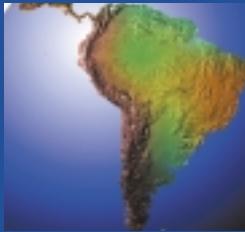
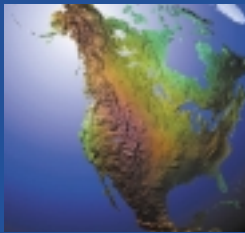
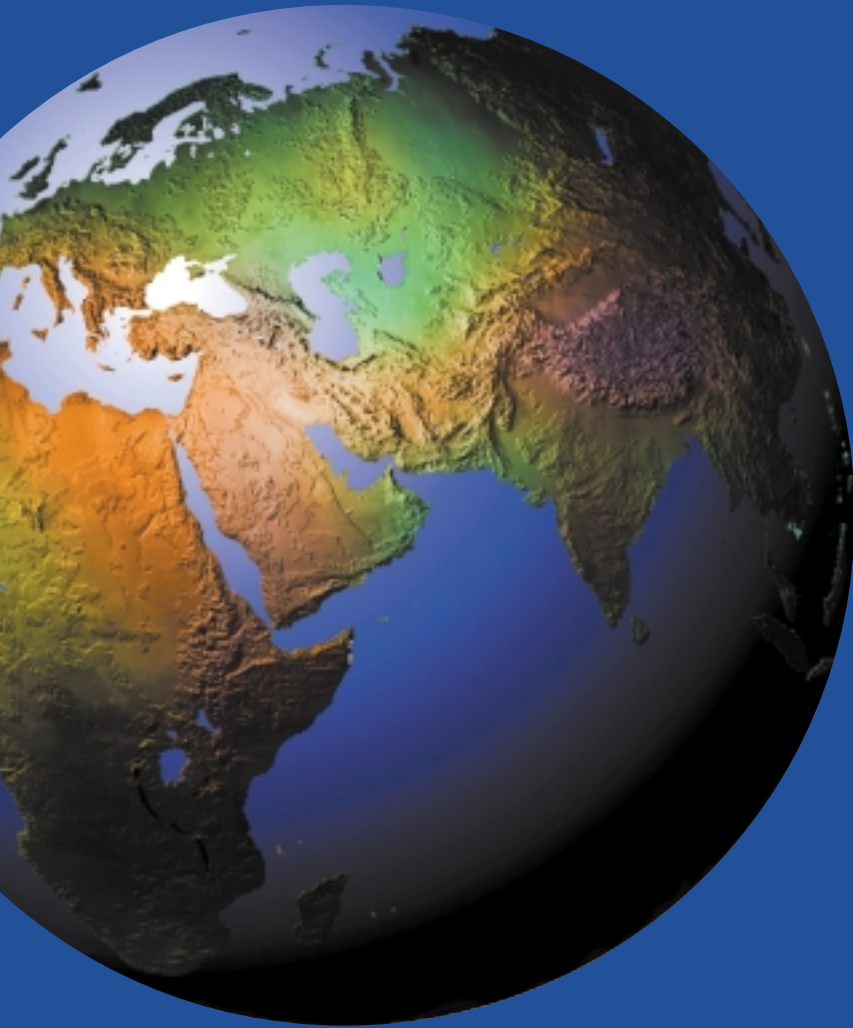




# Doing Business In Hungary



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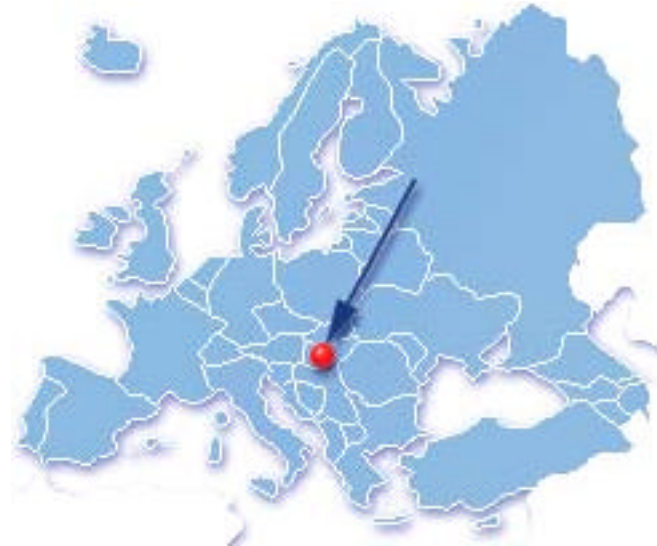
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## 1. Introduction – Why do business in Hungary?

Hungary is one of the oldest countries in Europe; with a history of more than 1000 years. Hungary's first King was crowned in 1001; the year of the Hungarian 'State-Establish'. In the middle-ages Hungary had a transmitter rule between east and west which came from this location.



Now, Hungary is a member of the European Union and endeavours to be a regional leader in Middle-Europe. In the 90's it was one of the most popular investment targets for companies from all over the world. More recently, large Hungarian companies deal in acquisitions in Middle-Europe and because of this location and our highly qualified labour force, well known international brands use Hungary as a regional centre.

## 2. MGI-BPO – MGI in Hungary

BPO was founded in 2001 primarily to capitalise on small to mid-size companies previously the province of the multinationals. Our reputation, built on our key objective, customer satisfaction, is endorsed by references we can cite from practically all areas of the accounting profession, not just by our number of clients.

Many of our colleagues hold leading positions on the supervisory boards and boards of directors of internationally recognized companies. We pride ourselves on the quality of our staff and their capabilities of performing even the most complex tasks.

BPO has extensive professional experience in domestic and international accounting. We use a documentation system for bookkeeping and auditing which is fundamental to our international business experiences but uniquely maintains its original Hungarian features.

We have developed a customs auditing and bookkeeping methodology, which is unique to small enterprises. To maintain momentum, we have developed, and continually upgrade our custom software, facilitating our own bookkeeping and auditing tasks and those of similar companies.

BPO is able to meet the most rigorous information requirements of companies based abroad and we are experienced in complying and preparing consolidated reports and statements.

BPO joined MGI, the international independent accounting, auditing and consulting network, in 2005.

### 3. The country

Hungary lies in the Carpathian Basin. Two large rivers cross the country splitting it into three parts. The west part is Transdanubium which is made up of mixed terrain: hills, a small plain and Lake Balaton. This is one of the most important tourist areas in Hungary. The middle part of the country consists of a plain, and it is here that the most important income resource from agriculture is generated; it is the home of Hungarian paprika. In the East is the famous Hungarian National Park, the 'Hortobágy', where thousands of protected animals live. And in north-east are the North-Middle-Mountains, the highest point of Hungary, the 'Kékes' (1,014 meters).



Budapest, the capital city, with a population of 2 million, lies by the river. It is not only political and economic, but cultural capital of the country. Other big cities are Debrecen, Miskolc, Szeged, Székesfehérvár, Győr and Pécs.

### 4. The Economy

#### 4.1 Hungary's Economy

Almost two-thirds of the GDP is produced by the service sector. Within this financial environment, real estate, renting and business activities, as well as public services, (administration, education, health, social work, etc.), play a prominent role. Added to this, industry/manufacturing produce about ¼ of the gross value. Agriculture and construction have a relatively low share - 3.9 and 5.6% percent respectively.

Because of the unfavourable international environment, the growth rate of GDP has slowed down since 2001, but it still exceeded most of the developed European countries growth.

The 5.2% growth in 2000 was a result of the expansion of the construction (19.2%), manufacturing (7.5%) and financial and business services (8.3%). Then between 2001 and 2003 almost all sectors produced weaker results. However, some figures are worth to mention: the agriculture growth by 23.4% in 2001 or the construction by 14.8% in 2002. Altogether, GDP grew by 3.1% in 2001; 3.3% in 2002 and 2.9% in 2003.

