Types of Business Associations

Articles of Association

An initial step in founding a business venture is the preparation of written Articles of Association (or 'Deed of Foundation'), which must be signed by all members (or their authorized representatives holding a power of attorney). An attorney or notary public must countersign this document.

The Articles must contain:

- the name, the company form and the registered office of the company;
- the name, the company form, registered office (address) and company registration number of the founders;
- the scope of the company's activities;
- the registered capital of the company, and the method (cash or in-kind) and date of contribution by the founder;
- authorities for signing on behalf of the company;
- name and address of executive officers;
- name and address of the auditor and supervisory board members, if auditor or supervisory board members were elected by the members;
- term of the company, if it was established for a definite period;
- other matters required by the Companies Act for the different forms of business associations.

A member providing in-kind contribution remains liable for five years to the company that their contribution was not worth less than the value stated in the Articles of Association.

Single-member Companies

Kft. and Rt. may be established and operated by a single member (shareholder), however at least two persons required for Kkt. and Bt. A company which is owned by one member is allowed to become sole member of another company (either set up a single-member company or acquire all shares or quotas of a company). The share capital of a company founded by a single-member must be paid up in full prior to submission of the application for registration.

It is the single-member's (shareholder) right and duty to make decisions on all issues falling within the authority of the general meeting (Member's Meeting) who shall notify the executive officers thereof in writing.

Pre-company Status

A new business association may begin to operate (e.g., enter into contracts, etc) from the date of the countersignature of the Articles of Association. However the business association will not be able to pursue any activities requiring a license until the Court of Registration has registered it since licenses are only granted to registered companies. Until it is registered, the business association has a special interim legal status as a 'pre-company'. This status has to be indicated on all company documents.

The rules applicable for the business association to be established apply to its pre-company, with the following exceptions:

- generally, no changes shall take place in the members of the pre-company;
- the articles of association shall not be altered, except to make corrections ordered by the court of registration;
- legal proceedings for the exclusion of a member shall not be initiated;
- no resolution may be made on termination of the entity without a legal successor, or transformation into any other business association or into a non-profit company;
- the pre-company shall not engage in any activity that is subject to prior official authorization (license);
- the pre-company shall not establish a business association, nor shall it join one as a member.

If the application for registration of a new business association is refused, the business association may not acquire further rights or assume new obligations, and must terminate its operations. The members (shareholders) are liable for debts arising from the undertakings of the executive officers up to the proposed registered share capital. The executive officers are personally and unlimitedly liable for debts exceeding the proposed registered share capital.

Registration

The foundation of a business association must be reported to the competent Court of Registration within 30 days of the countersignature of the Articles of Association. The Court must also be notified of any change in the registered data within 30 days of each change. If the court does not respond within a specific period of time, the registration is deemed to have occurred at the end of that period.

Business associations are deemed to be established as of the date of their entry into the register of companies. The pre-company status ends as of the date of registration.

The Management of a Company – Executive Officers

The duty of the executive officers is to manage the operation of the business associations which means passing resolution in all matters that do not fall into the exclusive competence of the Members' Meeting (General Meeting in case of Rt.) or the single member (shareholder) according to the Companies Act and the Articles of Association.

Individual persons can be appointed as executive officers (Managing Director, member of the Board of Directors, etc.) for a definite or indefinite period of time. If the appointment is for a definite period of time the term of the appointment cannot exceed five years. Executive officers may be re-elected, removed or recalled at any time without reasoning. The decision to appoint or recall executive officers and establish their remuneration falls within the exclusive powers of the members (shareholders) however the members may decide to transfer these rights to the supervisory board of the company, if elected.

Executive officers shall conduct the management of business association with due care and diligence as generally expected from persons in such positions and give priority to the interests of the business association. However in the event of any imminent threat for the business association's insolvency, the executive officers shall conduct the management of the business association giving priority to the company's creditors.

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

Supervisory Board

For the purpose of supervision of the business association's management, the members (shareholders) shall have the option – or the obligation in certain cases – to prescribe in the memorandum of association the appointment of a supervisory board. A Supervisory Board is comprised of non-executive directors.

The Articles of Association of Zrt. and Kft. may assign authority to the supervisory board to appoint or remove the executive officers, establish their remuneration and approve particular transactions (e.g. contracts).

The Companies Act reworded the previous provisions regarding the compulsory supervisory board election:

- All Public Companies Limited by Shares are obliged to set up supervisory boards except for any public or private limited company that is controlled by the one-tier system (by 'one-tier system' we mean that corporate structure when the Directors perform the duties of the supervisory board);
- A Closed Company Limited by Shares is not obliged to set up a supervisory board however a supervisory board must be set up if the shareholders, who represent at least 5 percent of the votes, require so.
- Establishment of a supervisory board shall be obligatory for companies where the annual average of the number of full-time employees exceeds two-hundred persons.
- Any companies without regard to company form shall be obliged to set up a supervisory board if separate acts require so in the interest of the public ownership.

Auditor

The auditor of a business association shall be responsible for carrying out the audit work in accordance with the Accounting Act and for determining as to whether the annual report of a business association provides a true and fair view of the business association's assets and liabilities, financial position and profit or loss and is prepared in full conformity with the effective legal regulations.

Appointment of an auditor shall be obligatory in every case when the Accounting Act requires so. Additionally, all Companies Limited by Shares is obliged to appoint an auditor. Also, Public Companies Limited by Shares must set up a so called 'Audit Committee' which consists of three members;

In order to be appointed as an auditor, the individual person or audit company must be registered in the list of registered accountants.

The auditor must be named in the Articles of Association and can be appointed for a definite period not exceeding five years. The auditor can be re-appointed following the end of his term of office.

The company must have the auditor to examine any report that is required to prepare in order to comply with the Accounting Act (not just its annual financial statements). Generally, the company's members may not make a decision to approve any report prepared pursuant to the Accounting Act in the absence of a written opinion from the auditor. Further, the auditor is expected to review all substantial business reports submitted to the members' meeting and report whether they contain correct data and comply with the law.

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

The auditor must safeguard the confidentiality of information he obtains about the affairs of the company.

A member (shareholder) of the company shall not be appointed as auditor. Executive officers, supervisory board members, their close relatives and employees of the company shall not be elected as the auditor of the company until at least three years after termination of their position.

The auditor must take part in meetings of the company's members. If required, the auditor may be invited to attend meetings of the executive board or the supervisory board with a right of consultation, or the auditor himself may initiate his attendance at such meetings. In this latter case, the auditor's request may only be refused in exceptional cases.

If the auditor verifies or otherwise learns that a significant loss of the company's net equity is probable he must request that a members' meeting be convened.

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

Termination of Business Associations

The business association shall terminate:

- if the period of time set forth in the Articles of Association expires or any other condition of termination is realized;
- if it resolves its termination without a legal successor;
- if it resolves its termination with legal succession (transformation – merger, demerger);
- if the number of its members declines to one person, unless otherwise allowed by the provisions on the individual forms of business associations (Kft. and Rt. can operate with only one member);
- upon being declared terminated by the Court of Registration;
- on other conditions depending on the actual form of the company.

Business associations are deemed terminated upon cancellation from the company register.

If a company ceases to exist without a legal successor, a 'final account' must be prepared, except when a winding-up procedure has been initiated due to insolvency. In this case, a liquidation procedure is followed in accordance with Act XLIX of 1991 on Bankruptcy, Liquidation and Final Account.

The closing balance is to be made by the liquidator(s), who can be appointed from the executive officers of the company, or the liquidator can be any private individual. Members representing one tenth of the votes or any creditor of the company may ask the court to appoint others as liquidators.

Transformation of Business Associations

Transformation can result from a change from one corporate form to another (e.g. a Kft. can re-register as an Rt., or vice versa), or from corporate reorganizations such as mergers and demergers. These can take a variety of different forms:

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

Compulsory Transformation

If a business association's equity shown in its annual report is less than the minimum capital required for its form of business association for two consecutive years, then the business association should be required to reregister as a different form of business association unless the members of the business association provide the necessary equity within a period of three months after the approval of the annual report for the second year.

The new form of business association chosen must be one for which the entity meets the minimum registered capital requirement or for which the Companies Act does not specify a minimum registered capital.

Liability of members of Business Associations

From 1 January 2004 Hungary has introduced a procedure whereby the 'corporate veil' (limited liability) can be lifted in certain circumstances. If the corporation cannot be found at its officially registered seat and its directors cannot be traced to their office addresses, the court can demand that the shareholders provide information on where the corporation can be found within 60 days. Failure to comply with this will result in the deregistration of the business association and may result in the loss of limited liability status. Loss of limited liability is only applicable for members (shareholders) having more than 50% stake in a business association and the total unfulfilled debt after the deregistration exceeds half of the Own Equity of the business association.

Limited Liability Company (Kft.)

The Limited Liability Company is a very popular form of company for small or medium-sized businesses in Europe. The Hungarian Kft. form is very close to the German and Austrian GmbH (Gesellschaft mit beschränkter Haftung) and similar to the British Ltd (private company limited by shares). It is possible to establish a single-owner Kft. The Kft. form is the most common company form for wholly owned subsidiaries.

Formation of a Kft.

In addition to the items mentioned above as rules applicable for all types of business associations, a Kft.'s Articles of Association (or Deed of Foundation) must include the following:

- the stake of each members;
- calculation of voting rights;

Capital Structure

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

Contributions in kind constituting a part of the subscribed capital may be any marketable object or intellectual work of pecuniary value, any right representing pecuniary value or any claim that is recognized by the debtor or that has been granted by a final and definitive court decision. Only those objects, intellectual works or rights, which can be subject to foreclosure and which can be transferred by the business association without the consent of a third party, may be taken into account as contributions in kind.

The amount of initial capital shall not be less than HUF 3 million. The Companies Act does not prescribe the ratio of in cash-in kind contribution. The registered capital of a Kft. might comprise exclusively in cash or in kind contribution.

Each member has an identified percentage share of the total capital and a single share may be owned by more than one person. A share cannot be less than HUF 100,000 and it has to be exactly divisible by 10,000.

The company may only be registered if, prior to the submission of the application for registration,

- contribution in kind has been made available to the company according to a Kft.'s Articles of Association, however if the value of the in kind contribution reaches or exceeds half of the registered capital the in kind contribution must be provided in full, and
- at least half of each contribution in cash has been deposited into the company's bank account.

The remaining part of the cash contribution must be made within one year of the registration and the remaining in kind contribution has to be provided within three years of registration. In case of a single-owner Kft., the value of the whole share must be made available at the foundation of the company.

Members' Meeting

The supreme body of a Kft. is the Members' Meeting, which must be held at least once a year.

The following falls, among other things, within the exclusive authority of the members' meeting:

- approval of the annual financial statements of the company, including the decision on the appropriation of after-tax profits (dividend);
- decisions on the payment of additional capital contributions and the repayment of capital;
- decisions to pay interim dividends;
- consent for the division of business shares, and approval for the withdrawal of shares;
- resolutions initiating the exclusion of a member;
- decisions on the repurchase of shares by the company, and the sale of these to members;
- election and removal of the Managing Director, and the establishment of his or her remuneration, as well as the exercise of employer's rights if the managing director is an employee of the company;
- election and removal of supervisory board members, and the establishment of their remuneration;
- election and removal of the auditor and the establishment of their remuneration;
- approval to conclude contracts which take place between the company and one of its members, its Managing Director or their close relatives;
- enforcement of indemnification claims against members responsible for the foundation of the company, Managing Directors or supervisory board members;
- the decision on termination without legal successor or transformation of the company;
- decisions on increasing or decreasing the registered capital;
- amending the Articles of Association;
- all issues which are assigned to the members' meeting by law or by the Articles of Association.

A simple majority is required to approve members' resolutions at the meeting, unless the Companies Act or the Articles of Association provide otherwise.

The members' meeting has a quorum if at least half of the registered capital or the majority of the eligible votes are represented, unless the Articles of Association stipulate a higher rate of participation. Unless otherwise provided by the Articles of Association, if the members' meeting did not have a quorum, any reconvened members' meetings called as a result of this shall have a quorum for the issues of the original agenda regardless of the percentage of the capital or voting rights represented by those present.

An extraordinary Members' Meeting shall be convened by the Managing Director promptly to consider any necessary action if the annual or interim balance sheet of the company shows that due to losses the owner's equity of the company has decreased to half of the registered capital or the company is threatened with insolvency or has suspended its payments and the assets of the Company do not cover its debts.

Managing Directors

The administration of the company's affairs and representation of the company is carried out by the Managing Director (or Directors).

Company Limited by Shares (Zrt. or Nyrt. – together Rt.)

A company limited by shares is the other popular corporate form for medium-sized or larger companies all over Europe. The Hungarian Rt. is very similar in form to the German and Austrian AG (Aktiengesellschaft) and similar to the British PLC (Public Limited Company).

An Rt. may be a private company or a public company. An Rt. is a private company if its shares are not issued publicly. An Rt. is a public company if at least some of its shares are issued to the public.

The share capital of an Rt. must not be less than HUF 20 million. The Companies Act allows that the share capital of a Zrt. might comprise exclusively in kind contribution.

Shares and Shareholders' Rights

Shares are securities embodying membership rights and can only be registered shares (issuance of bearer shares are not allowed).

