



HUNGARY

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Founding of a company (registration obligations, special bureaucracy)



In Hungary, investors can choose between nearly all of the legal forms already known from Germany. The most popular company form in Hungary is the company with limited liability, the so-called "Kft." In Hungary there is a well-functioning commercial register which can be completely accessed electronically. The application to found a company is transmitted by the representing lawyer electronically to the respective register court. The company only becomes legally effective with the registration in the commercial register. The signing of the foundation documents by a Hungarian lawyer removes the need for a notary as the signing by a lawyer fulfils the formal requirements. If the foundation documents are signed abroad, the signatures must be certified by a notary. Apart from that, in Germany a supplementary attestation in the form of an apostille is required.

Takeover of a company

The takeover of a previously founded company in Hungary is easy to accomplish by means of a share deal. However, in the case of the acquisition of a share in a company with multiple shareholders the legal right of first refusal of the remaining shareholders has to be taken into account which can be expanded in the articles of association. In addition, the acquisition of the individual assets/facilities of the company is also possible by means of an asset deal and is also practiced. It is, however, important to point out that with an asset deal according to the current Hungarian property law it is not possible to acquire the facilities of a company in the course of a single transfer of going concern, but instead all of the individual assets have to be separately named and transferred (Hungarian sales tax law, however, does have a legal institution similar to an operational handover). Finally, it should be observed that also in Hungary there are regulations concerning the transfer according to employment law. Particular attention must be paid to the respective regulations if in connection with an asset deal not all of the workforce is to be taken over.

Company management

Hungarian law also differentiates between the internal company management authority (limitable through the articles of association or company management regulations) and the external right of representation (which basically cannot be limited). The representation rules (single or joint representation) have to be listed in the commercial register. As far as authorised representatives are to be appointed, it should be taken into consideration that an authorised representative can only be a person who has an employment relationship with the respective company. A full power of attorney or general power to negotiate assigned to individual persons

or employees in Hungary is not permitted by law. It is only possible to work with specific special power of attorney for a certain, clearly defined task (or scope of functions).

Foreign exchange restrictions

The previous foreign exchange restrictions were abolished in Hungary in 2002 as part of a harmonisation measure prior to full EU membership in 2004.

Real estate and acquisition of land

Due to the fact that in Hungary agriculture is an important factor in the total economic performance of the country, the regulations with regard to the acquisition of farmland are particularly important for possible foreign investors. In general, according to the current prevailing Hungarian legal regulations only Hungarian private persons can acquire farmland to a restricted extent in terms of area. The new law governing farmland which came into effect on May 1, 2014 foresees in accordance with EU regulations that in general also natural persons from EU member states can acquire property in the form of farmland under the same conditions as Hungarian natural persons.

Natural persons according to the law are not to be seen as farmers, but from May 2014 they can acquire a maximum of one hectare of farmland. At the present time (and also after the changes in May 2014) stricter regulations apply regarding the right of first refusal, whereby a number of certain persons (among others also the Hungarian state) are granted a legal right of first refusal. From the spring of 2014 the acquisition of property and also the use of farmland is subject to authorisation from the respective authorities. There is only the possibility in very limited cases that a Hungarian company (with or without a legal personality) can acquire property in the form of farmland.

It is also important that in Hungary the purchase contract regarding the acquisition of a property has to be countersigned by a lawyer. A sales contract and the registration of the change in the land register are required for the transfer of ownership (constitutive effect). Reservations are usual in form of marginal notes and are an important instrument to secure the entitlement to register in the land register.

Labour law

In 2012, a new labour code came into effect in Hungary. As before, the new labour code regulates the individual and collective labour law as well as other non-standard forms of employments. The new labour code generally offers more flexible possibilities for the

employment of workers. A tendency is noticeable that the freedom of disposal of the employment contract parties was strengthened and that the law only contains compelling regulations with regard to a number of fundamental guarantees concerning the employment relationship.

Taking into account that many regulations of the previous labour code are no longer included in the new labour code or have been rephrased, in all cases a thorough examination should be made of the extent to which the existing interpretations of the Hungarian courts can be applied in the light of the range of regulations or how they are now to be interpreted.

Dismissal protection

The maximum duration of the trial period in Hungary is only 3 months. During the trial period there is no protection against dismissal. There are certain (i) prohibitions of termination (for example notice of termination of an employment relationship during pregnancy and during maternal leave) to be taken into account and also certain (ii) termination restrictions for employees who are due to retire or (iii) special dismissal protection regulations in collective labour law regarding an employee who is active in a union.