High consumer price inflation, (CPI), prevalent during the political and economic transformation period, reduced to 10% at the end of the decade and stayed at this level during 2000. In 2001, Hungary changed its exchange rate regime, from the former

crawling peg to floating with 15% band. In line with this, the full liberalisation of the exchange rate market took place and the National Bank of Hungary adopted the inflation targeting monetary regime. As well as the favourable external tendencies, the growth of consumer prices reduced by 4.7% by the year 2003 and 6.8% in 2004. However, partly because of the pass-through of international price hikes, partly because of harmonisation of administered prices and increase of VAT, CPI has increased markedly in 2004.

The run of general government balance follows the political cycles. By the year 2000, the government managed to reduce the deficit to 3%, a value fulfilling the respective Maastricht criteria. Then during 2001-2002 the deficit increased significantly to 4.4% in 2001 and, to the remarkably high 9.3% in 2002. Last year the overall government deficit fell to 5.9%, at which time the central government deficit became only 4%, but the balance of the social security funds ran to 1.9% of the GDP in that year.

By 2000, gross national debt came under Maastricht reference value of 60% of the GDP. The 53.4% in 2001 meant the minimum value for that indicator in the post-transition years. Because of the higher government deficit the debt/GDP ratio started to grow, reaching 59% in 2003. This is near the Maastricht reference value and in 2004 further increase was expected, although the indicator presumably will not surpass the threshold.

Also the current account deficit shows an ever-growing tendency in the last three years. In 2001 the deficit dropped to 6.2% from the 8.9% in the previous year, but from that year it increased by 7.2 and than 8.9% of the GDP.

In 1999 and 2000 external trade widened dramatically: in 2000 the volume of imports increased by more than 20% and the volume of exports by almost 22%. In the following year there was a substantial backslide in the growth rates, and in 2002 and 2003 the dynamic of both indicators was below its decade-end level. 2003 was the first year in 5 when the growth of imports exceeded exports.

During that period there was a significant foreign direct investment inflow into Hungary, especially the 4.4 EUR billion performances in the year 2001. Although one can see some setback also in this field in the last three years, in 2003 there was an increase in the reinvested earnings and in the investments flowing abroad from Hungary.

#### **4.2 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 on 1 May 2004.

#### **4.3 Currency and banking**

The official currency in Hungary is the Hungarian Forint (HUF). Currently, coins of 1; 2; 5; 10; 20; 50; 100 and notes of 200; 500; 1000; 2000; 5000; 10000; 20000. The exchange rate of the Hungarian Forint was 245.93 HUF/EUR (180.29 HUF/USD) at 31 December 2004.

Hungary has a developed banking system with banks classed at two levels: level one Hungarian National Bank; level two merchant banks.

The main aim of the Hungarian National Bank is to reach and maintain price-stability. After this the National Bank supports the government's economic policy.

The commercial banks (level two) handle accounts of private individuals and companies, accord credits and loans and offer investment services, safe service and bank guarantee etc.

#### **4.4 Government - The Political System**

Hungary has been politically stable since its transformation process began in 1989. The originally large number of political parties has consolidated, with only four parties successfully meeting the minimum 5% threshold to access the Hungarian Parliament during the last elections in 2002. The political arena is currently bipolar – the conservative right consists of two parties, the Viktor Orbán-led FIDESZ-MPSz and the Hungarian Democrats (MDF) currently in opposition, whilst the socialist-liberal pole includes the Hungarian Socialist Party (MSZP) and Alliance of Free Democrats (SZDSZ), currently making up the coalition government. The next general election is due to take place in 2006.

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

#### **5. Forms of business enterprise**

The primary legislation governing the form and regulation of companies is Act CXLIV of 1997 on Business Associations (the Companies Act), which came into effect on 16 June 1998. This Act is the successor to Act VI of 1988, which had already brought Hungarian company law substantially into conformity with European Union company regulations. Most of the types of companies and the associated regulations found in Hungary are similar to those used in European Union countries.

Five possible legal forms of business association are listed in the Companies Act:

- Unlimited Partnership (Közkereseti Társaság - Kkt.)
- Limited Partnership (Betéti Társaság - Bt.)
- Joint Company (Közös Vállalat - Kv.)
- Limited Liability Company (Korlátolt Felelősségű Társaság - Kft.)
- Company Limited by Shares (Részvénytársaság - Rt.)

The Kkt. and Bt. forms 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 other three are clearly recognized as legal entities. Notwithstanding this, all these forms are taxed at the level of the entity. 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.

## **5.1 Rules applicable to all Types of Business Associations**

### **5.1.1 Articles of Association**

An initial step in funding 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 and the registered office (address) 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;
- 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.

The value of any in-kind contribution cannot exceed the valuation approved by the statutory auditor of the company. A member providing an 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.

### **5.1.2 Single-member Companies**

A company may have a single member. 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. The single-shareholder has to make decisions on the issues falling within the authority of the general meeting in writing, and must inform the executive officers of these.

## **5.2 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 re-company, with the following exceptions:

- generally, no changes may take place in the members of the pre-company;
- the articles of association may not be altered, except to make corrections ordered by the court of registration;
- legal proceedings for the exclusion of a member may 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.

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 executives are personally liable for debts exceeding the proposed registered share capital.

### 5.2.1 Registration

The foundation of a business association must be reported to the 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.

### 5.2.2 Directors

A director of a company must be an individual. It is not possible for a company to be a director. An individual may be a director of a maximum of three different companies at any one time. Directors are elected by the Members' Meeting (General Assembly) for a fixed term, which cannot exceed five years. Officers may be re-elected or recalled at any time by the General Assembly.

### 5.2.3 Supervisory Board

A Supervisory Board is comprised of non-executive directors. A supervisory board must be established by:

- a Kft., if the registered capital exceeds 50 million HUF;
- all Rts.;
- any company, if it has more than 200 employees.

The Articles of Association may assign authority to the supervisory board to elect and remove the executive directors, establish their remuneration and approve particular transactions.

### 5.2.4 Auditor

A statutory auditor is required to be appointed by:

- an Rt.; a Kft., if the registered capital exceeds 50 million HUF, or if there is only one registered owner;
- the total net revenue of the company exceeds 50 million HUF in two years average;
- when any law requires (insurance companies, banks...)

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 period not exceeding five years. The auditor can be re-appointed following the end of his term of office.

The company must have any report it is required to prepare to comply with the Accounting Law examined by the auditor (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 Law 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 may not be an auditor. Executive officers, supervisory board members, their close relatives and employees of the company may not be elected as the auditor of a 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 (such that net equity is or will be less than 66 percent of an Rt.'s or less than 50 percent of a Kft.'s registered capital), 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.

#### 5.2.5 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);
- 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.);
- 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 IL 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.

#### 5.2.6 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)

#### 5.2.7 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.

#### 5.2.8 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 may result in the loss of limited liability status and recourse to 50 percent or 70 percent shareholders can be sought. This may be used as a mechanism to recover debts from customers that have failed to honour payment obligations and can no longer be traced.

### 5.3 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.

#### 5.3.1 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 must include the following:

- the registered capital and each member's stake therein;
- if part of the cash contribution is unpaid, the method and date of payment;
- questions relating to voting rights;
- the name of the first managing directors(s);
- the method of signature in the firm's name;
- if appointment of a supervisory board and/or an auditor is compulsory, the names of the first persons so appointed;
- the procedures to be followed if a members' meeting does not have a quorum and must be reconvened.

#### 5.3.2 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, or any right representing pecuniary value. 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 may not be less than 3 million HUF. At foundation, at least 30 percent of the initial capital or 1 million HUF must be contributed in cash.

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 100,000 HUF 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:

- contributions in kind have been made available to the company in full, and
- at least half of each contribution in cash, and 1million HUF in total, 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. In case of a single-owner Kft., the value of the whole share must be made available at the foundation of the company.

### 5.3.3 Members' Meeting

The supreme body of a Kft. is the Members' Meeting, which must be held at least once a year. The following falls within the exclusive authority of the members' meeting:

- hg
- all of the annual financial statements of the company, including the decision on the appropriation of after-tax profits;
- 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;
- 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;
- alteration of 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. If the balance sheet discloses that accumulated losses are equivalent to at least one-half of the registered capital or the company's equity has fallen below 3 million HUF or the company has gone bankrupt, the managing director is obliged to call an extraordinary meeting to deal with the situation.