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

All shareholders are entitled to participate, to request information and to make comments at members' meetings. Shareholders are entitled to make proposals and, if they hold shares with voting rights, to vote.

Shareholders are entitled to dividends voted by the members' meeting proportionately to the face value of their shares.

No dividends may be paid if as a consequence, the equity of the company limited by shares will be less than the minimum required share capital of an Rt.

General Meeting

The supreme body of a company limited by shares is the general meeting of shareholders.

Actions which fall within the exclusive competence of the general meeting, among other things, include:

- establishment and alteration of the Deed of Foundation (Articles of Association);
- decisions to change of the form of the company;

- decisions on transformation or termination without legal successor of the company;
- the election and removal of members of the board of directors, members of the supervisory board and the auditor, and the establishment of their remuneration;
- approval of the Annual Report, including the decision on the appropriation of after-tax profits;
- decisions to pay interim dividends;
- decisions on the acquisition of own shares;
- decisions to change the type of shares;
- decisions to convert the printed shares to non-certificated shares;
- decisions to modify the rights attached to different series of shares, and the share types and share classes;
- decision to issue convertible bonds;
- decision to increase or reduce the share capital;
- decision to exclude the execution of preferential prescription right;
- all issues which are assigned to the general meeting by law or by the Deed of Foundation.

The general meeting must be convened as frequently as required in the Deed of Foundation, but at least once every year. If so required, extraordinary general meetings may be held at any time.

The general meeting is generally called by the board of directors.

The general meeting has a quorum if shareholders representing more than half of the votes are present, unless the Deed of Foundation stipulates a higher rate of participation.

If the general meeting does not have a quorum, any reconvened general meetings will have a quorum in the issues on the original agenda irrespectively of the number of those present.

General meeting can be hold in such a way that the shareholders participate by using electronic telecommunication equipment. It is the free decision of the shareholders to decide that they will participate on the general meeting personally or by using electronic telecommunication equipment. Electronic telecommunication equipment means that closed system which enables to hold telephone- or videoconference and allows the identification and the uninterrupted conversation between the Shareholders, dependent upon the all-time condition of the electronic system which provides the technical background.

Board of Directors

An Rt. must have a Supervisory Board and a Board of Directors (except that the Deed of Foundation of a Zrt. may provide that there will be no board of directors and that the rights of the board of directors are to be exercised by a General Director.)

The Supervisory Board supervises the management of the company. The supervisory board may request information from the executive directors and officers, and may inspect the books of the company.

The board of directors is responsible for the management of the Rt.

The board of directors must consist of at least three and at most eleven members who must be natural persons. The board of directors elects its chairman from among its members.

The board of directors must exercise its rights and perform its duties as an independent body. The rules of procedure approved by the board of directors will provide for the allocation of tasks and responsibilities among the members of the board of directors.

The board of directors must ensure that the books of the company are kept according to the accounting law.

The board of directors must prepare reports on the management, the financial situation and the business policy of the company at regular intervals (at least once every year for the general meeting, and at least once every three months for the supervisory board).

The board of directors is responsible for preparing the Annual Report presented to the General Meeting and for presenting a proposal on the appropriation of after-tax profits.

The members of the board of directors participate in the general meeting of the company with a right of consultation.

Increase of Share Capital:

The share capital may be increased

- by the issue of new shares;
- to the extent that assets exceed share capital;
- by the issue of employees' shares;
- by the conversion of convertible bonds.

New shares or bonds may be issued publicly or privately.

The Deed of Foundation may authorize the board of directors to issue new share capital up to a defined maximum limit. Such authorization may be valid for a period of up to five years and for a share capital increase of up to 25 percent, and is renewable.

Reduction of Share Capital

The general meeting may decide to reduce the share capital and, in certain cases, is obliged to reduce the share capital. The share capital may not be reduced below the minimum registered capital (HUF 20 million).

If the reduction of share capital is not possible because the share capital of the company would fall below the minimum registered capital required, the general meeting must pass a resolution to transform the company into another form of business association, or to terminate the company.

In any share capital decrease, any own shares held by the company must be withdrawn first.

In respect of printed share certificates, the share capital reduction may be implemented:

- by exchanging the shares;
- by stamping the shares;
- by reducing the number of shares according to the procedure set forth in the deed of foundation.

Termination of Companies Limited by Shares

The general meeting of an Rt. may decide to terminate the company by a majority of three-quarters of the votes.

The assets of an Rt. undergoing voluntary dissolution may not be distributed until the company's deregister the Rt.

In the event of termination of an Rt. without legal successor, the assets remaining after the satisfaction of creditors must be distributed among shareholders on the basis of payments and contributions in kind actually provided, and in proportion to the face value of their shares. If the company has issued shares with preferred rights on liquidation, the rights granted by such shares must be taken into account when distributing the assets of the company.

Acquisition of an Influencing Interest in Business Associations

The Companies Act simplified the provision regarding the acquisition of interest.

These provisions are only applicable only for the members (shareholders) of Kft. and Rt. and are not applicable for Kkt. or Bt. The Companies Act regulate only one interest ratio that is the 'qualified interest' if a member (shareholder) h holds three-quarters or more of the votes in a Kft. or Rt.

The existence of 'qualified interests' must be reported to the Court of Registration by the member (shareholder) holding the interest within 30 days from the acquisition of such interests.

Please note that in case of public company limited by shares the Hungarian law may specify further obligations to comply with if somebody acquires interests.

Chapter 4

Working in Hungary

Working Permission

As a general rule foreign persons can usually be employed in Hungary only if they hold a valid work permit and stay visa or residence permit.

Stay visas: Foreign persons who want to enter Hungary to work must apply for a stay visa unless there is an agreement between Hungary and the relevant country. The stay visa is issued for one year. A stay visa is granted by any Hungarian embassy in the home country of the applicant. Stay visa can be applied for after obtaining the Work permit.

Residence permits: If the foreigner intends to work in Hungary and the stay visa has expired, a residence permit is required. The person must register and apply for a residence permit at the relevant police station for the place of residence. The registration procedure is subject to a fee.

Work permits: An application must be submitted by the employer to the relevant local Labor Center prior to applying for a stay visa (a so called 'Workforce demand'). Chief executives (including managing directors, general managers, board members of an Rt., members of the supervisory board, head of the Hungarian representation office and of the Hungarian branch office) appearing in the Company's documents filed with the Registration Court are not subject to work permit requirements. The required data and documents must be contained in the application. The work permit is granted for a maximum period of one year but may be extended.

An employee may begin to work in Hungary only after having received all the necessary permits.

As regards the employment of **citizens of the Czech Republic, Poland, Slovakia, Latvia, Lithuania, Estonia, Slovenia**, no Work permit is needed, and consequently there is no need to file a work force demand or to observe the 60 day deadline applicable in that case. If you wish to employ the citizens of these countries in Hungary, you shall only need to report their employment to the competent Labor Center, at latest on the day on which the employment starts (please note that the termination of the employment is also to be reported).

Additionally, the employee him/herself shall have to apply for a residence permit with the Immigration Authority within 90 days of entering Hungary. Such permit is valid for five years and is renewable. Furthermore, they shall need to report their residential address.

No work permit is needed for citizens come from **Finland, Great Britain, Ireland, Sweden, Spain, Portugal, Island and Greece** neither is the notification of the Labor Center necessary in their case. For **Danish, Belgian, French, Luxembourg and Norwegian citizens** a work permit is required, but their filing a work force demand is not. In case of all other EU countries (Austria, The Netherlands, Liechtenstein, Germany, Italy and Switzerland), the entire process of filing a work force demand and requesting a work permit must be followed.

Employment Law

The basic elements of employment agreements are regulated by the Hungarian Labor Code (Act XXII of 1992), which is broadly similar to employment law in other European Union countries.

The Law provides a basis for organized labor negotiations with trade unions or other representatives of employees (e.g., works councils). An employer may enter into only one collective agreement at a time. Notwithstanding this, more than one collective agreement may have effect on the employer (e.g., collective agreements of industrial branches or regions, if any). An employment agreement may not contradict the Labor Code or any collective agreement in force. An employment agreement can provide more benefits for the employee than those required by the Labor Code or a collective agreement.

Important minimum-provisions in connection with salaries include:

- 1) The basic salary, the place of work and the scope of work must be stated in the employment contract. (Every employee must have a written employment contract). As of 1 January 2006 the scope of work to be performed must be specified by the employer.
 - a) the basic work hours,
 - b) other components of the remuneration (e.g., bonus),
 - c) the date of payment of salaries,
 - d) the commencement date of the employment,
 - e) the amount of paid leave and the procedures for allocating and determining such leave,
 - f) the rules governing the periods of notice to be observed by the employer and the employee should their contract or employment relationship be terminated,
 - g) whether a collective agreement applies to the employee, and
 - h) the name of the trade union that represents the employee, and that work council, central work council, where elected or not.

(The employer is obliged to provide the above information to the employee in written form within 30 days after concluding the employment agreement).

- 2) There is a national Minimum Salary that must be paid to employees when they are employed full time (40 hours per week). As of 1 January, 2007 the minimum gross monthly salary is HUF 65,500, and as of 1 January, 2008 the minimum gross monthly salary will be HUF 69,000 according to Government Regulation No. 316/2005 (25. XII.).

Taxation

For taxes on dependent/independent personal services please refer to Chapter 6.

Chapter 5

Accounting and Auditing

Introduction

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

The current Act, introduced as part of the legal harmonization process in advance of EU Accession, replaces an earlier Act. The Act and its predecessor, the 1991 Act, draw on the Fourth, Seventh and Eighth Directives of the Council of the European Union. These Directives regulate, respectively: the financial statements of limited liability corporations; the basic rules pertaining to the preparation of consolidated financial statements; and the appointment and qualification of persons responsible for statutory audits. The acts and decrees dealing with banking and insurance companies are based upon the European Union Bank Accounting Directive and Insurance Accounting Directive, respectively.

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

Accounting Principles

The Act incorporates accounting assumptions and principles, which are predominantly the same as those approved by the International Accounting Standards Board ('IASB'). However, while some companies find it possible to report the same profits under Hungarian Accounting Law ('HAL') and International Financial Reporting Standards ('IFRSs'), there can still be significant differences between financial statements prepared in accordance with HAL and IFRSs. Some of these differences arise due to different recognition and measurement principles but normally most result from different presentation and disclosure requirements.

The Act adopts basic principles such as going concern, accruals, consistency and prudence. It requires annual financial statements to be prepared on the assumption that the entity will be a going concern. The principles of substance over form and materiality were first introduced in 1997 and have been increasingly invoked by preparers of accounts and auditors as these concepts have become more familiar. Effective from 1 January 2001, departure from the provisions of the Act is allowed when it is necessary to achieve a fair presentation.

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

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

Company bookkeepers are usually concerned to book accounting transactions in the way expected by the tax authority and to have the supporting documentation, which a tax authority auditor may be expected to request.

Accounting and Bookkeeping

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

- The accounting records of entities must be kept in accordance with the principles and rules laid down in the Act.
- This requirement does not preclude the use of accounting and reporting systems developed and/or held outside Hungary (e.g. in shared service centers). However, such systems must be capable of presenting accounting information in accordance with the Act and prime ledgers and accounting documents must be made available promptly in Hungary if requested for Tax Authority audits.
- The accounting records are generally closed out on 31 December each year. However, subsidiaries and branches of foreign entities except for banks and other financial institutions, and insurance companies can account to another balance sheet date if the

foreign entity's balance sheet date is not 31 December.

- The accounting records must be kept in the Hungarian language.
- Generally, the accounting records are kept and the financial statements are presented in Hungarian forint. Under very limited circumstances, other companies with a functional currency other than forint may keep their books and present their financial statements in their functional currency. To be able to use the company's functional currency instead of forint, the total of the absolute amounts of the financial assets and financial liabilities as at the balance sheet date and the total of the absolute amounts of the income and expense items for the year must be denominated in the functional currency in at least 75 percent in the previous and in the current year. Additionally, so called 'off-shore companies' are permitted to use another currency set out in their Deed of Association.
- Since 1 January 2004, single-entry bookkeeping is allowed only for a limited group of not-for-profit organizations.
- There is a standard chart of accounts comprising 9 prescribed classes of accounts and a memorandum class (Class 0):
 - The asset accounts are in Classes 1–3 and Class 4 includes the equity, provisions and liabilities accounts.
 - Costs are recorded in accounts classes 5 and 8 based on their nature, and revenues are recorded in the class 9 accounts.
 - Classes 6 and 7 may be used to account for direct and indirect costs based on their function. Their use is not mandatory, however, each entity is free to decide whether and how to use these classes of account.

There is flexibility to choose specific account headings to suit the business's needs within each class of the accounts.

- Descriptions of the accounting policies and the chart of accounts must be prepared. (These documents are usually among the first documents tax auditors look for to understand the entity's accounting policies and procedures.)
- Financial transactions should only be recorded in the books if they can be verified. In practice this means that bookkeepers expect to receive authorized supporting documentation before booking entries. It also means that they are sometimes reluctant to book accruals, estimates or provisions unless there is strong supporting evidence to substantiate these.

