



Ernst-Jan de roest
Correspondent

Establishing a Limited Liability Company in Hungary

In the past, Hungary has proven to be one of the most attractive countries in Central and Eastern Europe for foreign investors using Hungary as a base for their Central and Eastern European headquarters, holding, finance and/or trading companies, branches and distribution centers. Foreign-owned business organizations or individuals contemplating expansion of their activities to Hungary through the establishment of a Hungarian company, face many challenges that come with the necessary decision-making concerning the legal structuring of their Hungarian operations.

Hungarian law provides for a variety of legal forms under which business entities may be established in Hungary. These forms are közkereseti társaság (Kkt. / unlimited partnership), betéti társaság (Bt. / limited partnership), korlátolt felelősségű társaság (Kft. / limited liability company) and the részvénytársaság (Zrt. / Nyrt. / limited company).

A Kft. is often used by foreign companies to establish business in Hungary. This article deals with the most significant regulations on establishing and operating a Kft. in Hungary. The aim of this article is to serve as an introduction to the Hungarian legal background of the Kft.

1. Main characteristics, activities

A Kft. is established with a predetermined amount of registered capital deposited by its quotaholders. A member's ownership interest in a Kft. is embodied in what is known under Hungarian law as a quota, with the value of the member's quota representing the proportion of its rights, including its voting rights. According to this the member holding the quota is called a quotaholder. A quota does not have a printed form and Hungarian law forbids the issuance of a share certificate in respect of a quota.

The liability of the quotaholders is limited to the total contributed registered capital and subsequent contributions to the capital and any unpaid

contributions. No single quotaholder is responsible for the company's liabilities generally with the exceptions stated in the Companies Act (Act IV of 2006), which contains some provisions - effective also for foreign companies - on lifting the "corporate veil".

A Kft. may be established by one founder or several quotaholders. Quotaholders may not be recruited through public advertisement.

Companies in Hungary are established by their registration in the Companies Register by the Court of Registration, however the company may start its activity as a pre-company (special status) after filing its corporate documents with the Court of Registration with the exception of those activities which require licences. These activities may only be pursued after the registration of the Company in the Companies Register. Please note that the executive officers of the Kft. have joint and unlimited liability for the debts of the Kft. arising from the activity during the pre-company phase, which liability ceases to exist upon the registration of the Kft. in the Companies Register.

2. Foreign participation

Permission is not required for the formation of a company with foreign participation, even if the quotas are entirely foreign-owned. Foreign citizens can have unlimited participation in the management of this company form.

A company with foreign participation can have a wide scope of activities, although there are some activities that need special government permission.

3. Organisation (Main Organ/ Executive Officer/Supervisory Board/Auditor)

3.1 Main organ

The main organ of a Kft. is the quotaholders' meeting. Generally, the quotaholders' meeting of a Kft. may pass resolutions in writing, observing the relevant special provisions of the Companies Act without convening a meeting. In the case of sole-member Kfts, the sole member decides on all issues falling within the competence of the quotaholders' meeting, since the quotaholders' meeting need not be convened.



3.2 Executive officers

Executive officers conduct the management of the company. The managing director of a Kft. must be considered to be an executive officer. Only natural persons, including foreign citizens, may be executive officers. The duties of an executive officer may only be carried out in person, no representation is permissible. The Companies Act contains no limitation on the number of managing directors (the only requirement is that one managing director must always be appointed).

The quotaholders' meeting of the company (or the sole member in the case of a sole-member Kft.) may choose to appoint a managing officer by vesting general representation rights in an employee of the Kft. The managing officer acts independently in accordance with the instructions of the executive officer. The quotaholders' meeting of a Kft. may deprive an executive officer of his competence falling within the scope of management only in the cases and to the extent rendered possible in the Articles of Association.

3.3 Supervisory Board (SB)

Establishment of a SB is mandatory for a Kft. only if (a) the law so prescribes in order to protect public property or with respect to the activities pursued by the company or (b) it is necessary in order for employees to exercise their monitoring rights (in the case where the number of employees exceeds 200).

The Articles of Association of a Kft. may transfer to the competence of the Supervisory Board the election and removal of the managing director, the establishment of his remuneration, and may prescribe that the passing of certain resolutions must be approved by the Supervisory Board in advance.