### 5.3.4 Managing Directors

The administration of the company's affairs and representation of the company is carried out by the managing director (or directors).

#### 5.4 Company Limited by Shares (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 twenty million HUF. At foundation, contributions in cash must be at least 50 percent of the share capital or ten million HUF.

##### 5.4.1 Shares and Shareholders' Rights

Shares are securities embodying membership rights and can be bearer shares or registered shares. Different classes of shares can be issued, such as ordinary shares, preference shares, employees' shares, interest-bearing shares and reconvertable 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.

##### 5.4.2 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 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 the 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 for the issues on the original agenda irrespective of the number of those present.

#### 5.4.3 Board of Directors

An Rt. must have a Supervisory Board and a Board of Directors (except that the Deed of Foundation of a private Rt. 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.

#### 5.4.4 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.

#### 5.4.5 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 (20 million HUF). 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.

#### 5.4.6 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 after the company's registration is cancelled. 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.

#### 5.4.7 Acquisition of an Influencing Interest in Business Associations

Members hold a “significant interest” if they control more than 25 percent of the votes in a company. Members hold a “majority interest” if they control more than 50 percent of the votes in

a company. Members hold a “controlling interest” if they control more than three-quarters of the votes in a company. The existence of any of these “influencing interests”, must be reported to the Court of Registration by the party holding the interest within 30 days. Prior to reporting an influencing interest to the court of registration, the party holding such interest may exercise its voting rights only to the extent to which its participation is not subject to the disclosure obligation.

## 6. Direct taxation

### 6.1. Income tax – individuals

#### 6.1.1. Personal Income Tax

The legislative measures on personal income tax are more complex than they are in other countries, because the relevant law provides for rules as regards both individual entrepreneurs and those carrying on farming operation.

The broadly taken concept of 'income' comprises therefore not only income from wages and salaries in employment, but also revenues accruing from entrepreneurial activity, so this law specifies rules on what can be considered as cost and is thus deductible from overall income. It is a general rule in Hungary that the party paying off income is bound to deduct source tax (withholding tax) from the income disbursed or to pay tax on the services (in forms other than money) it provides to its worker. The employer may settle its workers' account with the tax office in cases when the employee has no other source of income (some incomes, as exceptions to this rule are set out in law, but in such cases the employee is to declare and document these sources of revenue with the employer). In any other case the employee becomes 'self-assessing', i.e. he himself gives account to the tax office about his incomes by way of systematically recording the documents and vouchers received from his employers (the paying principals are obliged to collect such documents once a year and send them on to the said persons) and by completing and filing his tax return. The disbursing parties (employers) are liable to deduct the source tax and then to pay it to the tax office, of which act they submit a detailed annual statement to the tax office. (This information constitutes the 'control data' which, after processing, are readily available to check each on individual taxpayer.

Foreign nationals are subject to taxation in Hungary, but law provides that they are to pay quarterly advance tax on their incomes received from abroad. After the lapse of the year they should file their tax returns with the tax they calculate. Should the amount of tax disbursed in advance exceed the calculated sum, the difference may be claimed back; otherwise the difference is to be paid in.

If the foreign national earns taxable income in Hungary with his work (activity) here, he will become a taxpayer in the self-assessment system in the cases specified here below. Law requires him to register with the Hungarian tax authority, to pay advance tax after a quarterly period, and to file a tax return at year-end. If the taxpayer terminates his income-earning activity before the end of the year and leaves the country, he is to settle his tax affairs prior to his departure.

Failing to meet these obligations (registration, filing of return and tax payment) generally incurs the payment of a fine which, in the first two cases (registration and return filing) is called default fine, whereas for failure of tax payment it is called tax penalty. The default fine may be from 60 to 200.000. Forint, while the tax penalty may attain 50% of the tax due, but, due to delayed settlement, interests are also payable, of which the amount is twice the prevailing base interest rate of the national bank.

Old-age pensions are not liable to tax in Hungary, no matter whether they are paid from abroad or originate inland. Of course the origin of amounts received from abroad under this title is to be certified.

As mentioned already, the incomes accruing from different sources are to be added up or contracted which amount than makes up the combined or contracted tax base. Hereto

belong, e.g., the earnings from farming, from independent work (free-lance intellectual occupation), for which the different costs incurred in work are allowed by law to be deducted and certain benefits are granted. The various remunerations, extra payments (per diems) during travels abroad and the property value of rights arising from the sale/purchase of companies all belong to the category of 'other incomes'. Other incomes may accrue from money/capital market transactions (gains from price quotations) or from the payment for securities, dividends and interests and from trading with business quotas. It should be noted here that in Hungary the tax on interest earnings is 0 % at the moment.

In terms of the rules specified in the law the costs of an enterprise may be set off against proceeds from entrepreneurial business activity, the difference between the two being termed as the entrepreneurial profit. The provisions in the law on accounting apply to the record-keeping on receipts and costs.

If a foreign person embarks on entrepreneurial or business activity in Hungary, then, owing to the complex character of the relevant statutory regulations, it is advisable to rely on the assistance of an accountant or advisory firms.

The taxpayer is free to choose between the systems of cost-accounting or that of pre-set cost ratio. Should he choose the latter one – for example, regarding receipts from independent intellectual work -, 10 per cent of the receipts may be accounted for as costs, but this way of calculating need not be proved by invoices or vouchers. In 2005, the tax rate in Hungary on the combined or contracted tax base is 18 % up to 1,500,000 forint in income, 38 % above this level.

## 6.2. Corporate income tax – companies

Legal (juristic) persons formed by the statutory rules of a foreign country, associate companies without legal personality, personal partnerships and other organisations are qualified as taxpayers with foreign residence.

It is a feature common to all foreign-residence taxpayers that their taxation liability extends to incomes from business activity performed in Hungary or to incomes originating in Hungary, their tax duties depending on how they acquire income in Hungary, whether they have an inland company seat or if they earn incomes without trading via a business site not qualified as company seat. As to the mode of income-earning, the law on taxation distinguishes between foreign entrepreneurs and foreign organisations.

The taxpayer is termed as **foreign entrepreneur** who has a company seat (establishment) in Hungary and whose income is generated by his trading through his seat or establishment in Hungary.

A **foreign organisation** earns income in Hungary, but via a company seat not located in Hungary.

It is a basic tenet in the tax law that if there exists an international agreement applicable to earned or allocated incomes, then provisions in such an agreement are to be given legal preference to those set out in the local tax law. The only exception to this rule is that applying the agreement must not result in the taxpayer's tax obligation being extended. Accordingly, no reference to this agreement may be used to impose on the foreign taxpayer's income a tax rate higher than the one specified in the taxation law, and no income declared to be tax-free by the law may be made taxable (for example, the gain earned by the foreigner from changes in price quotations when selling securities unrelated to company seat (establishment)).

### 6.2.1 Foreign enterprises

The law on taxation provides detailed specification on cases when the foreign entrepreneur's inland business activity is related to local company seat (establishment); this definition contains the principles worded in international conventions and, on several instances, the terms and expressions used therein.

In these terms, a company seat or establishment is:

- Such a permanent business establishment, equipment or facility where and/or through which the taxpayer, wholly or partly, carries on entrepreneurial activity, independently of the legal title under which the taxpayer uses it, with the addition that the term company seat or establishment extends to the site of business management in particular, to representation set up with inland seat, office, factory, plant, workshop, mine, gas or oil well, or any other facility in use to explore and exploit natural resources;
- The site of construction or assembly work - including that of supervisory activity related thereto - if this facility is being used over a (continual or interrupted) total period of at least three months; such a site is to be regarded as a construction site, independently of whether several and separate contracts underlie its operation or whether the orders for work were granted by different persons; construction work constituting a single unit from economic, business and geographical aspects is to be taken as a single construction site;
- The foreign national should be considered as possessing an establishment if he is directly utilising natural resources located in the country;
- The foreign national is also to be considered as possessing company seat or establishment when he is using immovable property or natural resources against charge, is transferring, selling or contributing a right of property value related to some natural resource or real property against charge;
- Furthermore, the foreigner in question is to be regarded as possessing an establishment if on his behalf activities are performed by some other person, and provided this person is empowered to enter inland contracts in the foreigner's name and if this person makes regular use of this right, or if the said person keeps a stock of commodities or products from which he regularly delivers on the foreigner's behalf;
- The foreign person is regarded as possessing company seat or establishment if, on his behalf, some other person takes out an insurance policy against inland risks (re-insurance is an exception), and
- If the foreign national carries on a business enterprise through a branch office.

