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JALSOVSZKY LAW FIRM ESTABLISHING A BUSINESS ENTITY IN HUNGARY

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ESTABLISHING A BUSINESS ENTITY IN HUNGARY



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1 Introduction

Since 1990, the Hungarian economy is based on the principles of market economy and considers the freedom of economic competition as a priority. On such basis, the regulation of business associations went through significant changes before evolving into its current form in Act V of 2013 on the Civil Code ("Civil Code"). The current regulations entered into force on 15 March 2014, replacing the provisions of Act IV of 2006 on the business associations. Both pieces of legislation present a set of rules that is reliable and enables market participants to customise their companies to their respective needs.

Generally, the Civil Code allows greater flexibility for the founders of Hungarian

companies when determining the contents of the company's establishing documents. This is so because, as opposed to the compulsory provisions of the previous regulations, deviation is generally allowed from the relevant rules of the Civil Code, subject to certain limitations.

The purpose of this summary is to outline a high-level overview of the main aspects that need to be considered in case of establishing a Hungarian business entity or acquiring a shareholding interest in a Hungarian company.

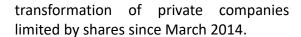
2 Company forms in Hungary

Companies may only be founded in the forms regulated in the Civil Code. The available company forms are the following:

- general partnership ('kkt.')
- limited partnership ('bt.')
- limited liability company ('kft.')
- private company limited by shares ('zrt.')

While the liability of the members of partnerships for the debts of the company is, in general, unlimited, the other two company forms offer limited liability to the shareholders. As a consequence, in the business practice, the 'kft.' and the 'zrt.' forms are the most popular forms of companies.

According to the provisions of the Civil Code, establishing public companies limited by shares ('nyrt.') upon foundation is no longer possible. Such companies may only be created by the



As the kft. and zrt. forms are the most commonly used forms of business entities in Hungary, in the forthcoming sections we give a general overview and comparison of these two company types.

3 Limited liability companies

3.1 Company name

The designation "korlátolt felelősségű társaság" (limited liability company) or its abbreviation "kft." must be indicated in the company's name.

3.2 Capital requirements

The current minimum amount of the registered capital of a kft. is HUF 3,000,000 (approximately EUR 10,000) which can be provided as a cash or as an in-kind contribution. An in-kind contribution may be any marketable thing of value or intellectual work, any intangible property or any claim that is recognised by the debtor or that has been granted by a final and definitive court decision.

The Civil Code has raised the minimum registered capital for limited liability companies from HUF 500,000 (approximately EUR 1,700) to HUF 3,000,000 for creditor protection reasons.

The contribution of each member may not be less than HUF 100,000 (approximately HUF 340). The Civil Code supersedes the previous regulation thus the contribution may not necessarily be divisible

with HUF 10,000 since March 2014.

Hungarian law also enables the members of a kft. to denominate the registered capital of the respective company in EUR or USD. In such case, the books of the company must also be kept and the annual report must be prepared in the same currency.

3.3 Membership rights

The membership rights in limited liability companies are represented by so-called "business quotas". The business quota is a notional concept as it is not embodied in physical or electronic form, but is solely registered in the members' list of the company. The business quota represents membership rights and obligations of each member of the company.

Each quotaholder has one business guota. The size of the business quotas of the different members different. can, however. be Furthermore one business quota may be held by more than one quotaholder. In such case, it is considered as a joint business quota and the relating rights may by the exercised ioint representative of the quotaholders.

If not provided otherwise, the extent of voting rights, rights to dividend and other membership rights are linked to the capital contribution made by the respective quotaholder.

3.4 Special rights

Special rights can be attached to the business quota of any of the quotaholders. Such special right can, for instance, offer the quotaholder voting preference, dividend preference, liquidation proceed preference or other preferences relating to the transfer of business quotas. There are no limitations or restrictions on the extent of such special rights, they are merely subject to the agreement of the quotaholders.

3.5 Transfer of ownership rights

Business quotas freely are transferable among the members of the company. However, the members may decide on various restrictions relating to transferability of the business quotas to third parties, such as pre-emption rights or the requirement for the members' meeting's consent.

