

The Brief

September 2011

Hungary - Monthly Legal Update

In this issue:

Public Law	p. 2
■ The new Public Procurement Act	
Real Estate	p. 3
■ A new company type: the regulated real estate investment company	
Taxation	p. 3
■ Judgment of the European Court of Justice on refunding excess VAT	
■ Act on 'Chips-tax' entered into force on 1 September 2011	
■ Changing rules on medical taxes and the R&D allowance	
Employment Law	p. 4
■ Plans for the new Labour Code and recent modifications to current legislation	



Gide Loyrette Nouel

Algiers

Tel. +213 (0)21 23 94 94
gln.algiers@gide.com

Beijing

Tel. +86 10 6597 4511
gln.beijing@gide.com

Brussels

Tel. +32 (0)2 231 11 40
gln.brussels@gide.com

Bucharest

Tel. +40 21 223 03 10
gln.bucharest@gide.com

Budapest

Tel. +36 1 411 74 00
gln.budapest@gide.com

Casablanca

Tel. +212 (0)5 22 27 46 28
gln.casablanca@gide.com

Hanoi

Tel. +84 4 3946 2350
gln.hanoi@gide.com

Ho Chi Minh City

Tel. +84 8 3823 8599
gln.hcmc@gide.com

Hong Kong

Tel. +852 2536 9110
gln.hongkong@gide.com

Istanbul

Tel. +90 212 385 04 00
gln.istanbul@gide.com

Kyiv

Tel. +380 44 206 0980
gln.kyiv@gide.com

London

Tel. +44 (0)20 7382 5500
gln.london@gide.com

Moscow

Tel. +7 495 258 31 00
gln.moscow@gide.com

New York

Tel. +1 212 403 6700
gln.newyork@gide.com

Paris

Tel. +33 (0)1 40 75 60 00
info@gide.com

Saint Petersburg

Tel. +7 812 303 6900
gln.saintpetersburg@gide.com

Shanghai

Tel. +86 21 5306 8899
gln.shanghai@gide.com

Tunis

Tel. +216 71 891 993
gln.tunis@gide.com

Warsaw

Tel. +48 (0)22 344 00 00
gln.warsaw@gide.com



PUBLIC LAW

The New Public Procurement Act

The Hungarian Parliament adopted Act No. CVIII of 2011 on Public Procurement (the “NPPA”), which replaces the current act on public procurement as of 1 January 2012.

The current act on public procurement is widely considered to be too extensive and complicated which is partly due to several amendments that have been adopted since it entered into force. Hence, the new act aims mainly to regulate public procurement proceedings in a simpler way. To meet this requirement, the NPPA intends to provide a regulatory framework for public procurement proceedings rather than regulating all their aspects in detail. As the NPPA only provides "high level" regulation on some aspects of the public procurement proceedings it will need to be completed by lower level regulation.

According to government officials, when drafting the NPPA, they examined ten European countries' public procurement regulations and took into account their findings. The NPPA complies with the relevant European Union directives.

Amendments introduced by the NPPA

To ensure a simpler regulation, the NPPA intends to enhance the role of general principles throughout the public procurement proceeding. Accordingly, the principles of transparency and effective use of public funds will be included in the NPPA along with the principle of good faith business practice and the duty to reasonably exercise procedural rights.

In addition to the wider application of general principles, the NPPA targets the following main objectives (each of them followed by an example of the related NPPA provisions):