In terms of the foregoing the category 'establishment' or 'company seat' includes, among others, the permanent business facilities such as buildings, offices, factories, mines, and permanent business equipment, through which the foreign firm created installations for continual and permanent business performance.

For a permanent installation, equipment or facility to be qualified as establishment (company seat) there is no need for the said unit to be owned by a foreigner. An installation, equipment or facility that is hired out, rented, leased, or in free use is also an establishment, provided it meets the criterion of 'permanence'. The criterion of

permanence is fulfilled for the facility, equipment or installation if it subsists continually, over a longer period or over an indefinite time.

Construction proper is separately specified as establishment by the law.

In establishing if a construction site is establishment (company seat), a separate examination should be conducted from site to site to see if this/these is/are establishment(s) or not. A geographically contiguous or economically interrelated construction project is qualified as a construction site.

Construction or assembly work site is to be taken as an establishment only if its duration lasts for at least three months, as mentioned above.

In all the instances when the Hungarian Republic has a convention to avoid double taxation with the foreign national's country, and if this convention sets out a divergent provision regarding establishment, then those specified in the convention apply; such a case occurs for the duration of construction work, for which the term 'establishment' typically prevails after a lapse of time longer than three months.

The law on taxation specifies, in line with the conventions, as establishment a person related thereto (representative) who carries on inland activity on the foreigner's behalf and makes regular use of this power. The representative in charge of insurance business is specifically mentioned by the law, and such a person is taken to be an establishment if the representative takes out insurance against inland risks.

The representative, though not independent, does not pass for the foreigner's establishment if his activity extends exclusively to storing, stocking, displaying and holding products, or to procuring products for the foreigner, or if the activity he performs has a helping or preparatory character.

The activity conducted by the non-independent representative creates an establishment from the year 2001 even if the said representative is a private foreign national.

In the category 'establishment' the law on taxation separately specified the term branch office as well.

There is a separate Act regulating investments by foreigners in Hungary, in which two types of business-oriented local units are distinguished, namely the branch office registered in the companies register and the companies founded with foreign participation. (In this latter case it is not the foreign partner that becomes the subject of corporation tax, - such a company is, by law, a taxpayer with inland residence.)

The foreign enterprise is entitled to carry on trading in Hungary via its branch office registered in Hungary; however, no branch office is required to be set up to carry on business in the following areas:

- a) training within high-level educational institutions;
- b) performing arts;
- c) provision of expertise (book-auditing, accountancy, record-keeping and legal services);
- d) professional sport activity;
- e) construction, assembly, installation and work management activity performed to fulfil jobs set out in foreign-trade contracts;
- f) activities limited to service provision or to inland marketing of products procured by the foreigner and stored inland, provided such a job is carried on without personal presence and using the trade card issued abroad by the trader;
- g) other, business-like economic activities that are allowed by law to be carried on without business installation in Hungary (e.g. counselling work by foreign private attorney's office, for which no branch office is allowed by the law on legal representation to be set up, and this work may only be done exclusively in terms of a contract concluded with Hungarian lawyers or attorneys' offices);

The law on taxation, generally in agreement with those laid down in international conventions, underlines instances which do not qualify as establishments, such as:

- a) an installation for the sole purpose of storing and displaying a foreigner's products or commodities;

- b) stocking and storing of a foreigner's products for the sole purpose of warehousing, displaying or of processing by third persons;
- c) upkeep of installation exclusively for procuring products and commodities for foreign persons or for gathering information;
- d) using an establishment for the sole purpose of other preparatory or helping activity;
- e) activity carried on via independent representative (including commission agents), provided this person acts in the framework of his usual work.

In the light of the preceding terms, no foreign enterprise becomes subject to the law on taxation which, for product display alone, hires a permanent showroom in Hungary or regularly stores product stocks – e.g. in a customs warehouse – or holds only materials and semi-finished products for later job processing through hired work. Nor is an establishment created by a foreign firm maintaining a representation office in Hungary for market research alone.

#### 6.2.2 Dividend tax.

Foreign persons receiving dividend have to pay dividend tax. Irrespective of the form in which it is provided the dividend shall be the amount received from the share or proceeds approved and confirmed by the foreign enterprise that is engaged in business activities through a branch office and the amount withdrawn by the foreign enterprise from its resident business premises, other than branch offices, from the profit (including the accumulated profits from previous years) remaining after payment of corporate taxes as well. The dividends received (realized) shall be subject to 20 per cent dividend tax. Payers shall declare, pay and deduct the dividend tax.

Payers need not determine, pay and deduct the dividend tax on that portion of the dividend used by the foreign dividend-receiving party for increasing the issued capital of an economic association or co-operative operating in Hungary, including the economic association and co-operative paying the dividend, or for participating in the establishment of a new economic association or co-operative in Hungary, provided that the payer transfers such portion directly for this purpose on the basis of the order by the dividend-receiving party with foreign domicile. At the same time, the payer shall inform the economic association or co-operative that the amount transferred is the income of the dividend-receiving party with foreign domicile qualifying as dividend pursuant to this Act. The amount transferred shall be considered as a sum on which no dividend tax has been paid, unless the party receiving the dividend or the payer provides proof to the contrary.

The dividend tax payment obligation shall become due according to the following:

- at the time of refusal of application for registration, or the termination of the registration proceedings at the Court of Registration
- at the time of implementing the resolution of the members' meeting, general meeting or that of the founders on the reduction of the issued capital or the cancellation of the increase of the issued capital of economic associations, co-operatives or their legal successors
- at the time of fulfilling the repayment (reimbursement) claim due to foreign parties receiving dividend as against the economic association, co-operative or their legal successors, on the basis of the termination of their membership (shareholders') relation, in particular, in the case of the bankruptcy or liquidation of the economic association or co-operative, or the acquisition of own business quota or shares

The Act determines among the transitional provisions those cases when there is no dividend tax paying obligation (the reason for that comes from the significantly higher

dividend taxes of the former years, therefore further tax burden would have been inequitable for the investors):

### **6.3. Local taxes**

Following a constitutional amendment, a law was legislated on local self-governments under # LXV/1990 (ÖTV for short). This legislative step enabled independent and democratically operating self-governmental bodies to play their important role as sub-systems within the overall state administrative system.

Acting in terms of their tasks and purview, the self-governments express local general will and local public interest. To do justice to their tasks they require their own revenues and - within the bounds of law - they are therefore empowered to impose local taxes and to fix their rates.

The right to levy local rates, as a basic self-governmental right, is specified in § 44/ of the Constitution. Detailed provisions on local tax revenues are given under § 82 of ÖTV. The new local regime of taxation was determined in the Act C/1990 (HTV), which came into effect on 1 January 1991.

The legal power and the ability to fix tax rates is a basic issue in local taxation. To fix the proper tax rates, self-governments are required to explore and investigate thoroughly the economic status of their areas and settlements, and to conduct analyses into economic and sociological aspects. The level of taxation may be set by self-governments, with due consideration being given to statutorily defined upper /maximum) limits.

There are binding exemptions and allowances specified in the law, but all these prescriptions may be extended by self-governments in the knowledge of local condition and endowments.

The HV rules that local taxes and rates may constitute only the receipts of the self-government fixing them; these financial amounts may not be withdrawn from these bodies.

In the practice of local burden-sharing, the local taxes, introduced since 1991, play an all-important and indispensable role in enhancing the safe management of affairs at local governmental levels as well as in raising the necessary resources and funds.