This last feature has implications for timely recording, for the preparation of reliable interim and management accounts, and for the ability to prepare annual statutory accounts reporting the same results as are shown in accounts prepared in accordance with IFRSs or parent company reporting rules. Many subsidiaries of multinational companies find it possible to book accruals at each month end and to report the same figures to their parent company as they do for local statutory purposes at year end but some incoming investors may be surprised by incomplete accruals and provisions, particularly in interim financial statements and management accounts.

Financial Reporting

All entities must issue a financial report following the end of each business year. The report is the responsibility of the entity and its authorized representatives. The form of report required is determined by the size of the organization and, in some cases, its method of bookkeeping. There are three different kinds of report:

- Annual Report
- Simplified Annual Report
- Consolidated Annual Report

So called 'pre-companies' (companies whose deed of association have been signed but which have not been registered by the Court of Registration) must prepare and publish a separate financial report covering the period from their date of formation until incorporation. In this case, the period end date is the date of incorporation.

Annual Report

Companies are generally required to prepare an Annual Report. The Annual Report consists of a balance sheet, a profit and loss account and a supplement (including a summary of accounting policies applied, notes to the accounts and a cash flow statement). A business report not forming part of the annual report must also be prepared. The balance sheet and the profit and loss account must each be prepared according to a prescribed structure and detail, in the Hungarian language and in HUF thousands (see *Accounting and Bookkeeping* for exceptions from using forint as a presentation currency).

The balance sheet and profit and loss account must be based on, and supported by, bookkeeping records. Comparative figures for the preceding reporting period must be shown.

The prescribed format for the balance sheet follows the format of the Fourth Directive of the European Union. As in the European Union, companies have a choice of profit and loss account format between a total cost model and a cost of sales model. The Act permits companies to adopt the model which the company considers to be most appropriate to the nature of its business.

The Supplement includes additional information necessary to give a true and fair view of the financial position and results of the business. This includes explanations of the accounting policies applied in the accounts and the cash flow statement.

The Business Report provides a commentary by management on the financial position presented in the accounts.

Simplified Annual Report

Companies which meet two of the three criteria detailed below in the preceding two years are permitted to prepare a Simplified Annual Report:

- total assets at year-end do not exceed HUF 500 million;
- annual net sales do not exceed HUF 1,000 million; or
- the yearly average number of employees does not exceed 50.

A Simplified Annual Report consists of a balance sheet and a profit and loss account simplified to show only certain headings and a simplified Supplement (for example, this need not include a cash flow statement or a movement schedule of the tangible and intangible assets).

Consolidated Annual Report

In addition to their separate accounts, companies having a majority holding in or exercising control over subsidiaries must prepare a consolidated annual report if they have met two of the following criteria during the preceding two years:

- Total unconsolidated assets exceed HUF 2,700 million,
- Total unconsolidated sales revenue exceeds HUF 4,000 million; or
- Total number of employees of the group exceeds 250.

The above exemption does not apply to banks, other financial institutions, insurance companies, and companies whose debt or equity securities are publicly traded.

A parent company which has one or more subsidiaries is not obliged to prepare a consolidated annual report, if it is itself a subsidiary of a company resident in the European Economic Area which is obliged to prepare a consolidated annual report under the Act or the applicable EU requirements (and has included the parent company and its subsidiaries in its own consolidated annual report). This exemption does not apply to the issuers of publicly traded debt or equity securities.

Consolidated accounts should present a true and fair view of the group's transactions with third parties. To this end, all intra-group transactions and balances are eliminated. The consolidated annual report consists of a consolidated balance sheet, profit and loss account and supplement. A consolidated business report must also be prepared.

Effective from business years beginning on or after 1 January 2005, listed companies must, while other companies may, prepare and present their consolidated financial statements in accordance with IFRSs as adopted for use by the EU.

Accounting Rules

Accounting Convention

Transactions are normally recorded at historical cost. Inflation accounting is not permitted. General revaluations of assets are only permitted in exceptional circumstances (such as on merger or the transformation of a company from a Kft to an Rt). Contributions in kind are recorded at the value recorded in the Deed of Association.

Foreign Currency Translation

Transactions denominated in foreign currency must usually be recorded at the exchange rate applicable on the day of the transaction. Differences between these amounts and the subsequent cash settlement must be recorded as financial expense or financial income.

Any balances denominated in foreign currency at year-end are valued at the year-end rate. The unrealized foreign exchange gains and losses deriving from the year-end valuations are netted. The net foreign exchange gain or loss is recognized in the profit and loss account.

There are special rules for unrealized losses on foreign currency loans taken out for the purpose of acquiring fixed assets. The loan amount is reported in the balance sheet at the current year-end rate but the unrealized loss can be deferred and taken to the profit and loss account in annual installments over the repayment period of the loan. should be eliminated On partial or full repayment of the loan previously deferred unrealized losses corresponding to repayment amounts become realized and must be charged to the profit and loss account immediately. Any unrealized foreign currency gain arising on the loan should be netted against the deferral.

Fixed Assets

Tangible and some intangible fixed assets may be recorded at cost less depreciation and impairment or revalued amount. If revaluation is undertaken, it is not necessary to revalue all the assets within the same class. Assets under construction, bonds and other securities held as income earning investments, goodwill, capitalized foundation, restructuring and development costs may not be revalued upwards. The revalued amount of assets must be reviewed annually.

If assets are revalued upwards, the revaluation surplus must be recognized directly in equity and presented separately as a revaluation reserve. Subsequent adjustments in the revaluation surplus are charged directly against the revaluation reserve; the depreciation charge recognized in the profit and loss account is based on the historical cost.

If assets are revalued downwards below their carrying amount, the revaluation deficit must be recorded in the profit and loss account as extraordinary depreciation.

The depreciable amount of most assets (other than land and works of art; and those assets, including goodwill, whose value does not diminish through use) must be depreciated or amortized over their expected useful lives, as determined by management. If there has been a permanent decline in value of a fixed asset (including securities and shares) as at the Closing Date for the preparation of the balance sheet, additional depreciation should be charged to reflect the revaluation of the asset to its market value. 'Permanent' means in evidence for at least one year. If the market value has been significantly less than the book value for at least one year, then a write down must be made. Impairment losses must be reversed if no longer appropriate due to a subsequent increase in market value.

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

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

Goodwill might not be recognized under certain types of business reorganizations.

Inventory

Inventory is valued at the lower of cost or realizable value. Cost can be calculated on a first in, first out or average cost basis. Inventories must be written down to market value in the case of loss in value but provisions, as distinct from write-downs (e.g., for slow moving goods) are not permitted. Write-offs must be reversed if no longer appropriate due to a subsequent increase in market value.

Securities

Long-term securities (held for investment or trading purposes) should be valued at cost unless the market value has decreased significantly below cost for at least one year at the date of preparation of the balance sheet. Securities with a maturity of not more than one year (short-term securities) should be valued at cost unless it is not expected that the face value will be repaid by the issuer.

Export Subsidies

Any export subsidies due may only be recorded as income when claimed, not when receivable.

Capital

A special non-distributable reserve must be separated within equity for certain capitalized costs and future liabilities. Dividends can be paid only if the total equity, excluding the non-distributable reserve, after the dividend payment, exceeds or equals the registered capital. Minority interests are disclosed separately as part of equity.

Liabilities

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

Provisions

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

Provisions are required to be made against specified kinds of liabilities: legally enforceable guarantees (such as warranties), early retirement pensions and severance payments. It is also possible to record provisions against other losses that are likely or probable to occur and can be estimated with reasonable certainty.

Profit and Loss Account Presentation

The principle of completeness (grossing up) means that some related items are presented separately in the profit and loss account. For example, the proceeds of fixed asset disposals and the write back of the prior year impairment of assets are reported under Other Income, whereas the book value of fixed assets disposed of and the full amount of the write down required at the current year end are reported under *Other Expenses*.

Dividends approved after the balance sheet date (at the annual general meeting or members' meeting) should be recognized as liabilities on the balance sheet date and presented on the face of the income statement as a deduction from profit for the year.

Extraordinary Items

Whereas IFRSs prohibit, HAL requires certain income or expense items to be categorized as extraordinary. Even immaterial and recurring amounts should be reported as extraordinary, if they are outside the normal course of business.

Extraordinary items include development grants, the value attributable to assets received as gifts and redemption of treasury shares. Further, the grossing up principle means that elements of a single transaction are sometimes reported separately under extraordinary profits and extraordinary losses. For example, the redemption of treasury shares will result in the presentation of an extraordinary loss (the book value of the treasury shares redeemed) and an extraordinary profit (the nominal value of the treasury shares redeemed), rather than simply the net profit or loss.

Prior Year Material Errors

Significant errors detected from prior years must be adjusted directly against the retained earnings and presented in a separate column of the financial statements. The amount which is considered significant can be decided by the company but cannot be more the lower of 2 percent of the total assets for the year in question and HUF 500 million. This amount could be below what is considered material under IFRSs. There are detailed rules defining what a significant error is and how the calculation of the total of significant errors is to be made. Errors increasing and decreasing profits cannot be netted in arriving at this total.

Fair valuation

Fair valuation of financial instruments and hedge accounting may be applied as an option from 2003. If fair valuation is applied, the classification of financial instruments and the recognition requirements are similar to those of IAS 32 and IAS 39. However, there are significant differences from IFRSs in terms of measurement.

Disclosure

The disclosure requirements in Hungary are less extensive than under IFRSs. Under HAL there is no requirement to disclose earnings per share or segment information in the financial statements.

Consolidated Financial Statements

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

Filing Requirements

All legal entities, which are registered in the Trade Register and maintain double or single entry books, must file their Annual Report together with the related auditor's report (if any) with the Court of Registration within 150 days after the balance sheet date. The managing director of the entity must sign the Report. It should contain the auditor's report, where an audit is required, as well as the proposal or resolution pertaining to the appropriation of the after-tax profit. The business report need not be filed but must be available for inspection at the registrant's own head office.

Consolidated Annual Reports must be filed within 180 days of the balance sheet date. Many Hungarian companies still tend to publicize their separate company results and regard the preparation and issuance of their consolidated accounts as less important.

Under Budapest Stock Exchange rules, listed companies must issue their preliminary un-audited announcement within 45 days of the year-end, the audited separate and consolidated financial statements within 120 days of the year-end.

Publication

All entities keeping double-entry books are required to publish their annual report and the related auditor's report (if any). However, there is no requirement to publish this information in any newspaper. The business report is not required to be published. The requirement must be satisfied by filing the information at the Company Information Office of the Ministry of Justice (in addition to filing the same information with the Court of Registration).

Auditing

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

There are exemptions for small companies. Companies with less than HUF 50 million average annual sales over the past two years (pro-rata annual sales in the first accounting year) do not have to appoint an auditor. There is no audit exemption for branches of foreign companies or group companies, banks and insurance companies; these must always be audited.

The independent auditor must be an individual or an accounting firm registered at the Chamber of Hungarian Auditors ('Registered Auditor'). If an accounting firm has been appointed as auditor, an individual Registered Auditor from the firm must be nominated as the responsible auditor and the audit report must be signed by this individual.

Only certain individuals and firms are authorized to sign audit reports on banks and insurance companies, member firms of the Budapest Stock Exchange ('BSE') or companies listed on the BSE. KPMG Hungária Kft. is one such firm.

Under the Act, the purpose of an audit is to establish that the annual report (or simplified report) has been drawn up in accordance with the Act and provides a true and fair view of the financial position and results of operations of the entity in accordance with HAL.

An auditor is entitled to request the company to provide facts and information in the course of an audit. Auditors have a duty of confidentiality with respect to the facts and information that they become aware of in the course of their duties. The auditor is required to draw attention to any breaches of the law or other matters detrimental to the

company's present situation or prospects (including losses of share capital, for which special rules apply) and may initiate the convening of meetings of management or shareholders if the circumstances justify this. The auditor must attend the general meeting of a the company approving the financial statements audited by the auditor.

Registered Auditors and the Chamber of Auditors are regulated under Act XV of 1997. The Chamber of Auditors has had certain responsibilities delegated to it by the Ministry of Finance. To become an individual Registered Auditor it is necessary to have at least three years' relevant work experience and to pass exams set by the Chamber.

The Chamber of Auditors is also responsible for auditing standards and has adopted International Standards on Auditing ('ISA'). Individual Standards were introduced over a three-year period (1999 to 2001) and all auditors are expected to comply fully with ISA (adapted as necessary to deal with particular local issues).

Other Matters

Specific rules and legislation apply to certain types of entities.

Banking and other financial institutions are legislated for under Act CXII of 1996 on Financial Institutions and Financial Institutional Activities and associated rules and regulations. Special accounting rules require banks to establish a risk reserve to cover the risks associated with off balance sheet commitments and contingencies. Other risks such as credit risk, country risk and investment risk should be considered in the valuation of the related assets at the balance sheet date (i.e., any specific provisions should be reflected in the reported value of the asset).

Insurance companies are legislated for under Act XL of 2003 on Insurance Companies and Insurance Activities.

Brokerage firms are regulated by Act CXX of 2001 on Capital Markets. Brokerage firms must also meet the requirements of several sets of rules and regulations established by the BSE.

Chapter 6

Taxation

Introduction

Personal income tax and VAT were introduced into the Hungarian tax system in 1988.

This was a first step in a long process of tax reform. The next major step, undertaken in 1991, was the modernization of the corporate income tax system.