Liquidation of the company

As far as a Hungarian company is solvent the shareholders are at any time entitled to liquidate the company without a legal successor. For this purpose a corresponding shareholders' resolution must be made and this, together with other, specific company-law documents, must be submitted to the registration office. It is important to point out that by law the registration office procedure must be carried out by a lawyer and that the corresponding shareholders' resolution also requires the countersignature of a lawyer. The liquidation of a Hungarian company is a complex process which as experience shows can last up to three years, whereby before submission of the application to deregister the company at the registration office among other things balance sheets must be prepared and a number of authorities have to be informed.

Other administrative or special bureaucratic points

In Hungary, when providing personal data, e.g. in contracts, it is always important to also give the complete (first name and surname) maiden name of the mother. This serves to identify the respective person more exactly.

Tax law

The Hungarian taxation procedure is mainly characterised by the principle that self assessment is valid. Accordingly, a company liable to pay tax must calculate, register and pay its tax liability by itself without a provisional assessment having to be made by the tax office.

Taxpayers may carry out an internal audit at any time until the time when an audit is carried out by the tax authorities in order to correct its tax return and tax payment without the imposition of a fine. However, a self-revision surcharge must be taken into account for a correction made starting from the day after the stipulated deadline to hand in the tax return has expired until the day when the self revision form is submitted.

The audits carried out by the financial authorities can be divided into two categories. The first category consists of a retrospective, detailed tax audit which is made according to the audit guidelines and the second type consists of regular audits in Hungary for the 3,000 most important taxpayers determined by the highest tax liability.

The tax audit is conducted with the aid of the official audit guideline. This guideline defines all the relevant audit objectives in the current tax year and the main activity areas to be audited, i.e. a group of taxpayers (e.g. car rental companies) or taxpayers in an area of the country (e.g. taxpayers in the Pest region) are audited. The tax audit has to be carried out within the limitation period and also within the defined review period. If the audit reveals a tax deficiency, the deficiency is punished by financial authorities in the form of a financial penalty and legal proceedings are possible and not unusual.

Auditing

All companies in Hungary with a double-entry system are subject to mandatory statutory auditing. Companies are exempt from this, however, which have an average sales revenue below a certain value (in 2013 sales revenue value was < 200 million forints (HUF), and from 2014 < 300 million forints (approx. 1 million euros). The last two previous reporting years are used to calculate the amount of the sales revenue. Furthermore, a further condition for the actual audit obligation is that the average number of employees in the company in the last two years was at least 50.

The company cannot claim exemption from the audit obligation in relation to the non realisation of the limit value if the company is included in a consolidation. Newly founded companies have to determine the value limit due to the information contained in their business plan.

Auditing activities in Hungary must be carried out in compliance with the national auditing guidelines which in principle conform to the international standards on auditing (ISA).

Financial accounting

According to Hungarian financial accounting law no. C/ 2000; RLG, all companies are obliged to maintain a double-entry system for financial accounting. Branch offices of companies with a foreign domicile in Hungary are also considered to be companies in the sense of the Hungarian RLG financial accounting law. In addition, the financial accounting may only be conducted in the Hungarian language (§§ 3 and 12 RLG).

The accounts must be maintained according to the regulations of the Hungarian RLG and where the law allows the possibility of choice (e.g. valuation of inventory by the first-in first out method or average prices), according to the regulations which are listed in writing in the financial accounting policy of the company. In the case of a company audit the financial authorities can check whether the financial accounting system corresponds to said conditions.

The company must report all business transactions in the annual financial statement which can have an impact on assets and liabilities or on the result of the reporting year (§ 15 par. 2 RLG).

The Hungarian RLG financial accounting law prescribes uniform account categories. The account categories one to four include the balance sheet accounts, whereby the account categories one to three are the accounts for assets and the account category four the accounts of the liabilities. The figures required for the preparation of the income statement and to determine the balance sheet result are included in the account categories five, eight and nine. The account categories five and eight include the costs and expenses. The account category nine records the proceeds and income.

Practical examples

Auditing

Background facts:

A subsidiary of a German company in Hungary working to commission was billed for service fees and price corrections from other group companies under different legal titles.

In 2011, costs passed on from the group amounted to approx. 1,050,000 euros and in 2012 approx. 1,350,000 euros.

In the course of the audit of the annual financial statement at the company we determined that the written contracts for the transactions concluded with the affiliated companies were not all available in writing. We pointed out to the company that according to the Hungarian civil code the contract parties can conclude a contract verbally, but that an independent third party must conclude a written contract for business transactions of such volumes.