From a local viewpoint, the outstanding aspect in locally judging the sharing of public burdens is that, as early as their introduction, such financing goals and targets be defined and decided on as are accepted by a wide circle of taxpayers. In operating the system, one should be consequent in making sure the all-inclusive character, the validity of the principle of fair and equal treatment and the public transparency of how the funds are put to use.

### **6.4 Taxation System of Local governments**

The introduction of local taxation systems is conditional on legal, economic and political factors. Two principal concepts are available for choice in defining the scope and purview of local self-governments:

- The law should only declare that the self-governments may levy local taxes, but no central legislative restrictions should be imposed on the types of the various taxes available for introduction or on their measures and rates;
- The other consideration states that law is to provide a background framework for admissible tax types, but no guarantee rules are to be fixed by legislation.

The legislation on local taxes was passed in terms of this latter concept. It was another major endeavour that the system of local taxes is to be formulated in line with, and adjusted to, the central taxes and their rates.

#### 6.4.1 Property-type taxes

##### **a. Tax on Buildings**

This tax obligation starts on the first day of the year following the one when the permit for use was issued, and ceases the day the building ceases to function as such.

As a main rule, the subject of taxation on building is the person who is its owner on the first calendar year (private person or enterprise).

As regards buildings located within the territory of the self-government, in the inner area and on the outskirts of the settlement concerned, the object of taxation is the constructed building part serving housing and other purposes.

There are important exemptions concerning emergency housing, tax objects located in health-care or recreational zones, social, medicinal, etc. constructions.

Depending on decision by the local governmental body, the tax base is the floor area in square meters of the building or its corrected market value. The upper limit on the annual rate is 900 Ft/m<sup>2</sup> or 3 % of the corrected market value.

##### **b. Tax on land plots**

This tax obligation begins on the day of the year in which the land plot was rated as belonging to the internal area or in which the ban on construction is lifted, and ceases on the last day of the year in which the plot was categorised as belonging to the outskirts or in which the ban on construction was imposed.

The tax subject is the person who was the proprietor of the plot on the first calendar year.

Major exemption instances are: land plots under ban to construct or develop, areas for public-use traffic, and plots held by bodies in charge of social, health and children' protection jobs, etc. The tax is levied in terms of the plot area given in square meters or in terms of the corrected market value of the land plot. Within this scheme the upper limit of tax rate is 200 Ft/m<sup>2</sup> or 3 % of the corrected market value.

#### 6.4.2 Communal taxes

##### **a. Communal tax payable by private persons**

The way this tax obligation arises for private persons is the same as it was for taxation on land plots and buildings. As to immovable properties owned by private persons or to those charged with property-value right to the benefit of private personas, the object of taxation is the building, and the unimproved land plot within the inner area as well as the letting right of apartments not owned by private persons.

The upper limitation to this tax rate is 12,000 Ft/year per taxation object or per each apartment-letting right.

##### **b. Communal tax payable by entrepreneurs**

The tax liability for entrepreneurs begins on the day their entrepreneurial activity has been started.

The corrected average statistical workforce or staff level employed over the area of the self-government by the taxpayer underlies as tax base. The upper limit on this tax rate is 2,000 Ft/year.

##### **c. Taxation on tourism**

Those private persons are liable to taxation that stays as non-permanent residents over the territory of the self-government for a time longer than a single guest night, or who possess a building capable of being used as vacation facility and not categorises as apartment unit.

Tax subjects are those private persons (natural persons) who own the building used for vacationing on the first day of the calendar year, or who spend at least one guest night at some accommodation facility.

Out of the several tax-exempting factors we should mention: private persons under 18 years of age or those above 70 years as well as private persons being taken care of in health or social institutions, etc.

For tourism tax payable during the period of stay there is no direct link between the person bound to pay (tax subject) and the tax authority. The law requires therefore the landlord (host) to collect the tax, as the party obliged to tax collection.

In case of a tax liability arising from building property tax, the upper limit on the tax rate is 900 Ft/m<sup>2</sup> at most, and 300 Ft per person and guest night, or the upper limit is 4 % of the amount charged for accommodation for each guest night started.

#### 4. Local trade tax

This tax type was introduced by 2800 local self-governments out of a total of 3250. The revenue collected from this tax totalled 230 billion forint in 2001; out of this amount the capital (Budapest) had a share of 101 billion.

The tax obligation starts with the day when the business activity commences and ceases the day trading is terminated.

When performing business on a provisional (casual) basis, tax liability depends on limitations set within the area of the local government and on the period of trading. The subject of trade tax is the entrepreneur himself. The activity liable to taxation is the entrepreneurial activity carried on over the territory of the self-government.

The object of taxation is the endeavour by the business enterprise as such to gain earnings and income.

The site of the enterprise is the company seat registered with the court of incorporation, whereas for private persons this location is the person's residential address.

The permanent business or plant facility is taken as establishment or business location, independently of the legal title of its usage.

The tax base is made up by the net price proceeds from the products sold or from the services provided, which represents the same value as the one in the term specified in the Act on accounting and accountancy (SZTV).

Should the entrepreneur carry on its trade over the area of more than one self-government, then the tax base is to be shared in line with the guidelines set out in the annex to the HTV.

In case of uninterrupted business activity, the upper limit to the tax rate is 2% of the tax base.

For provisional (casual) business performance, the tax is itemised and its maximum advance amount is 5,000 forint a day for each calendar day.

A private person whose activity performance is regulated by law is liable to tax payment. Foreign private persons and foreign organisations are also tax subjects, provided their tax exemption is not secured by international convention or reciprocity (convention ruling out double taxation).

As to tax exemptions and allowances, distinction must be made between compulsory exemption specified by law and exemption granted by self-governmental order.

The most important issues in the tax administration process as regards trade tax are:

- The taxpayer is to register with the office of the local self-government (this applies to any local rate or tax);
- HTV provides for an advance amount to be payable on trade tax, which is notified by the local self-government in its notice of payment obligation;
- The taxpayer is bound to return his tax on annual basis unit 31 May of the year following the base year (main rule);
- The taxpayer's right and duties are communicated in a decision by the authority;
- Upon taxpayer's request, the self-governmental tax authority grants payment relief (instalments, delayed payment, etc.);
- In the case of payment default or unjustified delays, the self-government imposes sanctions (delay penalty, tax fine, and delay fine).

When becoming tax subjects, foreign nationals and enterprises are to call on the central tax office (APEH) for registration, but they are also to contact the local self-government office for the same purpose. Upon completing and submitting the printed forms made available to them by the self-government and upon perusing the proper information also there from, they can be sure of the local tax(es) to which they are liable and they can ascertain the conditions obliging them or not to pay tax.

As to trade and tourism-related taxes in their own scope and purview, the Mayor's Office at the Budapest Metropolitan Self-government draws the attention of those interested to the following points:

The substantive legal rules on local taxes are regulated in the amended Act C/1990/, the notion of net price proceeds constituting a part of the tax base as regards local trade tax is specified in the Act C/2000 (§§ 72-74), while the tax subjects entitled to itemised lump-sum taxation within the local trade tax are defined in Act XCVII/1995 (§§ 51-53) on income taxation. The relevant decrees of the Metropolitan general Assembly are: Decree # 21/1991 (IX.5.) on local trade tax, and Decree 31/1994 (VI.10.) on tourism tax.

The procedural rules are laid down in the amended Act XCI/1990 on the order of taxation.

The general Assembly of Budapest introduced local trade tax for the administrative area of Budapest with effect from 05.09.1991.

Any entrepreneur carrying on, permanently or provisionally, entrepreneurial activity over the area of Budapest is liable to pay local trade tax {part (1) in § 1}. If the foreign entrepreneur/enterprise meets this condition, he/it is subject to local trade tax. The rules on the use of tax exemptions or allowances (§ 2), the method of establishing the tax base and rate (§§ 3-4) and the rules on paying taxes and benefiting from relief (§§ 6-7) are the same as the regulations applicable to inland entrepreneurs.