3.4 Auditor

According to the Accounting Act an auditor is compulsory for all companies using double-entry bookkeeping, except for enterprises whose annual



net sales (calculated for the period of one year) did not exceed HUF 100 million (approx. EUR 380 thousand¹) according to the average of the two business years preceding the business year and whose annual average number of employees is less than 50 (in the average of the two preceding business years). If the net sales figures / number of employees of an enterprise established without a legal predecessor are not available for either or both of the two business years preceding the subject business year, or if such figures are incomplete, the figures estimated for the subject year and, if available, the figures of the previous (first) business year (calculated for the period of one year) must be taken into consideration. This exception however is not applicable in certain cases, e.g. if the company is included in consolidation.

3.5 General comments

The first executive officers, Supervisory Board members and the auditor of the company are appointed in the Articles of Association, while later on these officials must be elected and appointed by a resolution of the quotaholders' meeting (or in the case of a single-member Kft., the owner). The managing directors and the members of the Supervisory Board are elected and appointed for a definite or an indefinite period of time, while the auditor is elected and appointed for a definite period of time but for a period of not more than five years. They may be re-elected, and may be removed

by the quotaholders' meeting (or in the case of a single-member Kft., the owner) of the company.

4. Capital, protection of capital

The minimum statutory registered capital of a Kft. is HUF 500,000 (approx. EUR 1,830). The capital may consist of in cash and in-kind contribution. The quotas of the quotaholders may differ from each other's, however no quota may be less than HUF 100,000 (approx. EUR 370).

Registration of the company may take place only if at the filing of the registration half of each of the cash contributions has been paid to the bank account of the company (the certificate of payment issued by the bank is required for registration). If not all of the cash contributions are paid upon the establishment of the company, the Articles of Association must provide for the method and maturity of payment of the remaining contributions. All cash contributions must be paid up within one year from the registration of the company, which must be reported to the Court of Registration. An in-kind contribution can be a thing of any kind with pecuniary value, rights pertaining to intellectual properties or any other right having pecuniary value, including any claim recognized by the debtor or based on a binding court decision. A quotaholder's undertaking of obligations to work or to perform another form of personal collaboration or to render a service can not be treated as an in

¹EUR 1 = HUF 262.78 according to the official mid-exchange rate issued by the National Bank of Hungary on March 17, 2010.

kind contribution. The in-kind contribution must be made available to the company at the time and in the manner specified in the Articles of Association. If the in-kind contribution reaches half of the initial capital upon foundation, the in-kind contribution must be made available to the company upon foundation in its entirety. If the in-kind contribution does not reach half of the initial capital upon foundation, it is possible to provide the contribution in-kind later, but within 3 years following the registration of the company at the latest.

In the case of a single-member Kft., the entire in-kind contribution must be made available to the Kft. before the registration of the company is initiated.

The Companies Act sets forth the following regulations for the purpose of protecting the capital (equity) of the company throughout its operation as well: The managing director must immediately convene the quotaholders' meeting for the purpose of taking the necessary action, if he becomes aware that (a) the company's equity has decreased to half of the registered capital due to losses; or (b) the company is threatened with insolvency or it has ceased payments or if its assets do not cover its debts. In such cases the quotaholders must decide especially on prescribing an additional payment

obligation or – if the possibility therefore is not contained in the Articles of Association – providing for the registered capital in some other way or decreasing the registered capital or, in the absence of all these, the transformation of the company into another business entity form or the dissolution thereof without a legal successor. The decisions must be executed within three months at the latest.

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of all these, the transformation of the company into another business entity form or the dissolution thereof without a legal successor. The decisions must be executed within three months at the latest.

If, on the basis of the data from the report prepared pursuant to the Accounting Act, a Kft. does not possess equity equal to the minimum statutory registered capital in two consecutive complete business years, and the quotaholders of the company do not provide for the necessary equity within a period of three months after the approval of the report prepared pursuant to the Accounting Act for the second year, the company must decide on its transformation into another business entity form within sixty days following the expiry of this deadline or it must decide on its dissolution without a legal successor. In the course of such transformation, a form of business entity must be chosen for which the Act does not specify a minimum amount of registered capital or whose minimum capital requirement can be satisfied by the company through transformation.