- **Fast and flexible procedure** (e.g. under the NPPA, restricted tenders without the publication of a tender announcement will always be allowed if the estimated contract value does not exceed HUF 25 million (in the case of public supply and service contracts) or HUF 150 million (in the case of public works contracts));
- **Reducing corruption and other abuses** (e.g. it will no longer be possible for public service providers to avoid public procurement by awarding the required supply or service to their subsidiaries);
- **Modification of the rules related to subcontractors** (e.g. if a tenderer participates in the performance of a contract in a proportion exceeding 25% of the contract value, it may no longer be qualified as a sub-contractor but will be deemed to be a joint tenderer);
- **Facilitating the participation of SMEs in public procurement proceedings** (e.g.: contracting authorities may restrict the circle of tenderers to SMEs with a turnover below HUF 100 million in the case of public service and supply contracts; and below HUF 1 billion in the case of public works contracts; the tenderers will be entitled to an advance payment in the case of public works contracts and contracts exceeding EU thresholds);
- **Flexible procurement regime** (i.e. contracting authorities or entities may apply their own rules for public procurements – a flexible procurement regime – in the case of public service and supply contracts provided that the value of the contract does not exceed the "national thresholds");
- **More efficient application of the law.** (e.g. the Commission for Public Procurements will be entitled to adopt “decisions of principle” in order to ensure the correct interpretation of public procurement law).

Civil Critics

The NPPA has also been strongly criticised since it was passed by the Hungarian Parliament. Transparency International (“TI”) argues that despite being considered as a framework regulation, the NPPA fails to regulate some important issues such as fines or procedural rules applicable to the public service providers. According to TI, the fact that contracting authorities will be entitled to apply their own procurement regime for proceedings in which the contractual value does not exceed the national threshold could reduce transparency and increase the risk of corruption. The fact that the NPPA does not provide for efficient means of control to outweigh such liberty makes the situation even worse, claims the TI, adding that such liberty may eventually restrict the efficient and transparent use of public funds.

Media criticism also pointed out that the NPPA remains silent on the possibility of conducting e-tenders and managing public procurement proceedings electronically. Furthermore, it does not regulate the long-awaited common database of contracts concluded as a result of a public procurement, although it could have improved the transparency of public procurements.



REAL ESTATE

A new company type: the Regulated Real Estate Investment Company

Hungarian legal regulations recently introduced a new company type in Hungary: the Regulated Real Estate Investment Company ("**RIC**"). RICs are publicly listed companies limited by shares, similar to the real estate investment trusts established in the USA in the 1960s and introduced in France in 2003.

The new Hungarian law sets out beneficial rules related to the establishment and operation of RICs, such as that (i) RICs are exempted from paying corporate income tax and local business tax as their income is taxed at the shareholder level, and that (ii) RICs may acquire any real estate or capital shares in a company which owns real estate by paying a preferential acquisition stamp duty of 2% (instead of the general rate of 4%).

The law prescribes strict requirements for companies operating as a RIC. Among others, the company must:

- be registered by the tax authority as a RIC;
- be a publicly listed company limited by shares having an initial capital of at least HUF 10 billion;
- limit its activities to the sale, lease and operation of its own real estate, management of real estate and asset management;
- pay out at least 90% of its profit to its shareholders as dividend;
- perform a mandatory re-evaluation of its real estate portfolio quarterly;
- ensure that at least 25% of its shares are owned by shareholders holding less than 5% of all shares; and that
- insurance companies and credit institutions do not hold more than 10% of all its shares.

If the company does not comply with the above statutory conditions, the law prescribes strict sanctions such as: (i) the tax authority may request the company's deletion from the commercial register, (ii) the company may be ordered to pay double the corporate tax, local business tax and the difference of the levied preferential acquisition stamp duty and the general rate.

Due to the beneficial tax treatment, RICs may present an attractive option to investors in the Central and Eastern European real estate market while also providing sufficient security thanks to the strict legal regulation.

TAXATION

Judgment of the European Court of Justice on refunding excess VAT

According to a recent ruling of the European Court of Justice (the "**ECJ**") the Hungarian VAT regulation that only allows reclaiming the input VAT if the purchaser has actually paid the purchase price does not comply with the provisions of the Council Directive on the common system of VAT (the "**Directive**"),

Pursuant to the regulation challenged by the ECJ, if the taxpayer has not yet actually paid the purchase price, the input VAT attributable to the purchase will have to be deducted from the amount of VAT to be reclaimed by the taxpayer. In such case, the VAT in question may have only been reclaimed in the preceding tax period, once the taxpayer has paid the purchase price in total.