Under § 2 of the Metropolitan Decree 31/1994 (VI.10.), tourism tax is payable by:

- A private person who, being no permanent resident, spends at least one guest night in the self-governmental area;
- The person obliged to collect the tax (landlord) but who missed to collect it;

Should any of the above conditions prevail, the foreign private person is also taxable. The regulations applying to inland private persons hold also for tax exemption (§ 3), tax base (§ 4), tax rate (§ 5), for the person obliged to collect tax (§ 6), tax payment (§ 7), and for the records to be kept on taxation.

For both tax types, the rules for registration and tax return are set out in the ART. Part (2) of § 11/C of ART rules that the fact of tax liability is to be declared by the taxpayer with the self-governmental tax authority, on a printed form designed for this specific

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purpose, within 15 days of the date of incidence of tax liability (since the beginning of activities). Declaring alterations affecting tax obligation is regulated in § 15 of ART. The deadline to returning local taxes is set in § 22 of ART, while the due date to return taxes with self-governments is given under Points II/15-16 in its appendix # 2.

Taxes on constructions and buildings, and communal taxes fall within the scope and purview of the area self-governments within Budapest. The self-governmental decrees vary from place to place in prescribing the conditions of taxation and all the issues presenting no infringement to the HTV.

## 7. Indirect taxes

### 7.1 VAT

#### 7.1.1 Scope of the Act

**1. Territorial Application** This Act shall be observed within the territory of the Republic of Hungary (hereinafter referred to as 'territory of the country'). The term 'territory of the country' shall also include free zones and transit zones.

**2. Personal Scope** The provisions of this Act shall apply to the taxable persons defined in Section 4. The provisions of this Act shall apply to taxpayers taxed under the Act on Simplified Entrepreneurial Taxation when expressly prescribed by the Act on Simplified Entrepreneurial Taxation.

**3. Material Scope** Based on the provisions of this Act, the following shall be subject to value added tax (hereinafter referred to as 'tax'): a) goods and services supplied for consideration within the territory of the country by a taxable person, and b) the importation of goods. The provisions of this Act regarding tobacco goods with tax seals affixed as governed under Act CIII of 1997 on Excise Taxes and Special Regulations on the Marketing of Excise Goods (hereinafter referred to as the 'Excise Act') shall only be applied if expressly prescribed by the Excise Act.

#### 7.1.2 Definitions

**Taxable Persons** 'Taxable person' shall mean any natural or artificial person or unincorporated organization who (which) may, in its own name, obtain rights, assume obligations, sue, and perform economic activities on its own behalf, regardless of the purpose and results thereof. In respect of jointly owned and jointly used movable and immovable property, the group of co-owners shall be considered the taxable person. The group of co-owners shall exercise the obligations and rights of taxable persons through their appointed representative. Unless otherwise provided for by law, the taxable status of a foreign-registered company shall be embodied by such company's branch office to the extent of the domestic business activities of the branch office established for such purpose. If a foreign-registered company has more than one branch office in Hungary, each branch office shall independently constitute the taxable status of such foreign-registered company. The business relations between a foreign company and its domestic branch office, or between a domestic branch office and another branch office of such foreign company shall be regarded as if they were established with a person not involved in the foreign company, in return for consideration. Agencies vested with authority to exercise executive powers shall not be treated as taxable persons, such as

a) Ministries, the official bodies of ministers without portfolio, the agency of national jurisdiction and other bodies with an independent chapter in the central budget, and other bodies - including the Hungarian Academy of Sciences as a public body - and persons vested with powers and authorizations, and the budgetary agencies which they supervise,

b) Local self-governments and local minority self-government bodies, and the budgetary agencies which they supervise,

c) Extra-budgetary funds and their managers,

d) Financial funds of the social security system and social security budgetary agencies,

e) National self-government bodies of minorities and national budgetary agencies of minority self-government bodies.

f) Development councils vested with legal personality under Act XXI of 1996 on Regional Development and Regional Planning and their departments.

g) All other bodies and persons vested with authority to exercise executive powers regardless of their organizational structure, in relation to their activities for exercising executive powers, and for the conveyance of any assets, rights, and the exercise of activities, which are subject to concession by contract under specific other legislation.

### **Economic Activity**

(1) Economic activities shall include any and all activities performed on a continuing basis for the purpose of obtaining income, in particular agricultural, mining and construction activities, all activities of producers, traders and persons supplying services including intellectual activities by independent contractors as well.

(2) Activities carried out under contract of employment, cooperative membership or any other legal relationship creating a bound to an employer which, as a consequence of the employer's liability, constitutes subordinate and superior positions in the conditions of and remuneration for such performance shall not be considered economic activities.

(3) The activities for exercising executive powers, and the conveyance of any assets, rights, and the exercise of activities, which are subject to concession by contract under specific other legislation shall not be treated as business activities.

**Supply of Goods** 'Supply of goods' shall mean the transfer of the right for consideration to dispose of tangible property as owner. The following shall, in particular, be deemed as supply of goods:

a) The actual handing over of goods, pursuant to a contract for the hire of goods for a certain period or for the sale of goods on deferred terms, which provides that in the normal course of events ownership shall pass at the latest upon payment of the last lease payment or the final instalment, or upon the expiration of the contract;

b) Transfer of the right of disposition of goods pursuant to a consignment contract between the consignor and the consignee;

c) The actual handing over of goods under contract between the contractor and his customer, whether or not the customer has provided any part of the materials used. The provisions of this Act shall also apply where the goods supplied under contract, pursuant to a legal regulation or a resolution of an authority, or by way of auction.

If a taxable person

a) Applies goods forming part of his business assets used for operations subject to taxation, including the transfer of title to a third party without consideration,

b) Uses or utilizes goods for pursuing economic activities which would otherwise not constitute an entitlement to tax deduction by the taxable person,

c) Uses or utilizes goods for his own purposes in a condition which would otherwise not constitute any right to tax deduction, if it was purchased directly as such;

d) Uses or utilizes goods as fuel for the operation of a passenger car (under tariff heading 8703), it shall also be deemed as supply of goods, provided that the value added tax on the domestic purchase, importation (hereinafter jointly referred to as 'purchase'),

extraction, production, manufacture, processing, conversion or refurbishing of the goods in question or the component parts thereof is wholly or partly deductible.

The following shall also be treated as supply of goods:

- a) The application by a taxable person of an investment project for the purposes of his business using goods purchased, extracted or produced in the course of such business, where the value added tax on such goods is wholly or partly deductible;
- b) The retention of goods by a taxable person when he ceases to carry out a taxable economic activity, where the value added tax on such goods became wholly or partly deductible upon their acquisition, extraction, construction, processing, conversion or refurbishing of which is deductible fully or in part.

(3) The following shall not be treated as supply of goods:

- a) Contributions in kind to religious organizations, non-profit and priority non-profit organizations, and in-kind donations made in connection with the performance of a commitment in the public interest if such donation is deemed to be deductible from the tax base pursuant to the Act on Corporate Tax and Dividend Tax or if it would be deemed deductible had the sponsor been subject to corporate tax, regardless of whether the option to decrease the tax base is in fact available;
- b) Samples of goods;
- c) Gifts of small value;
- d) The provision of mandatory copies of printed goods, if such provision is prescribed by a legal regulation;
- e) Transfer of ownership of goods to another party without consideration, when so required by law.
- f) Gratis delivery of goods that is directly related to the supply of goods or services performed for consideration on a single occasion or on a continuous basis, even if delivery occurs at different times, provided that
  - fa) The market value of the goods delivered free of charge does not exceed the price of the goods or services to which it pertains, and
  - fb) The conditions for gratis delivery are contained in the terms and conditions of the supply of goods and services for consideration.

**Supply of Services** 'Supply of services' shall mean any transaction for consideration which does not constitute a supply of goods within the meaning of this Act. The following shall, in particular, be deemed as supply of services:

- a) Assignment of rights and other intangible property;
- b) The assumption of obligations to refrain from an act or to tolerate an act or situation.