Business quotas may be transferred via a written contract between the seller and the purchaser. The purchase of the business quota must be notified to the managing director of the company which, upon such notification, register the new quotaholder in the members' list of the company.

3.6 Supreme body

The supreme body of the limited liability company is called the members' meeting which must be convened by the managing director.

The members' meeting has a quorum if at least half of the eligible votes are represented. If the articles of association permit so, the members' meeting may be held by electronic means of communication. The decisions falling within the scope of the members' meeting may also be made in a written form, without holding a meeting.

3.7 Generally, the decisions of the members' meeting are passed with simple majority of votes, although the Civil Code also requires that certain strategic decisions must be resolved with a qualified (75%) majority. The members may adopt higher majority requirements for certain decisions in the articles of association of the company. Executive officers

The executive officers of a kft. are called managing directors. The managing directors are, generally, elected by the members' meeting. The current regulations enable the companies to decide whether the managing directors should act individually concerning the operative day-to-day decisions of the company or to form a body of the managing directors. The Civil Code also allows legal entities and not just natural persons to be elected as managing directors.

3.8 Supervisory board

The election of a supervisory board is only mandatory if the number of full-time employees of the limited liability company exceeds 200 on annual average.

3.9 Auditor

The appointment of an auditor is only mandatory if the company's yearly revenues exceed HUF 300 million or the company employs more than 50 employees.

The auditor is elected by the supreme body of the company for a maximum term of 5 (five) calendar years starting from the date of the appointment.

4 Private companies limited by shares (zrt.)

4.1 Company name

The designation "zártkörűen működő részvénytársaság" (private company limited by shares) or its abbreviation "zrt." must be indicated in the company's name.

4.2 Capital requirements

The minimum amount of the registered capital is HUF 5,000,000 (approximately EUR 17,000) which can be provided as a cash or as an in-kind contribution. An in-kind contribution may be anv marketable thing of value or intellectual work, any intangible property or any claim that is recognised by the debtor or that has been granted by a final and definitive court decision. If any of the shareholders provides an inkind contribution to the registered capital of the respective company, the actual value of such in-kind contribution must be certified in writing by an independent auditor.

Hungarian law also enables the shareholders of a zrt. to denominate the registered capital of the respective company in EUR or USD. In such case, the books of the company must also be kept and the annual report must be prepared in the same currency.

There are no restrictions on the nominal value of the shares.

4.3 Membership rights

The membership rights in a zrt. are represented by shares. The shares are considered as securities and may exist in physical (printed) or in dematerialised form. In the latter case shares are recorded on the securities account of the shareholder.

If not provided otherwise, the extent of voting rights, rights to dividend and other shareholder's rights are linked to the nominal value of the share.

4.4 Special rights

Preferred shares may be issued by the company to its shareholders. The total nominal value of the preferred shares may currently not exceed 50% of the capital of the company. The Civil Code does not set out such an exhaustive list of preferential rights, enabling the shareholders to resolve on issuing preferred shares with any desired preferential rights, without any restriction.

In addition to preferred shares, other special types of shares (e.g. employee shares, interest bearing shares, redeemable shares, etc.) may be issued by the company.

4.5 Transfer of ownership rights

Shares are freely transferable, however certain restrictions may be imposed on the transferability of the shares by the shareholders. Such restrictions are only valid if indicated on the share certificate itself.

Physical shares may be transferred by physical delivery, together with a written endorsement.

Dematerialised shares are transferred via debiting and crediting the securities accounts of the respective shareholders.

4.6 Supreme body

The supreme body of a private company limited by shares is the general meeting which is convened by the board of directors or the chief executive officer.

The general meeting has a quorum if at least half of the eligible votes are represented. If the statutes permit so, the general meeting may be held by electronic means of communication. The decisions falling within the scope of the general meeting may also be made in a written form, without holding a meeting.

Generally, the decisions of the general meeting are passed with simple majority, although the Civil Code require that certain strategic decisions must be resolved with qualified (75%) majority. The shareholders may stipulate higher majority requirements for certain decisions in the statutes.