In 1993, the VAT legislation was further modified to conform, at least in principle, to the VAT systems used in the European Union.

1995 witnessed the introduction of a two-tier corporate tax system, comprised of a standard rate and a supplementary tax. New legislation, which came into force in 1997, left the standard rate untouched while replacing the supplementary tax with a withholding tax.

With Hungary's accession into the European Union, several changes have been implemented in the Hungarian tax legislation during the past few years to comply with the EU tax directives (e.g. Parent-Subsidiary Directive, Mergers Directive, VAT Sixth Directive).

The current, significant taxes and levies imposed in Hungary are:

- Corporate Tax
- Solidarity tax
- Bank Tax (now replaced)
- Personal Income Tax
- Social Security Contributions
- Simplified Tax and Contributions
- Gift and Inheritance Taxes
- Value Added Tax
- Customs Duties
- Excise Duties
- Motor and Vehicle Tax
- Registration Fees and Stamp Duties
- Property Transfer Tax
- Contribution to the Rehabilitation Fund
- Contribution to the Vocational Training Fund
- Contribution to the Cultural Fund

- Environmental Protection Charge
- Environmental Pollution Charge
- Innovation Contribution
- Energy Tax
- Registration Tax
- Luxury Tax

Corporate Tax

The basic principles for the taxation of business profits are detailed in the Corporate Tax Act. The taxable income of Hungarian companies is subject to corporate tax at a rate of 16 percent. From 1 January 2006, certain taxpayers which do not obtain tax incentives provided for in the Corporate Tax Act are taxed at a rate of 10 percent up to an amount of HUF 5 million positive tax base. The reduced rate is only applicable if requirements are met in respect of the number of employees and the amount paid on pension and health insurance contributions. The aim of this regulation is to support the small and medium sized enterprises.

There is no dividend withholding tax in Hungary as of 1 January 2006. As a result of this amendment the EU parent-subsidiary directive has become irrelevant in the context of dividend payments made from Hungary to an EU-based parent company.

As of 1 January 2006, offshore companies – taxed at a reduced rate of only 4% from 1 January 2004 – lost their offshore status; however, they can operate as normal Hungarian entities going forward.

The following table sets out as an example the rates of tax applicable in 2007 to corporate profits including the effect of surtax (so called solidarity tax) for corporations (introduced from 1 September 2006).

	Tax rate	Tax (HUF)	Income (HUF)
Taxable income			100,000
Corporate tax	16%	16,000	
Solidarity tax			84,000
Balance of undistributed income available for distribution as gross dividend			80,000
Tax charged on dividend payable to the company	0%	0	
Total tax charged on distributed income		20,000	
Net distributed profits			80,000

Determination of Taxable Income

The basis of assessment is the profit shown in the financial statements of the taxable entity, as adjusted by various additions and deductions required under the Corporate Tax Act.

The Act provides special rules, among others, for the handling of:

- Non-business expenses
- Depreciation
- Loss in value
- Receivables forgiven
- Thin capitalization
- Research and Development expenses
- Transfer pricing
- Loss carry forwards
- Inter-company interest; stock-exchange gains; royalties
- Local business tax
- Capital gain participation exemption

Non-Business Expenses

In general, expenses considered incurred for non-business reasons are not deductible for tax purposes. The tax legislation provides a list of various costs and expenditure that are not seen as incurred in the interest of the business, and hence, not deductible.

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

As of January 1, 2007, write offs on participations arising from investments made to solve negative equity problems through an increase in share capital are not subsequently allowed for corporate income tax purposes.

Depreciation

No depreciation is allowed on assets that have not been put into use or are still considered to be part of construction-in-progress.

Since 1997, the Tax Law dealing with Deductions stated that the depreciation allowed would be limited to the lower of the rates stated in the Corporate Tax Act or the amount of depreciation charged in the Financial Statements in accordance with the provisions of The Act on Accounting. However, effective 1 January 2001, the corporate tax depreciation rates must be used to determine the allowable deduction for tax purposes.

The Act on Accounting relates depreciation rates to the expected useful life of the asset. The exact text is as follows: 'the absolute amount of depreciation shall be planned with regard to the expected use of the individual asset, its duration arising therefrom, its physical wearing out and obsolescence, as well as to the circumstances typical of the

entrepreneurial activity concerned'. It can be seen that the criteria include not only physical life but also useful economic life.

The following table sets out most of the current maximum rates, for corporate tax purposes:

Machinery and equipment, breeding stock	14.5%
Computers	33%
Vehicles	20%
Buildings	2% / 3% / 6% (Depending on type)
Intangibles	Accounting Life
Leased assets:	
Leased Buildings	5%
Equipment in leased buildings and other leased tangible assets	30%

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

- 50 percent depreciation can be claimed on general IT machinery and on equipment exclusively serving motion picture and video production.
- Taxpayers can claim 50 percent depreciation in connection with brand new tangible assets that are acquired or produced in or after 2003 and which would otherwise be subject to a 33 or 14.5 percent rate; the same rules apply to intangible properties purchased or produced and to the capitalized value of experimental development.
- A taxpayer is permitted to deduct a development reserve, i.e. amounts expected to be spent on capital expenditure in the four years following the creation of the reserve. However such a reserve can only reduce the pre-tax profits by up to 25% (with an upper limit of HUF 500 million). In the tax return, development reserve may not be utilized for an investment or an asset purchased, which may not or should not be depreciated (e.g. land) based on the accounting regulations.

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

It is important to note that the amount of development reserve limits the dividend payment potential of the taxpayer, as it is accounted for through a transfer from profit reserves.

Any tax relating to that part of the development reserve, which is only utilized, or which is not utilized after the relevant deadline should be paid over together with default penalties.

Receivables Forgiven

Expenditure accounted as a consequence of forgiven or written off receivables are not deductible for tax purposes unless regarded as irrecoverable debts for accounting purposes.

Thin Capitalization

New legislation was initiated in 2001 that changed not only the debt to equity ratio for thin capitalization calculation purposes to 3:1 but also the definition of which debt instruments are included in the calculation. The revised definition indicates that interest on loan instruments payable on all of the taxpayer's non-trade and non-financial institution creditors is included when calculating the ratio. Accordingly, the thin capitalization rules cover interest on loans granted by both related and unrelated parties and also extend to bonds (not for bonds issued to reimburse normal liabilities towards suppliers) and other loan securities issued exclusively to one party (i.e. closed securities). The thin capitalization rules provide an exemption for loans made through banking institutions. From 1 January 2006 all (not made through banking institutions) liabilities on which interest is paid should be taken into account during the calculation. This means that interest paid in respect of cash pooling arrangements will also be subject to the potential non-deductibility rules.

R&D expenses

Generally, a double deduction can be claimed for R&D expenses. Nevertheless, there is only a single deduction for R&D activities supported by governmental (subsidies to the extent of the subsidies), or if the R&D activity is rendered by other taxpayers directly or indirectly.

Transfer Pricing

Transfer pricing rules allow the tax authorities to adjust taxable profits where transactions between related parties are not at arm's length. The current legislation prescribes not only the methods applicable for determining a fair market price but also the way in which these should be applied. The taxpayer may calculate the fair market price using any alternative method, provided they can prove that the market price cannot be determined by the methods included in the Act, and the alternative method suits the purpose. OECD transfer pricing principles are generally accepted in Hungary.

As of 2005, these rules should also be applied to transactions where registered capital is provided in the form of non-cash contribution, the decreasing of registered capital and in-kind withdrawal in case of termination without successor, if this is provided by or provided to a shareholder that has majority ownership in the company.

Taxpayers are obliged to produce detailed transfer pricing documentation. This documentation should be prepared by the deadline for the submission of the annual corporate income tax return of the company. Nevertheless, these records do not have to be filed with the tax return itself but must be available at the time of subsequent tax authority investigations.

As of 1 January 2007, advance pricing agreements (APA), a legal framework similar to binding ruling requests is established concerning the process of determining regular market prices. In this process, the Tax Authority will resolve the following with respect to a future transaction between related parties: the method to be applied for determining market prices, the facts and conditions underlying the transaction, and – if possible – the market price or range of prices.

Loss Carry forwards

Under the effective legislation, 2004 and subsequent losses can be carried forward without time limitation. However, should the taxpayer have a negative profit before tax position and have tax losses for two consecutive years (after the initial start-up period) or the total revenue of the company in the tax year does not exceed 50 percent of the total costs and expenses, the carrying forward of losses is subject to permission from the tax authority. The request should be presented by the deadline for tax return filing (or self-revision). Missing such an attachment would mean that the losses incurred cannot be utilized. The tax authority grants such permissions if the taxpayer can prove that the losses were incurred due to unavoidable external reasons or all reasonable efforts were made to mitigate such losses.

For companies formed before 16 June 1998 the start up losses of the first year of operations and the next two years could be carried forward indefinitely. Companies formed since 16 June 1998 with no predecessors may now carry forward losses incurred in the year of establishment and in the three subsequent tax years thereafter for an unlimited period of time.

In the event of transformation, a legal successor is permitted to use the losses of a predecessor, although the rules have changed since 2000 in this respect and so care is required for older losses. There are anomalies in the law and so care is necessary in this area.

No loss carry forward is available for financial institutions.

Inter-company interest; stock-exchange gains; royalties

The following is implemented in the Hungarian corporate income tax law

- The taxpayer can decrease its pre-tax profits by 50 percent of royalty income received
- Any capital gains realized in excess of expenditure accounted for from stock exchange transactions contracted on a regulated market decrease the taxable basis.
- The taxpayer can generally deduct 50 percent of net inter-company interest receivable.
- 50% of the net income realized on trading in emission quotas (with the exception of the quotas received without consideration from the state), and 50% of the income realized from the commissioning or handling of the quotas of other persons can decrease the taxable basis.

The above deductions are collectively limited to a maximum of 50 percent of profit before tax.

Local business tax

Taxpayers can decrease positive pre-tax profits (i.e. a tax loss cannot be created or augmented) by 100 percent of the amount of local business tax payable accounted for as expenditure. This effectively means a double deduction possibility for local business tax expenses.

Capital Gains Participation Exemption

As an incentive for the establishment of holding companies in Hungary, domestic or foreign participations of over 30% acquired from 1 January 2007 would be considered as 'an announced participation', where this is reported to the Tax Authority within 30 days following the acquisition. Any loss on write off, foreign exchange or loss suffered during cancellation from the books (except during transformations) should be added back to the corporate income tax base. The capital gain on such participations held for at least 2 years will be exempted from corporate taxation.

An investment can not be treated as an announced participation and the special rules applied if it was taken in a controlled foreign company.

Non-resident Companies

Branches and Permanent Establishments

Non-residents are in most cases able to conduct business in Hungary through branches registered with the Hungarian Court of registration, if they do not want to establish a Hungarian registered company. Hungarian branches are treated as any other corporate income taxpayer.

Tax Incentives

As a result of Hungary's EU accession, the intervention of the state in the private sector has had to be limited.

Tax Allowance for Small and Medium-sized Enterprises

(effective as of 1 January 2001)

Small and medium sized companies, as defined by the relevant authority, may apply for a tax incentive with regard to the interest payable on loans borrowed from a financial institution for the purpose of purchasing or manufacturing tangible assets (including a second loan obtained to refinance an existing one). The company must qualify as a small or medium sized company on the last day of the tax year when the loan contract is entered into and the contract must have been entered into on or after 1 January 2000.

The available tax incentive equals 40% of the interest paid on the loan in a tax year.

Development allowance

The Ministry of Finance grants tax incentives for a maximum 10-year period for investments, which are executed within the framework of the development program published by the government. The corporate income tax law prescribes the following investments, for which taxpayers could be entitled for development tax allowance:

- 1) For investments of at least HUF 3 billion at present value or in case of investments in certain special investments of at least HUF 1 billion (present value), which meet either of the following requirements during the four years following the first year in which the tax allowance is utilized:
 - the average number of persons employed should exceed by at least 150 (75 in certain special regions) the average number of persons employed in the year prior to the commencement of the investment; or
 - the taxpayer's annual wage costs should exceed by at least six hundred times (or by three hundred times in the case of certain special regions) the minimum wage calculated for the tax year compared to the wage costs of the year prior to the commencement of the investment or
- 2) For investments of at least HUF 100 million at present value for:
 - projects bringing an existing food facility producing foodstuffs of animal origin into compliance with the requirements laid down in legal regulations concerning food hygiene (permission of the European Council is needed as of June 1, 2007)
 - independent environmental protection or rehabilitation projects,
 - broadband Internet service projects (permission of the European Council is needed as of June 1, 2007)
 - motion picture and video production,
 - projects commencing or expanding R&D activities in certain places.
- 3) 3) For investments creating new jobs for the initial year and the following five years. The requirements for this allowance are depending on the size of the corporations (large/medium/small) and on the location (such as preferred, small county etc.). For example, in cases of a new category called investment implemented in the 48 most disadvantaged regions the required minimum increase of employees will be 20 or 5 for small and medium sized corporations.

The tax allowance can be utilized in relation to the above investments if the project in question is for the creation of a new facility, the expansion of an existing one, or involving a significant improvement in the product that is manufactured or in production technology.

