Hungary*

Hungary is playing a leading role in central Europe, both politically and economically. The country's advance towards a market economy requires a number of fundamental changes in its laws. The Hungarian Stock Exchange reopened in 1990, a move that will regulate the development of the Hungarian economy. Of all the changes needed to create an environment favorable to private investment, however, the recent enactment of the law on private business associations is probably the most important.

The new law on private companies (Act VI of 1988, the Economic Associations Act) became effective January 1, 1989. It regulates all aspects of private companies from their formation to their winding up. Foreign participation in Hungarian companies is regulated also by the law on protection of foreign investments (Act XXIV of 1988, the Foreign Investment Act), which provides foreign investors with numerous advantages and privileges in order to attract foreign capital and know-how. The Hungarian Parliament amended the regulations relating to foreign participation effective January 1, 1991.

The following report discusses the new law of business associations and its impact on foreign investors. The report also addresses a number of issues concerning foreign trade, real estate acquisitions, and privatization of state-owned companies.

I. Foreign Presence in the Hungarian Economy

A. Business Associations

To establish joint ventures the parties have a choice between two forms of business associations: the limited liability company, which is the equivalent of a closely held corporation; and the company limited by shares, which can be either private or public. The minimum initial capital of the limited liability company is one million forints (approximately $15,000). For the company limited by shares the minimum capital is 10 million forints (approximately $150,000).

To organize a company the incorporators have to file the company's articles of association with the Court of Registration. Unfortunately, the procedure is rather time-consuming as the Court of Registration reviews both the formalities and the substantive legality of the corporation.

The participation of foreigners is not limited. Foreigners may hold as much as 100 percent of the equity interest in the company, and a corporation's shares may be held by only one person. In addition, foreigners may fill all company offices.

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As a result, foreigners may have complete control over a company organized under Hungarian law.

At least 30 percent of the initial capital, but not less than Ft 500,000 (approximately $7,500) must be in cash. The rest may be in material or nonmaterial contributions in kind. Contributions in kind are duty-free. Patents, licenses, or know-how, as well as high technology equipment, are particularly welcomed.

Foreigners must pay their cash contribution to the company's initial capital in hard currency, which the company can keep in a hard currency account. The hard currency can be used to buy goods necessary for the company; these purchases are duty free. The company's accounts should be held by a Hungarian bank. At present loans for Hungarian companies are available only through Hungarian banks, although theoretically they are available also from abroad with permission of the Hungarian National Bank.

Hungarian companies are not allowed to have hard currency accounts derived from their business activity. Offshore companies, however, may have such accounts. While offshore companies are subject to Hungarian law, they are considered as foreign persons with respect to financial matters such as foreign trade, bookkeeping, loans, and accounts. The formation of an offshore company requires permission from the Ministry of Finance.

A Hungarian company is taxed at 35 percent on its first 3 million forints of net income and at 40 percent thereafter. However, companies that engage in specified activities important to the economy, and that have more than 50 million forints of initial capital and over 30 percent foreign participation, receive a tax holiday for the first five years and significant tax reductions in the second five years. The government publishes an annual list of qualifying company activities.

The profits of a company's foreign investors are freely transferable abroad in hard currency. Consideration for shares sold is also transferable, as are funds received in the event of a company's liquidation. This transferability is based on the national company laws and on bilateral agreements between the Hungarian Government and foreign governments. A bank guaranty is also available from the Hungarian National Bank.

B. Representative Offices

A foreign trading company may prefer to establish a representative office in Hungary rather than a company. The declarations of such a representative office are made not in its own right but only on behalf of the foreign company. A representative office can be established without an initial capital commitment, and the question of free transfer is not an issue. All expenses of the representative office must be paid for in hard currency. A foreign firm can establish a representative office with the approval of the Ministry of International Economic Relations. The representative office also must be registered with the Court of Registration. Taxation of a representative office is low, but calculated according to complicated rules. As in the case with companies, foreign citizens may hold all positions within a representative office.

II. Foreign Imports

Although import of foreign goods and services is still considered to be a state monopoly in Hungary, such import activities are subject only to a declaration by the company to the Ministry of International Economic Relations. For the purposes of foreign import, the Hungarian currency has in practice become convertible—the Hungarian National Bank is obliged to change Hungarian currency into hard currency to facilitate imports of certain goods and services by companies registered in Hungary.

Imported goods, services, and rights are divided into three categories, which are published annually. Certain goods, mainly military or strategic, are imported exclusively by state-owned firms. This military and strategic category accounts for 1 to 2 percent of total foreign imports. Approximately 95 percent of imports do not require any permission. These goods and services are classified as "liberalized goods." The hard currency value of the goods and services to be imported is sold by the Hungarian National Bank. The third category of imported goods and services (3 to 4 percent of total imports) is denominated "traditional conservative trade." Importation of such goods and services is subject to individual permission agreements, but state-owned companies have no exclusive rights in this category.

III. Real Estate

In general, companies, including joint ventures, are permitted to buy Hungarian real estate without limitation. An exception to this rule is that companies with 100 percent foreign participation are allowed to buy only that real estate obviously necessary for their activities. Such real estate cannot include offices and apartments, which may, however, be rented.

IV. Privatization

At present, Hungarian industry is mainly based on state-owned companies. The transformation of such enterprises into private companies is regulation by Act XIII of 1989, the Transformation of Economic and Business Organizations and Companies Act. By taking over the forms of business associations, foreign companies can acquire in this way parts of Hungarian companies. The aim of the Hungarian Government is to reduce the 80 percent state ownership in the economy to 20 to 30 percent. The State Property Agency, acting as trustee for the Hungarian state, oversees the transformation and privatization of state-owned companies.