The Hungarian corporation tax law includes further specific country regulations for the purpose of calculating expenses with regard to tax. According to Hungarian corporation tax law, expenses incurred which are not in the interest of the entrepreneurial activity cannot be recognised under law. Services provided whose value exceeds 200,000 forints and where due to the circumstances it is possible to determine that services were provided contrary to sensible entrepreneurial thinking can also not be taken into account. The regulation relates to services between affiliated companies and also to transactions with third parties.

For this reason, at an early stage in 2012 we proposed that verbal contracts should be put into writing and verified by further detailed information and documents that the services were actually provided and that the incurring of the costs was actually in the interest of the company. We frequently referred to the potential difficulties and associated tax risks, but the company management of the group was only prepared to focus on possible solutions at the beginning of 2013. In the meantime the group finds itself in a difficult financial situation. A new crisis manager was appointed who quickly recognised that measures should be immediately introduced to stabilise the group once more.

What can be done now?

The crisis manager has made use of Rödl & Partner and together with our colleagues from the tax consulting division we examined the tax risks and the accounting for the individual transactions according to corporation tax law and the OECD transfer price guidelines. Our legal department has drawn up contracts in writing for the contracts which were concluded verbally under consideration of the special points with respect to the legal requirements and form.

The Hungarian company prepared the proof of performance for the services it provided and respective documents and timesheets indicating the hours worked.

At the right time because just as the contracts and documents were ready for signing, the Hungarian tax office made contact and carried out a company audit regarding the repayment of sales tax. In the course of the company audit the tax office had access to the complete documentation with regard to the accounting and accepted these with the statement that the formal regulations had been complied with. The audit of the amounts in the contracts will be the object of a later comprehensive company audit.

What should one have done differently from the beginning?

In the course of our audit we become familiar with the activities and processes of the Hungarian subsidiary. Our task is to assess the risks present in the company and to advise the company management and the shareholders about such risks. The above example demonstrates that once a risk has been identified the required measures should be introduced without delay. Written documentation to verify the legality of the intra-group expenses in accordance with the Hungarian regulations should have been made at the very beginning.

Taxes

Background facts:

A German company (plant contractor) and a Hungarian company (ordering party) have concluded a series of contracts to build up a number of (technically complex) conveyor lines in Hungary. The installation was planned in a number of stages and lasted a couple of years. In the process the German company used Hungarian subcontractors.

The German company started the installation process and wrote its invoices without Hungarian sales tax as an intra community delivery. The German company received invoices listing Hungarian sales tax from the Hungarian subcontractors. Due to the lack of a Hungarian tax number, the German company was not able to reclaim the input tax from the subcontractor invoices in Hungary in the usual way, whereby in an input tax refund procedure, however, its application was rejected on the grounds that the German company has a branch office in Hungary and therefore has to register itself in Hungary for sales tax. One year after the start of the installation process the German company decides to retroactively apply for registration for sales tax in Hungary, cancelled all invoices issued up to that point without sales tax and issued new invoices which included Hungarian sales tax.

Due to the corrected invoices, the German company has carried out the corresponding correction to the tax returns and paid the tax arrears. The financial authorities, however, due to late payment charged the company with the payment of default interest on arrears to the amount of several million forints (HUF).

What can be done now?

The above described situation left the German company with no choice other than to pay the interest on the arrears.

What should one have done differently from the beginning?

In principle, the problem came down to the fact that the concluded contracts did not clearly define whether the delivery was an intra-community delivery with the associated installation or the activity was a construction and installation activity.

The German company initially assessed the delivery from a sales tax point of view to be an intra-community delivery with the associated installation. However, in the meantime the company management has changed its opinion and wanted the object of the contract to be

understood as a construction and installation activity. In the first contract the German company should have clearly defined the character of the contract. According to the EU sales tax directive and Hungarian sales tax law both options are possible.

As far as an intra-community delivery with the associated installation was actually the case, the German company was not allowed to register for tax in Hungary and the invoicing should have been maintained up to the end of the execution of the contract without the inclusion of sales tax. The German company could have contested the rejected application to deduct input tax in court. But if from the beginning the case concerned a construction and installation activity, then before the beginning of the activity the German company should have registered itself for sales tax in Hungary, its invoices should have listed Hungarian sales tax, the tax could have been declared and the input tax from the subcontractor invoices could have been deducted from the tax to be paid.

Law

Background facts:

The German XY-GmbH decides to expand its sales structure worldwide and would also like to start business operations in Hungary. Accordingly, XY-GmbH founds a (sales) company with limited liability according to Hungarian law, a so-called "Kft." company, with the German parent company as sole shareholder.