The following shall not be treated as supply of services:

- a) Payment of consideration if made with cash or a non-cash instrument,
- b) Commitment that has no direct impact on prices and is assumed for a sum provided not as a government aid on the basis of legal regulation or through public tender from some chapter of government funds or budget subsidies,
- c) The sum referred to in Paragraph
- d) Does not include any support for research and development purposes that is considered a consideration. He shall be considered to have received and supplied those services himself, where a taxable person acting in his own name but on behalf of another takes part in a supply of services,

The provisions of this Act shall also be applied if the supply of a service takes place under contract, pursuant to a legal regulation, a resolution of an authority, or by way of auction. Activities that a taxable person carries out for another person without consideration and for a purpose other than his normal taxable activity and which activities are not to be regarded under this Act as supplying goods shall be treated as

supplying services, provided that the value-added tax charged on such services is wholly or partly deductible.

### **Importation of Goods**

'Importation of goods' shall mean the admission of goods into the territory of the country in any manner.

### **Exportation of Goods**

'Exportation of goods' shall mean the supply of goods in direct consequence of which the customs authority confirms the goods as having permanently exited the domestic territory by the last day of the third month following the month of delivery. Such goods may not be used or utilized - with the exception of sampling and trial production - between the date of sale and the date of exit. The following shall also be construed as exportation of goods: - the supply of goods in direct consequence of which the customs authority confirms the goods transferred to a free zone, transit zone or a public customs warehouse (hereinafter collectively referred to as 'free zone');

**Supply of Goods and Services Directly Associated with International Transport and the International Trade of Goods** The following shall be construed as supply of goods and services directly associated with international transport and the international trade of goods: a) transportation of passengers and goods in transit; b) carriage of passengers if the point of departure or the point of destination is outside the territory of the country; c) carriage of freight if, upon performance of the consignment.

#### 7.1.3 Place of Performance

**Place of Performance for Supply of Goods** where goods dispatched or transported either by the delivering or the receiving party, or by a third party as commissioned by either of the aforementioned parties, the place of performance shall be the location where the goods are situated at the time of conveyance or the commencement of carriage with the receiving party named as the recipient. If, however, the goods are in a foreign country at the time of conveyance or the commencement of carriage, and the receiving party is an importer, then the territory of the country shall be construed as the place of performance for goods supplied by the importer. In respect of goods that are subject to be installed or assembled, the place where the goods are actually installed or assembled shall be construed as the place of performance.

**Place of Performance for Supply of Services** The place, where the principle place of business or the fixed establishment of the supplier of the service is located, or in the absence of such, where such party's place of domicile or place of residence is located shall be construed as the place of performance. In respect of services directly associated with an already existing real property or with the creation of such (also including the services of real estate agents, experts and architects), the place of performance shall be determined by the location of the real property. In respect of transportation the route actually covered by the service shall be construed as the place of performance. The venue where the following services are actually supplied shall be construed as the place of performance:

- a) Cultural, artistic, scientific, educational, entertainment and sports services and services associated with the performance of such;
- b) Auxiliary services associated with transportation, thus in particular warehousing, security and guard services for means of transportation;
- c) installation, repair, maintenance, restoration and conversion of goods, with the exception of real property;
- d) professional experts' activities directly associated with the goods, with the exception of real property.

#### 7.1.4 Tax Payment Obligation

**Tax Payment Obligation upon the Supply of Goods and Services** The tax on supplies of goods and services shall become chargeable upon performance or partial performance (hereinafter jointly referred to as 'performance'). In respect of simplified invoices, the date of performance shall be the date of issue. If the law prescribes a qualification in respect of establishing the tax base, the date of performance shall be the date of receipt of the qualification document. Where any payment is to be made before the goods are delivered or the services are performed (hereinafter referred to as 'advance payment'), the date when such payment is received (credited) shall be construed as the date of performance.

The amount of money received (credited) shall be considered as that containing the amount of tax as well.

**Tax Payment Obligation upon the Importation of Goods** In respect of the importation of goods the tax shall become chargeable a) upon the date of acceptance of the customs declaration of goods for clearance for the domestic market or for admission under preferential rates (special quota); b) upon the occurrence of specific events in connection with customs formalities, based on which the goods are to be considered cleared through customs for the domestic market.

#### 7.1.5 Tax Base

##### **Tax Base in Respect of the Supply of Goods and Supply of Services**

In respect of the supply of goods and services, the tax base shall be the consideration received for performance.

##### **Tax Base in Respect of the Importation of Goods**

In respect of the importation of goods, the tax base shall be the customs value of the goods established pursuant to the relevant legal regulations, which shall be increased by the following: a) customs duties, taxes, and duties and other mandatory payment liabilities imposed or charged in connection with the importation of goods, with the exception of the tax regulated by this Act; b) the consideration payable for royalties and license fees, if the customs goods to which it pertains are a carrier medium, and if the consideration payable for such right is not part of the customs value; c) incidental costs incurred before the goods delivered to the first domestic destination, thus in particular insurance and transportation costs. If the goods imported are eligible for partial relief from duties in the amount defined by law, the tax base shall be reduced by such amount.

#### 7.1.6 Rate of Tax

There are 4 tax rates:

- 25 % of the tax base (general tax rate)
- 15 % of the tax base (see Schedule)
- 5% of the tax base (see Schedule)
- 0% of the tax base (the amount of tax to be charged shall be zero per cent of the tax base in the case of:
  - a) The exportation of goods;
  - b) The supply of goods if treated the same as the exportation of goods;
  - c) Supply of goods and services directly associated with the international transportation and the international trade of goods.)

#### 7.1.7 Special Exemptions

##### **Special Exemptions in Connection with the Supply of Goods and Services**

The goods and services listed under Schedule shall be exempt from value added tax.

##### **Special Exemptions in Connection with the Importation of Goods**

The goods imported duty free shall be exempt from value added tax, except where the

- a) Relief is part of the preferential treatment granted to the country of origin;
- b) Relief is contingent on the method of financial settlement;
- c) Relief is granted up to a specific amount (partial relief);
- d) Goods are imported for a business association as contribution;
- e) Goods are imported and paid for using the cash deposit and/or contribution paid to a business association;
- f) Relief is granted within the framework of cross-border trading;

The following shall also be exempt from tax:

- a) Goods imported by travellers or as gifts under preferential customs rates, up to the rate of allowance prescribed by law;
- b) Goods admitted under the transit, customs warehousing, temporary importation and inward processing procedure under the conditions prescribed by law.

#### 7.1.8 Deduction of Tax

##### **Constituencies and Extent of the Tax Deduction Right**

The taxable person shall have the right to deduct the following from the amount of tax he is required to pay the amount of tax he has paid:

- a) In connection with the purchase of goods and services to another taxable person (including, in the case of transformation, the predecessor of that taxable person) or to an eligible taxpayer taxed under the Act on Simplified Entrepreneurial Taxation;
- b) As charged on imported goods;
- c) As charged on services he has ordered in his own name;
- d) On tangible assets manufactured by himself [Paragraphs a) -d) hereinafter jointly referred to as charged tax].

Taxable persons shall also be entitled to tax deduction in respect of the supply of goods and services performed outside the territory of the country, however only to the extent applicable for the same supply of goods and services as if performed in Hungary. In the case of transformation, the successor (if there is more than one successor, the one designated by the parties in a special agreement) shall be entitled to exercise the right of tax deduction in respect of tax paid by predecessor as charged as of the day of the successor's registration in the Register of Companies.

##### **Personal Conditions for Exercising the Tax Deduction Right**

The right of tax deduction may only be exercised by taxable persons who (which) are required to pay tax and use single-entry or double-entry bookkeeping. Taxable persons may not exercise the right of tax deduction in respect of the purchase of goods or use of services for which the rules of itemized expense accounting are not applied.

##### **Material Conditions for Exercising the Tax Deduction Right**

Unless otherwise prescribed by the Act on the Rules of Taxation, the right to a tax deduction may only be exercised by persons who have a document verifying the amount of tax charged. The following documents issued in the name of the taxable person shall qualify as such:

- a) An invoice, simplified invoice or document serving as an invoice
- b) A resolution on the amount of tax
- c) Other documents or certificates that contain all of the authentic information and data necessary for verifying the amount of tax. The amount of tax charged may not exceed the amount indicated in the document described in Subsection (1) as tax, or that can be calculated as such.