For eligibility for the tax allowance the requests should be submitted to the appointed minister who shall grant an authorization in decree when the present value of the investment, costs and expenditure exceeds EUR 100 million. If this value is lower than EUR 100 million, only notification is needed prior to commencement of the investment.

The decision must be adopted within 60 days from the date when the application was submitted or when re-submitted. This deadline may be extended once, by a maximum of 60 days. The tax payer should present the required data to the appointed minister before the investments starts.

The benefit of this incentive is a tax relief of up to 80 percent of the corporation tax liability, however in total no more than a certain percentage (intensity ratio) of the capital invested, defined or staff costs (depending on the particular industry).

Tax Benefit on Software Development Wage Costs

A new tax benefit was introduced in 2005 such that 10% of the payroll costs booked as direct R&D costs and 10% of the payroll costs of software developers may be deducted from the payable corporate income tax in the respective tax year and in the next three years in equal instalments, provided that the taxpayer has payable corporate income tax in the respective period. If there is no tax liability in that tax year, any remaining amount can be carried forward to be utilized in the following year. The maximum amount of tax benefits is capped at 70% of the calculated tax liability.

Relief from Tax

Foreign Tax Credit

A domestic tax credit system is available for corporations in order to avoid double taxation on foreign-source income other than dividends (which are usually exempt). Hungarian tax treaties apply either the exemption or the credit method to prevent double taxation.

Surtax (so called solidarity tax) for corporations

From September 1, 2006, a surtax of 4% is levied on corporate entities. The tax is calculated on the accounting pre-taxation profit increased by grants provided, assumed liabilities, amounts of free service provision and the tax paid abroad accounted as expenditure, and decreased by grants, income received from assumed liabilities, amount of services received for free and dividends received. When calculating the tax base for solidarity tax, the tax base amendment rules for preferential transformations, preferential exchanges of share and preferential transfer of assets should be used in accordance with EU legislation.

4% of the tax base should be declared and paid by the deadline for preparing the financial statements. In addition, quarterly tax advances should be paid in equal amounts based on the previous year's tax liability that should be supplemented up to the actual year's tax liability by 20th of the last month of the tax year (top-up liability).

In accordance with international treaty regulations, foreign taxes can be credited against the surtax or income taxable abroad can be exempted. The surtax should be accounted for similarly to the corporate income tax, and so it does not decrease the amount of pre-taxation profit.

Withholding Tax

Dividend withholding tax was abolished with effect from 1 January 2006. As withholding taxes on royalty and interest income were abolished earlier, companies (foreign or domestic) will not be liable to any withholding taxes on any type of Hungarian source income paid to companies (but not to individuals).

Taxation of Individuals

Personal Income Tax

Residence

Under Hungarian domestic law, individuals with Hungarian citizenship (with the exception of dual citizens without a permanent or habitual residence in Hungary) and foreign nationals with a valid permanent residency permit and stateless persons are treated as residents for income tax purposes. In case of other natural persons, the residence status can be determined first by permanent residence, second by the center of vital interests and third by habitual abode. Individuals are considered to have an habitual abode in Hungary if they stay in the country for more than 183 days (including the date of arrival and the date of departure) during a calendar year.

There is no codified test for the application of the 183 days but in practice it is understood to be a physical presence test. In the case of any doubt, an individual is responsible for proving that his/her stay did not exceed 183 days.

Non-resident individuals are subject to income tax on their Hungarian source income under the same rules as residents i.e. same tax rates. For tax purposes Hungary means the territory of the country. Hungarian resident individuals are subject to individual income tax on their worldwide income.

Income derived from Hungarian sources is in particular:

- Income derived from employment with a Hungarian employer;
- Income from activities exercised in Hungary; and
- Income from assets (any property value) situated in Hungary.

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

Income

Individuals are subject to tax on a progressive basis on the aggregate amount derived from different types of income unless the income is specified as non-aggregated income (e.g. dividends) that is taxed separately at flat rates (see below). Income is defined as 'any increase in wealth or value obtained in any manner and form'.

Income of directors, regardless of whether or not they carry out their function as employees, is taxed as employment income. The term 'director' is not defined under the income tax law.

Rates

The individual income tax is levied on the aggregate taxable base according to a progressive scale. There is a two level tax table for 2007, as illustrated below. Tax on employment income from a Hungarian employer is withheld at source by the employer.

Annual taxable income in HUF	Tax payable
0 – 1,700,000	18%
Over 1,700,001	306,000 + 36% on the excess over 1,700,000

Flat rates applicable to certain types of income are as follows:

- 20% on interest income from saving deposits
- 20% on gains realized on stock exchanges from trading options and futures
- 25% on income from lending of securities
- 25% or 35% on dividends (depending on ownership proportions)
- 25% on certain capital gains from trading options and futures
- 25% on gains from the alienation of immovable property
- 54% on the value of benefits provided in kind (payable by the provider).

Taxation of Certain Specific Benefits

- Housing provided by a Hungarian entity both in cash and in kind is taxed as a part of employment income if supported by an employment contract or as benefit in-kind under certain circumstances. In the case of foreign employees, who are only seconded to Hungary and do not possess an employment contract with a Hungarian entity, housing may be treated as a non-taxable benefit in kind.
- Company cars used for private purposes are taxed according to special rules. This tax is based on the value, the age of the car and when it was placed into service. The tax is due and payable monthly by the Hungarian benefit provider company.
- Relocation services provided by the employer in kind are no longer tax exempt. All allowances are taxed as cash benefits. Reimbursement of home leave expenses of family members is taxed as a cash benefit. Professional training of employees may be treated as business expenses.
- Should the interest charged on an employee loan be less than the Hungarian National Bank prime rate plus 5 percentage points – or the standard market rate if the payer is able to prove that the standard market rate is lower- then the difference is taxable as income from dependent activities (salary income). Salary advances not exceeding five times the minimum wage (currently HUF 65,500/ month) are not treated as below market rate loans, if the loan is re-paid within 6 months.

- Business travel and accommodation expenses are business expenses where supported by proper documentation. If the invoices are not issued in the employer's name (i.e. the actual payer of the expense), or if invoices are not provided to the employer, the costs reimbursed by the company are treated as employment or other income of the individual.
- Meals are taxed as fringe benefits.
- Certain life insurance premiums paid by the employer for the benefit of an employee may be tax-exempt. Lunch vouchers up to a low amount are exempt.
- Any value of property or benefit received from a person (other than a foreign private person) to whom no Hungarian tax law applies (i.e. which is not obliged to deduct the relevant Hungarian taxes as a payer company) should be declared and taxed in Hungary. Such income should be treated under the same category as defined by the payer of the value. For example, if the foreign payer treats the benefit as employment income, then it should be the same for Hungarian taxation purposes. The recipient is personally liable for declaring and paying the taxes on these benefits to the Hungarian tax authority.

Exemptions

Some types of income are exempt or not taxed under the tax legislation.

The most significant types:

- gains from dwellings if proceeds from such are used for purchasing a new primary home in Hungary (unless such new home is subsequently disposed of within five years)
- income from the disposal of real estate if the real estate was purchased 15 years prior to the sale;
- certain housing subsidies;
- educational, health and social welfare benefits in kind, insurance compensation, compensation for meals and work clothes provided by the employer;
- certain scholarships.

Deductions

In general, expenses incurred for the purpose of pursuing business activity are deductible in order to determine the taxable base of income from independent or other activities.

Tax legislation provides individuals with two options for the deduction of such expenses: either the deduction of actual expenses or a deduction of an allowance of 10 percent of gross revenues. Increased allowances are available for small entrepreneurs.

No expense deductions from employment income are allowed. Foreign mortgage and other interest are not deductible, nor are contributions to foreign pension or insurance schemes.

Tax assessment

There remains the opportunity to choose for year-end individual tax assessment to be prepared by the employer from 1 January, 2007. This possibility is available for individuals

who would be entitled to ask for tax assessment prepared by the Tax Authority, who have the requested certifications and statements and pass these documents to the employer before the due date. More details are provided under the Rules of taxation section.

Surtax (so called solidarity tax) for Individuals

A new tax is implemented for individuals from 1 January 2007. According to the applicable rules, all individuals are obliged to pay a 4 percent surtax on their income above the annual pension contribution limit (HUF 6 748 850 annual gross income). Individuals would be obliged to pay surtax advance if their income is expected to exceed the limit prescribed by the law during the year. In this case surtax advance and personal income tax advance would be determined together but confirmed separately by the payer.

Relief from Tax

Elimination of double taxation

Under its double tax treaties, Hungary mainly gives relief by way of exemption with progression. This means that the income taxed abroad does not form part of the Hungarian taxable income, though it is included in the taxable base in order to determine the tax rate applicable to the taxpayer's other income. The wording of each double tax treaty should be considered on its own merits.

Social Security Contributions

The health insurance contributions payable by employees is 7 percent which is divided into two parts as of 2006. An amount equal to 4 percent is payable for cash support and 3 percent for in kind support.

The remaining 8.5 percent pension contributions are generally divided into those made into the Social Security system (0.5 per cent) and those made into the private pension funds (8 per cent). For 2006, the ceiling for the payment of the contributions under the state pension scheme and under the private schemes is HUF 6,748,850 for individuals.

Employees should pay 0.5 per cent to the public scheme and 8 per cent to the private scheme or the total 8,5 per cent to the public scheme. Additional contributions of 1.5 percent may be made to the private fund. Individuals may also contribute to voluntary private pension funds, which make up a third pillar of the system.

A summary of 2007 employer and employee contribution¹ rates is as follows:

Hungarian Employers	Pension Insurance	Health Insurance		Unemployment contribution	Total
		Cash support	In kind support		
(required to pay a contribution calculated on the basis of the wages and salaries of their employees)	21%	5%	3%	3%	32%
Employees					
(the contribution is withheld from their salaries or wages by the employer)	8.5%	4%	3%	1,5%	17%

Social security contributions are mandatory for Hungarian employees, foreign employees employed by Hungarian entities, foreign employees under certain Social Security Totalization Agreement provisions and in certain other cases, including employment by another EU company. Employees not subject to but wishing to benefit from the Hungarian social security system are allowed to contribute to the system based on an agreement.

In addition, there is a fixed health care charge of a maximum HUF 1,950 per month/per employee. An 11 percent health care charge is due on a broad range of receipts including:

- remuneration and benefits-in-kind not subject to the 29 percent social security contribution noted below;
- preferred rates of interest on loans;
- company-owned or leased automobiles (computed at 25 percent of the company car tax instead of 11%); and
- other income (including special income from capital, third party contributions to the voluntary pension plans, payments of insurance premiums, etc.).

¹ Please note that personal income tax and surtax for individuals described previously are also payable by employees and contribution to the vocational training fund covered later is compulsory for employers (a further 1.5% of the total annual wages).

There is a 14 % health contribution obligation based on the following separately taxed incomes:

- income withdrawn from enterprises,
- income from lending securities,
- dividends taxed at 25 % or 35 %,
- income from capital gains
- income from renting out real estate (if the rental income exceeds 1,000,000 HUF, it is payable on all the income, subject to the cap below)

The 14 % health contribution payment is capped at HUF 450,000 per annum (including the health insurance contribution paid by the employer plus 11 percent health care charge on the incomes above). The contribution should be withheld by the payer; however, the individual is obliged to declare before receiving payment that their income reached the above cap. Should the individual not make this declaration, they must pay 6% in addition to the 14% contribution included in their personal income tax return.

As of 1 January 2007, all taxpayers must file monthly electronic tax and social security returns, the paper based filing system will be ceased. Additionally, employers may declare earnings below the minimum contribution base through electronic filing of tax returns; there is no need for the filing of any additional form. According to the law, for those tax payers paying contributions (for example those, who are employed with a START card) or granted allowances on the basis of special acts, the regulations on the minimum contribution base are not applicable.

Gift and Inheritance Duties

Inheritance duty is payable on bequests located in Hungary. In case of a bequest located outside of Hungary, but inherited either by a Hungarian citizen or Hungarian legal entity the rules are also applicable provided that no similar duty has been levied on the bequest in that country.

The applicable rate of inheritance duty depends on the relationship between the descendent and the heir. In case of close relationship the applicable rates are between 11, 15 and 21 percent according to a progressive scale depending on the value of the inheritance. In case of real estate used for dwelling purposes the rates are much lower starting from 2.5 percent (up to HUF 18 million value) through 6 to 11 percent. The highest rate of inheritance duty is 40 % (in case of inhabited real estate 21%).

Real estate, movable property and the establishment of pecuniary value without consideration are subject to gift duty. The applicable rates of gift duty are almost the same as the rates of inheritance duty starting from 11 through 18 to 21 percent in case of close relatives. However lower rates are applicable in case of inhabited real estate (5 percent, 8 percent or 12 percent). The highest rate is also 40% (for inhabited real estate 30%).

There are personal and subject exemptions from inheritance and gift duties. For example foundations, churches, public organizations, non-profit corporations are not liable to pay duties.

And gifts provided for the purpose of domestic scientific, art, educational purposes also enjoy exemptions.

Transfer of assets without consideration

The transfer of assets without consideration under current rules qualifies as a gift subject to stamp duty.

Should one entrepreneur in the transaction be the 100% owner of the other entrepreneur, or should both of the companies be 100 % owned by a third company, assets acquired without consideration in the course of this transaction would be subject to a preferential rate of stamp duty. The rate of stamp duty, depending on the value of the asset transferred for free, would not exceed 21% (in contrast with the general rule, based on which the rate may be up to 40%).