The German company management has appointed a Hungarian managing director to manage the Kft. who reputedly as an experienced businessman maintains good contacts to potential customers. In the contract of employment it is agreed that the managing director will be given the title of commercial manager. After a short time, however, it turns out that the managing director does not possess the qualities required to successfully manage a company and has entered into disadvantageous business relations which can only be ended with a considerable loss to the company. Furthermore, due to a coincidence the German company management has also learned that the Hungarian managing director has also apparently misappropriated company funds through fictitious invoices to companies of closely linked acquaintances and friends.

After the German company management learns about the above-mentioned irregularities, a resolution is carried out to immediately dismiss the Hungarian managing director from his office of managing director, but without a notice of termination in writing of the underlying employment relationship. A new managing director is appointed in his place.

The former managing director now takes legal action against the company through the respective industrial tribunal and claims compensation due to the unlawful ending of his employment relationship.

What can be done now?

In this situation it is important to send the former managing director a corresponding notice of termination at the earliest opportunity in order to limit his possible claim to a loss of income due to the unlawful notice of termination. Furthermore, the initiation of criminal proceedings can be considered.

What should one have done differently from the beginning?

Due to the fact that with the commissioning of a managing director the factors of company law and also employment law have a role to play, these factors must be appropriately taken into account in the design of the employment contract of the managing director. In this respect when the Hungarian subsidiary was founded, the employment contract of the managing directors should have already included a “uniform legal relationship for the managing director” because the task of a managing director also includes the operative management of the company and the management of company affairs.

In these cases the employment contract in parallel to appointment under company law in connection with the regulations to end the employment relationship should expressly refer to the fact that a dismissal under company law is also to be viewed as notice of termination of the employment relationship. Therefore, apart from the corresponding resolution from the shareholders' meeting to dismiss the managing director, the notice of termination of the employment relationship of the managing director does not require any further legal declaration from the side of the employer. The action against unfair dismissal of the former managing director and the considerable associated costs and time involved could easily have been avoided.

Financial Accounting

Background facts:

A German company has founded a branch office in Hungary. Rödl & Partner has informed the German company that the financial accounting of the branch office will have to be carried out to comply with the regulations of Hungarian financial accounting law. The company decided, however, to maintain the financial accounting of the branch office according to Hungarian law in Germany and Rödl & Partner in Hungary should only prepare the tax returns of the branch office according to the documentation and figures made available by the company and also to prepare the annual financial statement of the branch office according to the account balances and documentation provided by the company.

Rödl & Partner prepared the sales tax returns based on the figures provided, but it was frequently the case that despite an urgent request the data was not made available before the deadline to submit the tax return. Rödl & Partner also did not receive account balances required for the preparation of the annual financial statement and therefore it was not possible to prepare the financial statement.

A number of years after the founding, the competent tax office carries out a company audit in relation to sales tax. In the course of the audit, on the basis of the documentation provided by the client the financial authorities determine that for a number of tax assessment periods a zero report was submitted, although on the basis of the actual figures there was an obligation to pay sales tax. For this purpose, the financial authorities used the figures (which did not include a zero report) for the sales tax. In addition to the payment of the sales tax a significant fine was imposed on the company.

In the meantime the shareholders and der company management in Germany understood that the financial accounting for the branch office had not been managed separately, although this was required.

As the company was not in a position to transfer such a high fine in one amount, an application was made to the financial authorities for payment facilities. A requirement for the submission of the application for payment facilities was the sending of the last two annual financial statements and an interim financial statement. Due to the tight deadline to submit the application for payment facilities the annual financial statements had to be prepared at short notice. It was therefore agreed that Rödl & Partner based on the account balances made available would prepare the annual financial statements since the founding without conducting a check of the correctness of the figures. During the preparation of the annual financial

statements Rödl & Partner found errors in the account balances and the company requested these to be corrected.

Finally, the client was granted payment facilities, but there is a risk that in future a company audit will be carried out. In the event of a company audit all the account balances, entries and financial accounting documents will be checked and it is very probable that further errors will be found in the financial accounting.

What can be done now?

The financial accounting for all the years since founding the branch office should be examined and checked. If the number of errors found leads to more time being required to correct the errors than the new booking of the documentation, then a new booking would be the best solution. After the correct preparation of the financial accounting, the tax returns and the annual financial statements can be prepared again.

What should one have done differently from the beginning?

The Hungarian legal regulations should have been considered from the very beginning and the financial accounting should have been carried out separately according to Hungarian law.