4.7 Executive officers

The executive body of a private company limited by shares is its board of directors which consists of a minimum of three natural person members.

If the statutes so provide, the company can elect a single chief executive officer instead of a board of directors.

4.8 Supervisory board

The election of a supervisory board is only mandatory if it is requested by the shareholders controlling at least five per cent of the total votes or if the number of full-time employees of the company exceeds 200 on annual average.

4.9 Auditor

The appointment of an auditor is only mandatory if the company's yearly revenues exceed HUF 300 million or the company employs more than 50 employees.

The auditor is elected by the supreme body of the company for a maximum term of 5 (five) calendar years starting from the date of the appointment.

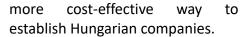
5 Documentation for company establishment

In this section we give a practical overview of the required documents for the incorporation of a company in Hungary.

5.1 Documents prepared by legal counsel and to be signed by the founders or the executive officers of the companies are:

- constitutive document (Articles of association/Statutes/Deed of foundation – depending on the respective company form);
- power of attorney given to the attorney representing the company in the court of registration procedure (this is an obligatory document as the company must be represented by an attorney or a legal counsel in the course of the court of registration procedure);
- declaration of acceptance of the executive officers/supervisory board members/auditor (the appointments will only become effective if the elected persons declare their acceptance);
- specimen signature of the persons signing on behalf of the company;
- in case of a limited liability company: a members' list indicating the members/quotaholders of the company and limitations on the transfer of the business quotas; and
- other ancillary documents set forth by laws.
- **5.2** Documents to be provided by the founders are:
 - in case the founder of the company is a foreign

- entity: the certificate of incorporation of the founder (such certificate must not be older than 3 months and signing authority on behalf of the entity must be apparent from it) and its official translation;
- declaration of the executive officer or documentary evidence on the valid use of the registered seat/branch office of the company;
- verification of payment of the registered capital of the company – a bank certificate or the declaration of the executive officer of the company on the payment of the contributions; and
- tax identification number of the quotaholders/shareholder s and the executive officers if individuals are reluctant to provide their home tax number, a Hungarian tax number can be obtained.
- 5.3 Furthermore, the verification on the payment of the obligatory procedural duty and the publication fee shall also be submitted to the Court of Registry. Starting from March 2017, however, the establishment of a kft. has become free of procedural duty enabling founders an even



If a member or an executive 5.4 officer of a Hungarian company does not have a Hungarian address or registered seat, a delivery agent must be appointed. The delivery agent will receive any official deliveries addressed to respective member or executive officer by a court or other authority. The delivery agent can be a legal person or a private individual, who has a registered office or residence in Hungary.

If a delivery agent had been appointed, a document containing the authorisation of the delivery agent and the declaration of acceptance must be submitted to the Court of Registry.

6 The establishment process

A company is considered as formed, if it is entered into the register of companies. The date of incorporation of the company is considered to be the date when the registration takes place. The company may start its operations as a "precompany" as of the date of the countersignature of its constitutive document and engage in business operations after having received its tax identification code.

A simplified registration procedure may be applied, if the company's constitutive document is based on a standard form prescribed by the laws. The use of standard forms provides less flexibility but leads to lower registration fees and quicker registration. An estimated timeline of a company registration is the following:

- (i) day 0: all the required information on the company given to the attorney;
- (ii) between day 0 and day 4: preparation of the required documents by the attorney;
- (iii) between day 4 and day 11: signing of the documents by the founders and executive officers; it is to be noted that some of the documents need to be notarised and apostilled (or attested by the Hungarian consulate) if signed outside Hungary;
- (iv) day 11: countersignature by the attorney;
- (v) day 12: filing the application with the competent Court of Registration;
- (vi) day 15: receipt of VAT number of the company; and
- (vii) between day 16 and day 35: registration of the company by the Court; it must be noted that the Court shall register the company within 1 business day of the receipt of its VAT number in case of a simplified procedure, otherwise the procedure can take 15 business day at most.