No stamp duty is payable in respect of gift (free) transactions taking place by 31 December 2006 if it is prescribed by a legal provision and regarding acquisition of assets without consideration (not including the acquisition of real estate and motor vehicles) if the acquisition is based on a contractual arrangement concluded and performed prior to 31 December 2006.

Besides, there are limited cases, which are exempted from stamp duty (i.e. free transfer of assets prescribed by a legal provision, gifts provided to a public organization) from 1 January 2007.

The exemption from stamp duty liability is to be extended in the future to the free provision of remuneration by an employer to an employee, if the transaction is exempt from personal income tax.

Indirect Taxes

Value Added Tax

The Hungarian VAT regime has been increasingly harmonized with the EU Sixth Directive over time.

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

Taxable transactions and place of supply

VAT is levied on supplies of goods and services performed in Hungary, on intra-Community acquisitions and on importation of goods (for VAT purposes the territory

of Hungary includes the customs free and transit zones as well as bonded warehouses) Certain kinds of goods and services are exempt from VAT.

Generally, the Hungarian VAT law applies the destination principle to cross-border transactions. Therefore, exports of goods, certain services and intra-Community supplies of goods are exempt from VAT (with the right to deduct input VAT). In other words, these transactions are not subject to Hungarian VAT. The supplier of such transactions being a VAT registrant can claim input tax credits to recover the VAT paid on its own business related purchases.

A temporarily exported good is exempt from VAT if it is returned to the exporter in an unchanged form and if the good is duty-free.

Formerly, the assignment of receivables in case of factoring qualified as a VAT exempt activity. As of 1 January 2007, the Hungarian legislation qualifies the assignment of receivables for consideration as an activity outside the scope of Hungarian VAT, i.e. it is not deemed to be a supply of services. The rationale for the modification is that effectively only the purchaser of receivables, i.e. the factoring company provides business services. From 1 January 2007, only the factoring company will be regarded as providing VAT exempt services to the client. Therefore, companies financed through factoring will no longer generate VAT exempt revenues in this way, and, as a consequence, the VAT content of their purchases is not subject to partial deduction limitations.

In the case of import of goods and certain services acquired abroad, the importer must self-assess VAT on the amounts charged to it. The most important services that must be treated as 'imported services' if the supplier has no Hungarian VAT registration are as follows:

- 1) If the purchaser is a Hungarian resident:
 - hiring out of movable tangible property;
 - transfer and assignments of copyrights, licenses, trade marks and similar rights;
 - advertising services;
 - consultancy, legal, accounting, tax, IT, translating, engineering services;
 - data processing;
 - banking, financial and insurance services;
 - the supply of personnel;
 - telecommunication services;
 - radio and television broadcasting;
 - electronically supplied services;
 - granting access to gas and electricity systems and the transport of gas and electricity and related services
 - agency services to intermediate supply of goods or services other than those mentioned above.
- 2) If the services are physically carried out in Hungary:
 - cultural, artistic, scientific, educational, sport or similar activities;
 - ancillary services related to transportation of goods (such as loading, warehousing);

- work on movable tangible property;
- product related advisory services.

3) Services connected with immovable property located in Hungary.

Concerning telecommunication and truck hiring services, the concept of effective use and enjoyment is to be considered.

Registration for VAT purposes

There is no possibility to register for VAT purposes with retroactive effect. Furthermore, the VAT charged before the registration for VAT purposes in Hungary is not deductible and not reclaimable. The duration of the registration procedure is short, as receiving the tax number takes a few days and moreover in case of registration at a client desk, the tax number is delivered immediately.

The Hungarian VAT law introduced the term import tax agent. If the activity of a foreign taxpayer is limited to the exempt import of goods followed by intra-Community supply, it may appoint an import tax agent. This way, the foreign taxpayer is able to avoid VAT registration in Hungary. The import tax agent acts in its own name and on behalf of the importer, as long as they are obliged to issue sales invoices, to prove the delivery of goods out of the country and furthermore to declare the import and the following intra-Community supply of goods in their own tax returns.

Tax base

The basis of assessment is the sale value of the goods or services although an adjustment is possible if the sale value is significantly below market price. In the case of importation of products, the basis of assessment is the value for customs duty, increased by the amounts of stamp duties and other tax related payment obligations. Foreign currency values are determined using exchange rates quoted by the National Bank of Hungary. The same exchange rate is used when determining the VAT base.

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

VAT rates

There are two VAT rates in Hungary:

- 20 percent – is the general rate and is applied to most products and services;
- 5 percent – the reduced rate, which is largely restricted to books, daily newspapers and all types of newspapers from 1 July 2006 and basic medicines.

As of 1 September 2006, the preferential rate of 15 percent has been abolished and the new standard VAT rate of 20 percent is applicable to all supplies of goods and services previously classified as preferential supplies.

Reporting obligations

Taxpayers are obliged to file VAT returns on a monthly, quarterly or annual basis depending on turnover levels and whether they have a Community tax ID.

In connection with intra-Community transactions, administrative obligations, such as Intrastat and EC Sales List filings, exist. Taxpayers are obliged to submit Intrastat returns monthly, if the value of their dispatches of goods or arrivals of goods exceeds the annual threshold determined by the Statistical Office. The threshold for IC acquisition is 60 million HUF, for IC supply it is 100 million HUF. The Taxpayers have to submit EC Sales Lists quarterly as part of the VAT return on intra-Community supply and acquisition of goods.

For imported services and intra-Community acquisitions, taxpayers shall report VAT payable in one reporting period. However, taxpayers supplying fully taxable goods or services may deduct the input VAT in the same reporting period thus resulting in no actual VAT payable on that transaction.

Invoicing

The purchaser may assume the seller's obligation to issue an invoice based on a prior written agreement (self-billing) between the parties. The parties would have joint and several liabilities for the obligations by law.

The changes to the underlying legislation have made it possible to issue invoices in any foreign language. However, the tax authority may ask for an official translation of such an invoice in reasonable circumstances (i.e. when it is required in order to ascertain tax liabilities).

As of 1 January 2007, the required information content of invoices does not include the date and method of payment. If the date of issue of the invoice is the same as the date of supply, the date of supply also ceases to be compulsory information.

Suspension of tax ID

The Tax Authority is entitled to suspend the application of the tax ID under certain circumstances.

Taxpayers are not entitled to deduct input VAT during the time period of the suspension. If the Tax Authority cancels the tax number, the taxpayer will not be able to exercise its right to deduct tax. Should the suspension be abolished retrospectively, deductible tax incurred during the suspension period becomes refundable.

VAT-reclaim

Non-resident taxpayers of any EU Member States and from countries that have concluded bilateral agreements for the avoidance of double taxation on VAT, i.e. Switzerland and Lichtenstein may obtain a VAT refund under certain circumstances.

Customs Duties

Exporting to and from Hungary

As a Member of the European Union, Hungary belongs to the Customs Union of the EU. Customs duties are payable on the imported non-community goods from countries or territories not forming part of the customs territory of the EU.

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

Import procedures

General procedures

All goods must be declared to the Customs Authorities ('Customs') at import. The clearance procedure can be initiated at the border Customs Office or non-community goods may be transported to the final destination and may be cleared at the local Customs Office.

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

Valuation

Although there are six methods of valuation based on WTO rules, they should not be applied alternatively, but in strict order. The first and simplest is the transaction method, which is based on the price paid or payable for the goods. Certain costs, such as freight and insurance, must be added to this price. The transaction method cannot be used, for example, where there is no sale, or where the relationship between the parties influences the sale price – in such cases the remaining five methods must be considered in strict order.

Classification

The Hungarian tariff is based on the Community Combined Nomenclature (CN) and on the international Harmonized System (HS) used by many industrialized nations of the world. This classifies all goods of international commerce so that each article is classified in one place, and one place only, within the tariff. Classification determines the rate of duty applicable to imported goods and whether any special preferential treatment is available.

Origin

The origin of imported goods and the route they take to the EU have considerable influence on their liability to duty. If they originate in, and are directly consigned from

a country, which has a preferential agreement with the EU, the duty rate is reduced significantly or possibly to 0%. The EU has such agreements with other country groupings such as EFTA (European Free Trade Association – now within the European Economic Area), ACP (African, Caribbean and Pacific states), OCT (Overseas Countries and Territories), Mashraq and Maghreb. Suspension of the full rate of duty may be available from specified countries at certain times of the year on particular goods. Similarly a quota may be in force, which allows predetermined quantities of goods of certain tariff headings to be imported at lower than full rates of duty.

Charges at importation

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

VAT is also charged at importation. Any such VAT paid may be recovered as input tax providing the importer is registered for VAT and the goods are for use in its VAT-able business activities. Evidence of VAT paid in this way is the VAT statement issued by the Customs authorities direct to the importer of the goods every month in the case of traders with deferred payment facilities. In other cases the invoice from the customs clearance agent is acceptable.

The acquisition of goods into Hungary from other EU Member States by a person registered for VAT in Hungary is known as an intra-community acquisition. A person making an intra-community acquisition in Hungary is required to self-account for Hungarian VAT on their VAT return at the rate of VAT applicable to the goods by reference to the consideration paid. Provided the goods are acquired for a VAT-able purpose that person may make a simultaneous matching deduction on their VAT return for the VAT arising on the intra-Community acquisition.

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

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

Customs duty relief and suspension procedures

A number of reliefs are available in respect of imported goods based on the different circumstances below:

- They will not permanently enter the community;
- they have already borne duty in the EU;
- they are imported for a specific non-dutiable purpose such as medical or research use, or for testing.

Four of the most common reliefs are:

- Inward Processing Relief (IPR) – where goods are imported from outside the EU for processing and re-export, duty may be waived at import or refunded at export,
- Outward Processing Relief (OPR) – where goods are temporarily exported outside the EU for processing, a proportion of the import duty is waived on their return,
- Temporary importation – where the goods should be re-exported in the same condition to a third country within a specified period of time
- General Relief laid down in the 918/83/ECC Council Regulation.

The customs warehousing procedure may allow the storage in a customs warehouse of:

- non-Community goods, without such goods being subject to import duties or commercial policy measures;
- Community goods, where Community legislation governing specific fields provides that their being placed in a customs warehouse shall attract the application of measures normally attaching to the export of such goods.

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

In order to take advantage of most custom reliefs, authorization must be obtained in advance from the Customs authorities.

Export procedures

As with imports, goods must be declared to the Customs authority at export. The same form is used, but generally fewer details are required (unless the goods being exported are under Customs control for duty relief purposes).

From a VAT perspective, the export of goods to a destination outside the EU can be zero-rated provided the exporter can produce the necessary evidence of export.

For goods destined for other EU Member States the supply may be exempted for VAT purposes provided the customer's VAT number is quoted on the sales invoice and evidence of movement to outside Hungary is retained. Exemption for VAT purposes does not apply for dispatches of goods to customers in other EU member states which are not registered for VAT. In such circumstances the supplier may be required to register for VAT in the Member State to which the goods are supplied, dependent on the level of sales to that state.

Excise Duties

The legislation follows the concepts laid down in the relevant EU legislation and the new excise law was ratified by the Hungarian Parliament in November 2003 and became effective on 1 May 2004.

Excise duty is charged on a variety of goods including alcohol, tobacco products, motor vehicles, hydrocarbon oils and their derivatives, and goods containing any of these products. Excise duty is usually related to weight or quantity rather than to value.

The general foundation of the excise tax requires that the tax liability be computed at the time the excisable goods enter the country or when produced in Hungary.

Other Taxes and Duties

Surtax (so called solidarity tax) for financial institutions

A new contribution by financial institutions replaces the bank tax with effect from 1 January, 2007. Under the provisions of the law, financial institutions are subject to a tax of 5% levied on interest or interest-type revenues derived from loans incorporating direct or indirect interest-subsidies regulated by different laws.

The financial institutions will make an advance tax payment each quarter, on the 12th day of each month following the quarter. The financial institutions must settle the difference between the expected annual tax and all accumulated advance payments by the 20th day of the last month of the tax year. The tax must be calculated, declared and paid by the deadline set out for preparing annual financial statements, or if there is no obligation to prepare financial statements, the deadline is the 150th day following the end of the tax year.

Motor Vehicle Tax

The operators of road vehicles (cars, trucks, etc.) are subject to a differential annual tax payment. From 1 January 2007, the motor vehicle tax liability is calculated on the basis of the age and the power (in kW) of the motor vehicle instead of the weight of the vehicle. The tax is HUF 300 per kW in the year of production and the subsequent 3 years and continuously decreases to a minimum of HUF 120 per kW applicable to at least 17-year old vehicles.

Registration Fees and Stamp Duties

There are a number of types of fees and duties that may also apply to business associations. The registration fee at the Court of Registration amounts to HUF 600,000 for public limited liability companies and HUF 100,000 for other legal entities, including private limited companies. In the case of registration of a branch, the fee is HUF 250,000.