Therefore when determining the sum of the registered capital of the Kft. upon its establishment we suggest that the above rules should be taken into account, considering especially that ventures often have losses in the first financial year(s) of their operation. There is another equity element, i.e. the capital reserve, where the quotaholders may put any asset upon foundation or later upon a capital increase as well.

5. Functional currency

According to the general rule, a Hungarian company must keep its books and prepare its annual report in Hungarian forints. However, according to the Accounting Act, a company may keep its books and may prepare its annual report in a foreign currency if the currency of the primary economic environment of its activity (functional currency) is that foreign currency, provided that at least 25%² of (a) its revenues, costs and expenditures, as well as (b) its financial assets and financial obligations emerged in that



²From January 1, 2010, it has become possible to keep the financial records and books in EUR notwithstanding the percentage of the company's revenues, costs, assets and obligations in EUR.

foreign currency also in the previous and in the subject business year, separately. (When establishing the existence of the above conditions, the cumulative amount of the items listed in the above sections (a) and (b) must be taken into account separately.)

6. Business year

According to the Accounting Act, the business year may be different from the calendar year in the case of a subsidiary involved in the consolidation of its foreign parent company or in the case of the subsidiaries of the above subsidiary (except for credit institutions, financial enterprises and insurance companies), if the business year is different from the calendar year in the case of the foreign parent company and in the case of the consolidated report of the foreign parent company as well.

7. Establishment

PROCEDURE

The establishment of a Kft. in view of corporate regulations consists of the following steps:

1) Discussions with the lawyer and/or advisor regarding the intentions and purposes of the Hungarian operations to determine the most optimal legal structure.

2) Collecting the necessary data, preparing and reviewing drafts of the documents necessary to establish the Kft. These documents are in general:

- articles of Association;
- declarations of the Managing Director(s) on the acceptance of the appointment and on miscellaneous corporate law issues;
- specimen(s) of signature of the Managing Director(s);
- list of quotaholders;
- proxy for our law office to act on behalf of the Kft. during the registration procedure;
- declaration whether the company required the reservation of the firm name;
- document entitling the company to use a property as its seat.

3) Signing the documents. In the case of foreign founders signing abroad, the documents must be signed through a special procedure, e.g. they must be signed before the Hungarian Embassy / Consulate, or signed before a notary



and in certain cases additionally endorsed with an Apostille.

4) The capital must be appropriately paid.

5) The documents mentioned under point 2 must be filed with the Court of Registration together with -normally- the following documents:

-bank certificate issued by the bank keeping the company's bank account on the payment of the cash contributions;

-document verifying the official translation of the foreign name of the company (if any).

6) The Kft. must be registered in the Companies Register by the Court of Registration.

In general, the time frame of the procedure is 5 á 6 weeks. This time frame can be reduced strongly in case the necessary information, signing of the documents and so on greases the wheels. Subject to special requirements a "fast-track" registration may also be available, which takes only 1 working day instead of the normal 15 working days.

8. Last remark

This article is intended to serve as an introduction to the most significant regulations on establishing and operating a Kft. in Hungary. When deciding to make use of a Kft. for the Hungarian operations, it should be taken into account that the legal climate is always subject to changes. In addition, there are various other factors that should be considered in the process as well, including the applicable

tax climate(s), commercial implications and accounting practices.

Consequently, individuals or companies doing business in Hungary, or planning to do so, are advised to acquire recent, more detailed and tailored legal advice. Of course the authors of this article Ernst-Jan de Roest tax advisor with Ernst & Young Belastingadviseurs LLP, the Netherlands and Gabor Hugai, attorney with Szabó Kelemen & Partners Attorneys and member of the Budapest Bar are more than happy to be of service in that regard. Therefore, should you have any questions with respect to this article, or wish to discuss any of the subjects included herein, we would encourage you to contact us.

Contact details:

dr. Gabor Hugai

Telephone: +36 1 288 8206

E-mail: Gabor.Hugai@sz-k-t.hu

Website: www.sz-k-t.hu

Ernst-Jan de Roest

Telephone: +31 88 407 0728

E-mail: Ernst-Jan.de.Roest@nl.ey.com

*Tekst: Ernst-Jan de Roest
Foto: Team HiZ*