7 Governance, Regulation and Ongoing Maintenance

7.1 Accounting requirements

The companies incorporated in Hungary need to comply with various Hungarian accounting and filing requirements. The Hungarian accounting rules in line with EU are and International Accounting Standards. Double-entry bookkeeping is required for limited liability companies and for companies limited by shares.

Act C of 2000 on accounting regulates the accounting, audit and reporting requirements and contains the rules for the financial statements to be prepared by the companies.

The company needs to keep an ongoing record on its financial status during the financial year. The company has to take into account the basic principles of accounting when preparing its records. Such basic principles contain rules for the invoices and accounting documents issued or received and the method of the accounting.

7.2 Reporting requirements

The company needs to prepare at the end of each financial year a financial statement. A company is entitled to prepare and submit a simplified financial statement if two of the three following conditions can be applied to the company: (i) the company's balance sheet total does not exceed HUF 1,200 million (approximately EUR 3,871,000), (ii) its annual net turnover does not exceed HUF 2,400 million (approximately EUR 7,742,000) and (iii) the company employs less than 50 employees in average. Companies not fulfilling the above requirements need to prepare and

submit a business report in addition.

Companies considered to be parent companies are required to prepare and submit consolidated reports.

The companies' financial statements need to be uploaded to the Electronic Financial Statement Website and these documents are available to the general public.

7.3 Audit requirements

The appointment of an auditor is only mandatory if the company's yearly revenues exceed HUF 300 million or the company employs more than 50 employees.

7.4 Registers

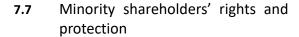
Hungarian companies need to maintain different registers themselves, e.g. register of the company's members.

7.5 Annual return

Hungarian companies need to submit concerning each financial year an annual return until 31 May of each calendar year if the financial year of the respective company is the same as the calendar year, otherwise, within 5 months from the end of the financial year.

7.6 Requirements for local shareholding/directors

There are no requirements for local shareholding or directors, but in regulated sectors some restrictions may apply.



The protection of minority interests is guaranteed in the Civil Code.

The members (shareholders) of a company having at least 5% of the voting rights can request that the meeting of the supreme body is convened. If the executive body does not comply with such request, the minority can enforce its right in the court.

Minority shareholders has various additional protective rights, such as they can request that an auditor examines the last financial statement of the company or a given act of the executive officers of the company from the last two years. Also, minority shareholders can enforce the claim of the company against its members (shareholders), executive officers, supervisory board members or the appointed auditor of the company if the supreme body of the company decided not to do so, or the supreme body did not decide on this point even though it was on the agenda of the meeting.

8 Foreign Investment, Thin Capitalisation, Residency and Material Visa Requirements

8.1 Any significant barriers to entry for an offshore company

There are no general barriers to entry for offshore companies. Restrictions may apply in the sectors where a permit for the beginning of the company's activity is required.

8.2 Any capitalisation obligations

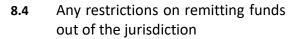
The capital requirements for the limited liability company are set out under Section 3.2 of this summary and the capital requirement for private companies limited by shares are set out under Section 4.2.

In case the company does not fulfil according to its balance sheet data the minimum capital requirement determined for its company form in two successive financial years, then the supreme body of the company needs to decide either on the provision of the necessary capital or the reorganisation to another company form.

8.3 Any special business or investment visa issues

The citizens of the European Economic Area countries do not need any permit to live and work in Hungary. Some restrictions may apply to employees from Romania, Bulgaria or Croatia. Third country citizens need to apply for a residence permit and a work permit in order to live and work in Hungary.

A third country citizen may apply for a Hungarian residence permit for maximum 5 years if he/she can prove to own, or if a company in his/her majority ownership owns treasury bonds of a nominal value of at least EUR 250,000 specifically issued by the Hungarian State for this purpose.



Hungary does not levy withholding tax on dividend payments made to non-resident enterprises.

9 Our firm

Jalsovszky Law Firm is a leading independent commercial law firm with unrivalled expertise and experience in tax, mergers & acquisitions and corporate finance. We are international in quality and perspective, we are independent in the personal nature of our delivery of legal services and we are local in the sense we understand how things work locally and we can use that to our clients' advantage.

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