Property Transfer Tax

Individuals and legal entities are subject to property transfer tax levied on the transfer of Hungarian real estate or any rights related to such property and motor vehicles. The tax is payable by the transferee and is levied on the market value (including VAT) of the property transferred, at the following rates:

- 2 % for apartments and houses on the first HUF 4 million of their value and 6 % on the remaining value;
- 10 % for all other real estate properties and any taxable right;
- 2 % on commercial real estate if the buyer is a property trading company (with specific requirements);
- 18 or 24 HUF/cm³ depending on the engine capacity of motor vehicles;

Local Taxes

There are a number of local taxes, which may be imposed at the discretion of the various local authorities:

Local Business Tax

Enterprises pay local business tax on all business performed on a permanent or temporary basis in municipal areas. The base of this tax is an enterprise's gross sales revenue less cost of goods acquired for resale and the value of mediated services and subcontractors' fees (both terms defined somewhat narrowly). Material costs are also fully deductible. Some part of the tax base (maximum 90 %) is exempt from local business tax if it results from an activity carried out abroad. This exemption can be used only if local tax is imposed by a local authority abroad. The maximum rate of tax is 2 % of the tax base, which can be lower depending on the particular municipal area where the company is undertaking its business. Service providers get very limited relief and are required to compute their local tax based almost wholly on gross revenues. Financial income (e.g. interest) and royalty revenue have been excluded from the local business tax base since 1 January 2006.

As the national law provides no minimum levy, it is up to each municipality to determine whether it will impose this tax and if so, the rate it will charge. There still exist some municipalities that do not charge this tax at all.

If the taxpayer hires new employees, it is possible to obtain a local business tax base decrease of HUF 1 million for each new individual (provided that the employees are taken over from unrelated parties). However, if the number of the employees decreases by more than 5%, the tax benefit should be repaid.

Offshore companies have become subject to local business tax from 1 January 2006, but this change in the regulation should not be disadvantageous in most cases.

Property Taxes

A property tax can be imposed in each year. For buildings, the tax is based on square meters (maximum HUF 1043 per m² per year) or on the market value of the building (maximum 3%). Similarly for land, the tax is based on square meters (maximum HUF 232 per m² per year) or on the market value of the land (maximum 3%).

Community Tax

This tax is based on the number of employees, and may be imposed at a maximum rate of HUF 2,317 per employee / per year.

Contribution to the Rehabilitation Fund

This fund provides assistance to disabled employees. Disabled people should comprise a minimum 5% of an employer's headcount. Any employer not meeting this criterion is obliged to pay a contribution of HUF 152,000/per disabled person not employed per annum (for 2006). The contribution is not levied if the total number of employees does not exceed 20.

Contribution to the Vocational Training Fund

Employers are required to contribute to this fund, which supports various vocational schools in Hungary. The contribution is at a rate of 1.5 percent of the total annual wages.

Contribution to the Cultural Fund

Retailers of certain listed products (films, magazines, construction etc.) and providers of certain services (such as video-rentals and advertisements) are obliged to pay contributions to the cultural fund. The basis of payment is a percentage of the net sales revenue (excluding VAT) minus the purchase price of listed services and products used for products or services sold. The rates vary from 0.2 % to 25 % depending on the particular product or service provided.

According to the Act on the Program of the National Cultural Fund, constructors of apartments and other buildings with a value exceeding HUF 120 million are obliged to pay contributions to the Cultural Fund of 0.2 % of the investment value. The investor should include in the subcontractor agreement whether or not the total value of investment will exceed HUF 120 million. Where the investment value exceeds HUF 120 million, the investor must notify the constructor in writing that the building will be subject to cultural contribution. In case of failure to notify, the cultural contribution is accounted for the investor.

Environmental Protection Charge

This single-stage tax is imposed on the domestic manufacturer, importer or intra-Community acquirer of certain listed products used within the Territory of Hungary which could prove to be harmful to the environment.

These products include:

- certain oil products;
- rubber tyres;
- cooling equipment and refrigerants;
- wrapping materials (special rules to commercial packaging such as PETs);
- batteries;
- commercial printed papers;
- electric and electronic equipment.

The amount of levy is specifically set out for each type of product and is generally computed as an amount per kilogram of product (or on the amount of commercial packaging)

Companies can apply for specific Environmental Protection Charge exemption in case they comply with the formal and substantial conditions and strict deadlines.

Environmental Pollution Charge

From 2004, any person emitting pollutants into the environment (air, water, soil) is liable to environmental pollution charge payment. The basis for this charge is the total amount of the pollutant emitted annually, expressed in its relevant unit of measurement.

The size of the pollution charge is determined by the unit charge of the pollutant.

The emitter must pay 90 % for air pollution, 80% for water pollution and 75 % for soil environmental pollution charges in 2007 of the fee actually payable according to the law.

The payable amount increases continuously from year to year. For the air and water charges the payable quota will be 100% in 2008 and for the soil charge from 2009.

Each charge is paid quarterly in the form of a tax advance, the difference between the actual pollution emission charge and the tax advances paid should be settled not later than 31 March of the following year. In certain instances exemptions or allowances can be available to those which fulfill certain conditions.

Innovation Contribution

- A new contribution as of 2004, innovation contribution is payable by every entity subject to the Accounting Law, however micro- and small enterprises are exempted.
- The base of the contribution is the same as for local business tax.
- The applicable tax rate is 0.3 % from 2006 onwards.
- The annual amount of innovation contribution payable can be reduced by the cost of R &D activity carried out by the taxpayer itself (state subsidies received for this purpose are excluded) or provided by entities prescribed in special law (i.e. foundations).
- The tax return is to be filed by the last day of the fifth month following the relevant year.
- Quarterly advance payments are due by the 20th day of the month following the quarter.

Energy Tax

The energy tax is payable based on megawatts for electricity and on gigajoules for natural gas. The rate of energy tax is defined as HUF 186 / MWh for electricity, and HUF 56 / GJ for natural gas. This tax is related to national and administrative institutions and energy-intensive producer sectors. Tax must be paid by:

- public utility providers selling energy to public utility consumers;
- energy traders selling energy to eligible consumers;
- eligible consumers purchasing energy directly from a producer or in an organized market;
- eligible consumer purchasing energy directly from other EU member state;
- eligible consumer purchasing energy directly from third country;
- legal entities, non-legal entities, individuals performing business activities produces energy for their own use (with some exceptions);
- public utility providers, energy traders and distributors, which purchase energy for their own use, except if this purchasing is in order to compensate the loss of network; and
- end users purchasing previously non-taxed energy .

The tax liability arises on the day of performance as defined by the VAT law or on the last day of the period for tax return or on the day of private utilization respectively. The monthly tax return is to be filed by the 20th day of the following month.

This tax falls under the responsibility of the Customs Authority.

Registration Tax

Registration tax payment liability arises on the sale of cars and motorcycles through which cars are put into Hungarian circulation. The tax is borne by the seller, importer, and the party acquiring the vehicle from another member state or the one transforming the vehicle. The amount of flat rated tax varies between HUF 235,000 and 6,050,000 depending on the engine capacity and the environmental classification and does not form part of the VAT base. The motor vehicles purchased from EU States are taxed more beneficially from 1 January 2006.

Partial Refund of Motor Vehicle Registration Duty

The European Court of Justice stated in an earlier judgment that the regulation of the Hungarian Motor Vehicle Registration Duty before 31 December 2005 conflicted with community law. Before this date, high registration duty was levied on used motor vehicles purchased from other EU Member States (equivalent to rates for new motor vehicles).

The Parliament has introduced a legal provision which facilitates the recovery of the registration duty for taxpayers which have paid the higher amount of duty.

The provision comes into force on 15 February 2007. Private individuals and companies who released into free circulation used motor vehicles in Hungary between 31 May 2004 and 31 December 2005 are entitled to make a reclaim.

Luxury Tax

From 1 January 2006 a new tax is levied on immovable properties (homes and holiday-homes) over a value of HUF 100 million. The subject of the tax is the private person, the proprietor / owner or any person who has pecuniary rights on the property.

The tax is administered by and supports the local government. The tax base is the value of the property. The Act determines the frame-rules for the calculation methods of the value by counties, settlement-types and property-types. The detailed rules for the calculations, however, are set by local regulations which have to be passed on the basis of the Act.

The annual tax rate is 0.5 per cent of the amount over HUF 100 million of the calculated value. To avoid double taxation, local taxes payable in connection with the property can be deducted from the luxury tax.

Simplified Tax and Contributions ('EKHO')

With the introduction of a new type of tax ('EKHO') from 1 January 2006, private persons working in the field of culture, media or arts and their contracting payers can fulfill tax and contribution obligations in a simplified procedure.

The precondition of the possibility of opting for EKHO is that in connection with the private person's activity, personal income tax and social security contributions had already been paid according to the general rules in virtue of at least one legal relationship.

EKHO is paid jointly by the individual and the payer. The rate is 15% for the private person and 20% for the payer. EKHO can be chosen by individuals earning up to HUF 25 million income per annum.

Simplified Entrepreneurial Tax (EVA)

From 1 January 2003 an optional simplified entrepreneurial tax regime (egyszerűsített vállalkozói adó, i.e. EVA) is available to entrepreneurs, general and limited partnerships, limited liability companies, cooperatives and certain other business forms.

This regime replaces entrepreneurial/corporate income tax, dividend withholding tax, VAT and company car tax.

The regime is available if certain conditions are met. The most important requirements for choosing EVA are that (i) the taxpayer's annual turnover, increased by VAT, should not exceed HUF 25 million in the 2 years preceding the tax year in question, (ii) the taxpayer does not carry on any business activity subject to special regulations, e.g. activities subject to excise duty regulations, (iii) the taxpayer does not have or is not obliged to have an EU VAT identification number and (iv) the taxpayer has a Hungarian bank account.

Taxpayers may only opt for the EVA regime if (i) their members are exclusively individuals and (ii) they do not have a participation in another company (publicly traded shares and participating bonds in a cooperative-credit institution may be held).

As of 1 October 2006 the tax is levied at a flat rate of 25% on the taxpayer's turnover, increased by VAT and adjusted in respect of certain items as specified by law (e.g. increased by the amount of income received from affiliates). The tax base can be reduced by the cost of the compulsory electronic tax return process as of 1 January 2007.

A taxpayer who opts for the regime for a tax year must inform the tax authorities by 20 December of the preceding year (annual obligation). The tax year for the regime is the calendar year. Annual tax returns for a tax year must generally be filed by (i) 15 February of the following year for taxpayers that are not subject to the Accounting Law and (ii) 31 May for taxpayers that are subject to the Accounting Law. The tax is self-assessed and must be paid upon the filing of the return. Advance tax payments must be made quarterly for the first three quarters by the 12th day of the month following each quarter.

A taxpayer applying the regime is not regarded as a taxable person for VAT purposes, and is thus not entitled to deduct input VAT. However, in spite of the fact that the taxpayer is not required to pay VAT, it is obliged to reflect the amount of VAT (calculated from the gross amount) in its invoices issued. This VAT remains deductible for the customer.

Taxpayers applying the simplified entrepreneurial tax must pay vocational training contributions at 1.5% of twice the minimum monthly wage per employee.

Offshore companies

The Hungarian offshore regime has been abolished from 1 January 2006. Hungarian offshore companies ('HOCs') lost their offshore status as of 31 December 2005, at the latest, but they can operate as normal Hungarian entities. This means that the profits of former HOCs will be taxed at the general CIT rate (currently 16%) and they will not enjoy local business tax exemption by virtue of their status.

Nevertheless, HOCs can retain their foreign currency accounting status even after 31 December 2005 and the following rules can still significantly lower the tax burden of former offshore companies if they continue their current main activities (intra-group financing, receiving royalties).

- Under certain circumstances, taxpayers can exempt 50 percent of royalty or net interest income and gains realized on stock exchanges for corporate tax purposes (i.e. an approximately 8% effective tax rate might be achieved).
- Unrealised gains or losses arising from foreign exchange fluctuations on long term investments or liabilities can be deferred.
- Interest and royalty income is exempted from local business tax.
- No Hungarian withholding tax is levied on dividend payments from Hungary to corporates in any country in the world.

Chapter 7

Property Investments by Foreign Investors

Introduction

Interest in property investment in Hungary has grown sharply in recent years. We describe the main tax issues involved with the acquisition and use of property below.

Possible Forms of Investment

1. Use of a Hungarian subsidiary of a foreign company.
2. Use of a Hungarian branch office of a foreign company. The Branch Offices Act effective from 1 January 1998 means that foreign-registered enterprises can only do business in Hungary via branch offices. This restriction on forms of doing business also refers to foreign entities' direct property investments in Hungary.
3. Direct investment by foreign individuals.

Acquiring Property

Real estate

General Overview

Up until 1989, the fundamental concept of real estate ownership in Hungary was that all land belonged to the state – apart from a relatively small proportion of privately owned property and land owned by local co-operatives – and companies could only obtain a right to use land.

In the 1990s, the interest of foreign investors and the number of foreign owned property investment companies both increased rapidly, particularly in Budapest and in certain cities

in the Western part of Hungary. These investors have been attracted by the demand for modern office, retail and industrial premises and for real estate in general. Prices have risen rapidly.

The following real estate opportunities exist for foreign investors:

- the acquisition of real estate by a foreign owned Hungarian legal entity or a foreign legal entity.
- the acquisition of real estate by non-resident individuals.
- long-term rentals.

Acquisition of Real Estate by a Business Venture

A business venture may acquire ownership and other real estate rights, except for agricultural land, provided that this falls within the scope of its business activity as defined in its Articles of Association.