**Date of Tax Deduction Right**

The date of the tax deduction right shall be the date of performance as indicated in the invoice, simplified invoice or document serving as invoice issued for the goods or services supplied.

**Division of Value Added Tax** Taxable persons shall record the amounts of value-added taxes separately as deductible and non-deductible (itemized breakdown). A taxable person receiving any budgetary subsidies is not subject to taxation shall, unless otherwise prescribed by the act on the annual budget.

**Special Rules on the Division of Tax Charged on Tangible Assets**

In respect of tangible assets, taxable persons shall subsequently modify the amount of deductible and non-deductible value added tax during the 4 years following the year when the tangible asset was placed into service, or in 9 years if it is a real property, if the ratio of utilization of the tangible asset for the supply of goods or services, with or without entitlement to tax deduction, changes in excess of 10 percentage points in the year under review when compared with the ratio of final utilization regarding the year when the tangible asset was placed into service.

**7.1.9 Persons Subject To Tax Payment Obligation****Persons Subject to Tax Payment Obligation in Connection with Supplies of Goods and Services**

In respect of the supply of goods and services, the tax shall be paid by the taxable person subject to perform.

**Persons Subject to Tax Payment Obligation in Connection with the Importation of Goods**

In respect of the importation of goods, the tax shall be paid by the importer. If the customs procedure is handled by an indirect customs representative on behalf of the importer, the tax shall be paid by such indirect customs representative.

**7.1.10 Rules of Procedure**

In the course of procedures related to taxation, concerning matters not regulated in this Act, the provisions of Act XCI of 1990 on the Rules of Taxation, and the provisions of Act C of 1995 on Customs Law, Customs Proceedings and Customs Administration in respect of the importation of goods, respectively, shall be applied.

**Obligation to Issue Invoices** Every taxable person shall issue - an invoice; - a simplified invoice or an invoice of his choice, on request, if payment is made in cash or with a non-cash instrument upon receipt of the goods or services. - If the consideration is not expressed in money, the taxable person shall issue a document serving as invoice in connection with the goods and services supplied by him. The tax base and the amount of tax shall be indicated in detail according to the tax rate charged and in total in all invoices and in documents serving as invoices. In simplified invoices, the consideration with tax included shall be indicated as broken down by the tax rates applied, along with the percentage rate of the tax charged which is necessary to clearly determine the amount of tax corresponding to the prices of goods or services. This percentage rate shall be:

- a) 20.00 per cent if the tax rate applied is 25 per cent;
- b) 13.04 per cent if the tax rate applied is 15 per cent;
- c) 4.76 per cent if the tax rate applied is 5 per cent.

**Tax Records** In the interests of the assessment, declaration, payment or refund of tax by self-assessment, taxable persons shall keep records in sufficient detail so as to permit

establishing and verifying the amount a) of the tax payment obligation on the supply of goods and services, or any exemption from such; b) the amount of tax charged, including the deductible and the non-deductible portion of the amount of tax payable broken down in accordance with the corresponding tax rate.

**Tax Assessment** Taxable persons subject to tax payment obligation shall file a tax return

- a) On a monthly basis, if the annual total amount of tax to be accounted for the year preceding the subject year is positive and is at least 1 million HUF, or
- b) On a quarterly basis in other cases. Taxable persons subject to file quarterly tax returns shall switch over to filing on a monthly basis if their tax to be accounted, as totalled from the beginning of the year, is positive and has reached 1 million HUF. The first monthly return shall be filed for the month immediately following the quarter, closed by the preceding tax return, in which the aforementioned amount limit was reached.

**Payment and Refund (Accounting) of Tax** The tax payable shall be the total amount of the tax payment obligation incurred during the tax assessment period. Taxable persons may deduct the total amount of deductible taxes charged during the tax assessment period from the amount of tax payable. The resulting difference shall be the tax amount to be accounted.

#### 7.1.11 Individual Tax Exemption

(1) Taxable persons whose principal place of business or place of domicile is located in the domestic territory shall be entitled to choose individual tax exemption at the beginning of the tax year if

- a) Their total revenue from the goods and services they supplied in the tax year preceding registration and
- b) The revenue, prorated, that can reasonably be expected for their economic activity in the tax year in which they register remains below the limit prescribed in Subsection (2).

(2) The limit for individual tax exemption shall be

- a) 6,000,000 forint for the family estate farmers specified in the Act on Arable Land and for agricultural smallholders using flat-rate taxation in accordance with the Personal Income Tax Act;
- b) 4,000,000 forint in all other cases.

## 8. Other Taxes and Duties

### 8.1 Motor Vehicle Tax

The operators of road vehicles (cars, trucks, etc.) are subject to a differential annual tax payment based on the weight of the vehicle. The current rate is HUF 1,200 per 100 kilos. Motorcars with a catalytic converter enjoy tax allowance between 20 and 50 percent.

### 8.2 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 80,000 for other legal entities. In the case of registration of a branch, the fee is HUF 250,000.

### 8.3 Property Transfer Tax

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

- 2% for apartments and houses on the first HUF 4 million of their value and 6 percent on the remaining value;

- 10 percent for all other real estate properties;
- 2 percent on commercial real estate if the buyer is a property trading company (with specific requirements)
- No tax on transfer of securities.

#### **8.4 National culture contribution**

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). The rates vary from 0.2 percent to 25 percent depending on the particular product or service provided. This provision is currently under consideration and may be subject to change.

According to the Act on the Program of the National Cultural Fund, the constructors of flats and other buildings with a value exceeding HUF 120 million is obliged to pay contributions to the Cultural Fund of 0.2 percent 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 to be built is subject to cultural contribution. In case of failure to notify, the cultural contribution is borne by the investor.

#### **8.5 Environmental Protection Levy**

This single-stage tax is imposed on the domestic manufacturer, importer or intra-Community acquirer of certain listed products, which in the opinion of the government could prove to be harmful to the environment. These products include:

- fuels and other crude oil products;
- rubber tires;
- cooling equipment and refrigerants;
- wrapping materials;
- batteries;
- thinners and solvents;
- commercial printed papers.

As of 1 January 2005, the government intends to levy environmental charge also on electronic and electric equipment as well as vehicles, while the environmental charge on thinners and solvents is expected to be abolished. The amount of levy is specifically set out for each type of product and is generally computed as an amount per kilogram of product.

#### **8.6 Innovation Contribution**

A new contribution as of 2004, innovation contribution is payable by every entity subject to the Act on Accounting. The base of the contribution is equal to the local business tax base. The applicable tax rate is 0.2 percent in 2004, 0.25 percent in 2005 and 0.3 percent in 2006. 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 these purposes are excluded). The tax return is to be filed by the last day of the fifth month following the actual year. Quarterly advance payments are due by 20th of the subsequent month.

### **9. Contributions – social security**

#### **9.1 Social security**

Compulsory social security covers the insured (employees, members, independent contractors, individual entrepreneurs, etc.): payment entitles them to social security

services and to the benefits of the private pension fund upon paying for membership. Those not insured can receive care in the social security system as a family member, or in the private pension fund as heir (beneficiary), or can obtain eligibility for social security care and services by paying a membership fee based on a separate agreement. Certain parts of the social security contributions are to be paid by employers, others by employees.

The retirement age of women born after 31 December 1946 and men born after 31 December 1938 is 62. (Those born before these dates – with the appropriate employment and other conditions – are able to take early retirement.)

## 9.2 Pension and health contributions

	Contribution By		Contribution Total	Monthly Max Base
	Employee	Employer		
<b>Pension</b>	8,5%	18%	26,5%	16,440 HUF/day
<b>Health</b>	4%	11%	15%	-
<b>Unemployment</b>	1%	3%	4%	-
<b>Health Per Person</b>	-	3,450 HUF/person/month	3,450 HUF/person/month	-
<b>Accident</b>	-	5%	5%	-