Business ventures can acquire real estate in two ways:

- if it is provided by an investor as an in-kind contribution
- if it is purchased by the business venture.

Properties in Hungary are registered in the land register, which is open to the public, and anyone can purchase an official copy of information in the register.

Companies, which own properties in Hungary are generally allowed unrestricted use of their property and may sell it, utilize it (e.g., rent it) or take out loans secured on it (e.g., to mortgage it) or sell rights associated to it.

Acquisition of Real Estate by Non-Residents

According to the Act on Acquisition of Real Estate by Non-residents, non-resident individuals and legal entities may acquire Hungarian real estate (excluding arable land) provided they obtain a permit granted by the local director of the regional public administration office. No permit is needed if the acquisition occurs through succession.

The permit may be issued if the acquisition does not infringe any local or public interests. The director shall request a statement by the mayor of the local council in respect of this. If the permit is denied, the decision can be appealed in court.

Long Term Rental

Non-residents are allowed to rent apartments or houses in Hungary. During the rental period the tenant will have exclusive use of the property and is considered as a 'quasi-owner'.

Restrictions on Acquisition of Certain Land

No foreign party, whether a private individual or company, may acquire title or any other right to Hungarian arable land. This same restriction applies to acquisitions by Hungarian subsidiaries of foreign investors.

With the effect of the accession to the EU (1 May 2004) Act LV of 1994 on Arable land makes available the acquisition of arable land for such EU citizens, who plan to settle down in Hungary as independent agricultural manufacturer entrepreneur, have been legally resident and have been pursuing agricultural activity in Hungary for at least three years.

The above acquisition of arable land by a foreign natural person may only be exercised in accordance with the respective rules stipulated for the acquisition of arable land by domestic natural persons not exceeding the size of 300 hectares or the value of 6000 gold crown (aranykorona) of the total arable land owned by such natural person.

Foreign legal or natural persons may only acquire title to property not classified as arable land (henceforth 'property') with an acquisition permit, unless the property is inherited. Permits are issued by the head of the relevant county administration. However, land acquisitions carried out by certain foreign legal entities are not subject to such a permit if the acquisition is carried out on behalf of their Hungarian branch.

As of 1 May 2004 a citizen of a member state of EU and for legal entities registered in an EU member state, in a member state of the treaty on the European Economic Area, or any other country, which shall be similarly classified on the basis of an international treaty may acquire property under the same conditions as domestic persons (no permit is required) except in case of acquisition of the secondary place of resident, which will be subject to the necessary permit for an additional five years. (Should the EU citizen be legally resident for a continuous period of four years, no permit is needed for the acquisition of the secondary place of residence.)

Transfer Tax Issues Involved with Acquisition

Those acquiring property are required to pay a property transfer tax of 10 percent of the commercial value of the property. This duty is reduced to 2 percent for enterprises whose main core activity is trading in real estate (effective from 1999, such property must be sold by the enterprise within two years of acquisition); for residential property the duty is 2 percent for the first HUF 4 million of commercial value, and 6 percent thereafter. For further details on taxation of Real Estate please refer to Chapter 6.

Foreign Exchange Regulations

As of June 2001, the Hungarian Forint received 'hard currency' status and foreign exchange regulations changed. Property acquisitions may now be paid for in any currency, whether Hungarian Forint or foreign currency.

Rules on Existing Properties (Sale or Use of Properties)

Tax Regulations

VAT

The use by foreign parties of any Hungarian property is liable for VAT reporting (but not necessarily VAT payment – see below for exemptions), except for the non-commercial sale of an individual's property. Investors must thus register for VAT in Hungary and issue VAT invoices when selling or renting/leasing property.

Vendors are not liable to pay VAT on certain real estate transactions (treated as exempt) including the rental of residential property or the sale of residential property for the second or subsequent time after its construction. However, the vendors are not entitled to reclaim any VAT charged to them in connection with these activities

Based on the rules effective as of 1 January 2004, the rental of non-residential properties is exempt from VAT under the general rules. Under these rules rental fees are VAT exempt, meaning that the input VAT incurred in connection with the rented property cannot be deducted. Nevertheless, taxpayers may opt for a VAT-able status at the beginning of the tax year regarding the rental of non-residential properties.

VAT is payable at the general rate of 25 percent on the use (sale or rental) of all other properties, which are not considered exempt.

Tax may be charged on property (building tax, land tax, local business tax and community tax); please refer to Chapter 6.

Income Taxes and Dividend Tax

The rules governing the taxation of income from the use or sale of property in Hungary is analyzed below. However, where a double tax treaty exists, the terms of that treaty would override the Hungarian tax provisions in any cases where the two might contradict.

Foreign Individuals

Foreign individuals are taxed at 25 percent on income from the sale of property in Hungary. The documented costs of acquiring and developing the property allowed by Hungarian law may be deducted from the income from the sale. Tax can be reclaimed on any income from a property sale used by the seller or a close relative to buy or to secure title to residential property within the period allowed by law after the date on which the income was acquired.

Hungarian Subsidiaries of Foreign Companies

Subsidiaries are liable for corporation tax under the general rules as described in the general information section. Corporation tax is thus currently 16 percent of taxable

income, which is the profit before tax calculated using the rules of the Act on Accounting adjusted for reconciling items under the Act on Corporation Tax.

The income of investors selling property is the selling price of the property. The accounting amount recorded as the value of the tangible asset may be included in the cost of sales figure.

If the selling price exceeds the book value, the difference is defined as profit and is subject to 16 percent corporation tax. The income calculations are based on nominal, historical forint figures; there are no rules for relief for inflationary gain.

The buyer must register the property at the Land Registry Office and depreciation is tax-deductible each year. The amount of depreciation is governed by the rules discussed below. If the vendor and buyer of the property are related parties, particular care must be taken to set a price, which is at arm's length.

Book depreciation on property is limited for tax purposes to rates recognized under the Act on Corporation Tax. The maximum tax-deductible depreciation on industrial buildings and buildings with long useful lives is 2 percent, while rental properties can be depreciated at a preferential rate of 5 percent. When calculating book depreciation, it is important to ensure that it corresponds to the anticipated useful life of the property and to the company's accounting policy.

Under the Act on Corporation Tax, 20 percent withholding tax must be deducted from dividends paid abroad by Hungarian companies unless paid to an EU resident parent whose holding in the payer meets certain conditions. The paying agent is not required to assess or deduct tax on any part of a dividend used by a foreign recipient to increase the registered capital of a Hungarian operational company or to form a new Hungarian company.

If tax is deducted from a foreign shareholder at a higher rate than that allowed for under an applicable double tax treaty, the foreign recipient may reclaim the difference. Alternatively, special procedural rules allow the use of the reduced treaty rates already at the time of paying the dividend.

The provisions of the EU parent-subsidiary directive have broadly been implemented into the Hungarian tax legislation. Based on these regulations, dividends distributed by Hungarian companies to shareholders located in the EU may be exempt from withholding tax if the shareholder holds at least 20 percent of the shares of the Hungarian company for at least two years on a continuous basis. Nevertheless, if a third party gives a guarantee to the tax authority at the time of the dividend payment, the two year holding period might also be completed subsequent to the payment.

Capital gains derived from the alienation of real estate are taxed as ordinary business income.

Branch Offices of Foreign Enterprises

The general rules on taxation of Hungarian branch offices state that such offices of foreign enterprises are treated identically to Hungarian-registered companies unless otherwise stipulated in an act of law or by a government decree issued pursuant to such a law. One such stipulation is the restriction on property acquisition mentioned above.

Thus, branch offices are treated like domestic companies for corporation tax purposes. Business performed at branch offices is taxed in the same way as that performed by legal entities. Accordingly, branch offices must assess and pay tax on their taxable profits. However where a double tax treaty applies, it may be possible to apply somewhat different principles to the determination of a branch's tax base.

Foreign-registered enterprises owning a branch office, as defined in the Act on Corporation Tax, may only withdraw the branch office profits in the form of a dividend. However, according to the practice of the Hungarian Ministry of Finance, in the case of an applicable tax treaty between Hungary and the country of the foreign company's residence, no dividend withholding tax is payable. This exemption does not apply to some states such as France and Canada since these have specific paragraphs covering withholding tax on branch distributions, but even in these cases the preferential withholding tax rates prescribed by the treaties may be applied together with the parent-subsidiary directive rules in case of recipients seated in the EU.

Since business activity can only be carried on through a branch or a subsidiary, and since income related to real estate is deemed to create a permanent establishment, the registration of a branch is obligatory.

Transfers of Ownership of Property Holding Companies

There is no specific Hungarian legislation regulating companies whose core activity is the ownership or use of property. General corporate legislation applies to these companies.

Property sales affected by way of transferring shares in a property holding company (rather than selling the property itself) are not subject to either transfer stamp duty or VAT.

The sale by a foreign entity of a holding in a Hungarian company is not liable to Hungarian corporation tax. A foreign individual is liable to 20 percent Hungarian personal income tax on the gain from selling the holding, but this could be reduced or eliminated by an applicable tax treaty.

Hungarian companies or branch offices selling property must book the selling price of the investment as income, reduced by the book value of that investment. If the company being sold has incurred a loss that decreases the value of the investment, the Hungarian investor may deduct this loss for tax purposes only when the investment is sold, regardless of whether loss in value on the investment has been booked for accounting purposes.

Appendix A

Income Tax Treaties and Withholding Tax Rates

Income	Dividends (%)	Minimum Holding (%)	Interest (%)	Royalties (%)
Non-treaty Rates *	0	-	0	0
Country:			0	0
Albania	5/10	25	0	5
Australia	15	-	10	10
Austria (EU) **	10	-	0	0
Belgium (EU)	10	-	15	0
Belarus	5/15	25	5	5
Brazil	15	-	10, 15	15, 25
Bosnia-Herzegovina***	10	-	0	10
Bulgaria (EU)	10	-	10	10
Canada	5/10/15	25	10	10
China	10	-	10	10
Croatia	5/10	25	0	0
Cyprus (EU)	5/15	25	10	0
Czech Rep. (EU)	5/15	25	0	10
Denmark (EU)	5/15	25	0	0
Egypt	15/20	25	15	15
Estonia (EU)	5/15	25	10	5, 10

Income	Dividends (%)	Minimum Holding	Interest (%)	Royalties (%)
Finland (EU)	5/15	25	0	5
France (EU)	5/15	25	0	0
Germany (EU)	5/15	25	0	0
Greece (EU)	10	-	10	10
India	10	-	10	10
Indonesia	15	-	15	15
Ireland (EU)	5/15	10	0	0
Israel	5/15	10	0	0
Italy (EU)	10	-	0	0
Iceland	5/10	25	0	10
Japan	10	-	10	10
Kazakhstan	5/15	25	10	10
Korea	5/10	25	0	0
Kuwait	0	-	0	10
Latvia (EU)	5/10	25	10	5, 10
Lithuania (EU)	5/15	25	10	5, 10
Luxembourg (EU)	5/15	25	0	0
Macedonia	5/15	25	0	0
Malaysia	10	-	15	15
Malta (EU)	5/15	25	10	10
Moldova	5/15	25	10	0
Mongolia	5/15	25	10	5
Montenegro****	5/15	25	10	10
Morocco	12	-	10	10
Netherlands (EU)	5/15	25	0	0
Norway	10	-	0	0
Pakistan	15/20	25	15	15
Philippines	15/20	25	15	15

Income	Dividends (%)	Minimum Holding	Interest (%)	Royalties (%)
Poland (EU)	10	-	10	10
Portugal (EU)		15-	10	10
Romania (EU)	5/15	40	15	10
Russia	10	-	0	0
Serbia *****	5/15	25	10	10
Singapore	5/10	25	5	5
Slovakia (EU)	5/15	25	0	10
Slovenia (EU)	10	25	0	10
South Africa	5/15	25	0	0
Spain (EU)	5/15	25	0	0
Sweden (EU)	5/15	25	0	0
Switzerland	10	-	10	0
Thailand	15/20	25	10,25	15
Tunisia	10/12	25	12	12
Turkey	10/15	25	10	10
UK (EU)	5/15	25	0	0
Uruguay	15	-	15	10, 15
US	5/15	10	0	0
Ukraine	5/15	25	10	5
Vietnam	10	-	10	10

* In Hungary tax on dividends is eliminated as of 1 January 2006. Withholding tax on interest and royalties has been eliminated earlier, thus there should no longer be any withholding taxes on payments made from Hungary to non-individuals.

** (EU): EU Parent-Subsidiary Directive enacted legislation may bring the rate to 0% provided certain ownership conditions are met.

*** Based on double taxation treaties concluded with former Yugoslavia (1985).

**** Montenegro has declared that it will honour all tax treaties that applied with respect to Serbia Montenegro. Application of the treaty with Montenegro has to be confirmed by Hungary.

***** Based on double taxation treaties concluded with former Serbia and Montenegro (2001).

Appendix B

Treaties Concluded by Hungary in Order to Avoid Double Taxation on VAT

Austria

Belgium

Denmark

Finland

France

Germany

Italy

Netherlands

Liechtenstein

Luxembourg

United Kingdom and Northern Ireland

Slovenia

Spain

Sweden

Switzerland

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