The ECJ pointed out that this regulation infringed the Directive by allowing taxable persons to carry forward such an input VAT several times until the transaction is completed and by placing an unreasonable burden on companies.

In the light of the ECJ ruling, it was certain that the disputed Hungarian VAT regulation would have to be amended. The Hungarian Parliament passed an act on the modification of the Hungarian VAT Act on 19 September 2011. The act repeals the VAT regulation disputed by the ECJ and provides for certain possibilities to have the historic VAT and/or tax sanctions recovered.

On the one hand, if the taxpayer reported not reclaimable VAT due to unpaid purchases in its last VAT return submitted before the entry into force of the bill, the taxpayer may apply for this VAT amount in a separate request by 20 October 2011 at the latest (subsequent to this deadline applications will not be accepted). The tax authority must transfer the refund within 30 days of receiving the application or within 45 days for refund over HUF 1 million. Alternatively, the taxpayer may recover the VAT amount in its future VAT return.

On the other hand, if the tax authority levied a tax penalty and/or late payment interest on the taxpayer due to the now repealed VAT regulation before the entry into force of the bill, the taxpayer may request the review of such tax sanctions by 20 October 2011 at the latest (subsequent to this deadline, requests will not be accepted).



Act on 'Chips-tax'

A public health product tax, otherwise known as "chips-tax" has been introduced to the Hungarian tax regime as of 1 September 2011. The products subject to "chips-tax" include pre-packaged food and drinks high in sugar, salt or caffeine content (e.g. certain sweetened drinks, energy drinks, cakes, salty snacks and food flavourings).

The "chips-tax" must be paid by the entity that sells the taxable product in Hungary for the first time. However, this sale may be exempt from the "chips-tax" if the purchaser resells the product abroad. Sales abroad and reselling in Hungary are not subject to the "chips-tax".

The amount of the tax is set based on the measurement unit applicable for the respective food and drink categories (HUF 5 per litre for sweetened drinks, HUF 25 per litre for energy drinks, HUF 100 per kilogram for cookies, HUF 200 per kilogram for salty snacks and HUF 200 per kilogram for food flavourings).

The frequency of the tax returns and the deadline for the reporting and the payment of the "chips-tax" correspond to VAT reporting and payment. Taxable persons exempted from VAT or from filing VAT returns, as well as entities not subject to VAT must declare and pay the "chips-tax" annually by the 25th day of the second month following the tax year.

According to recent news, the Government is considering extending the scope of taxable products.

Changing rules on pharmaceutical taxes

The Hungarian Government has recently modified the regulation governing the specific tax liability of drug firms. Pursuant to the modifications, as of 1 July 2011, pharmaceutical companies holding marketing authorization are obliged to pay 20% instead of the former 12% on the producer price or import price of all its medicinal product and dietary supplements sold in pharmacies with public financing (with certain exemptions) based on and consistent with the amount of social security subsidies recorded under prescription sales for the month. The sales representatives' fee will also be significantly increased to HUF 832,000 per month. Small and medium-sized enterprises are, however, subject to a lower sales representatives' fee if certain conditions are met.

EMPLOYMENT LAW

Plans for the new Labour Code

The draft of a new Labour Code was released by the Ministry of Justice this summer, which is likely to be accepted by Parliament by the end of the year, after several readings by the Government, trade unions, etc. The Government aims to simplify the current Labour Code and shift the balance of power in favour of employers. Further details are expected when the Government presents the draft to the Hungarian Parliament. We will keep our readers posted about these details and any further developments.

Amendments to the current Labour Code

The current Labour Code was modified by Act No. CV of 2011 published on 19 July 2011. Most of the amendments entered into force on 1 August and the rest will enter into force on 1 December 2011. The major changes are outlined below.

Extended probation period

Collective agreements may stipulate a probation period of up to 6 months, instead of the present limit of 3 months.

Length of working time

To mitigate the effects of the economic crisis and to allow more flexible employment, the Labour Code stipulates that the employer and the employee may agree on the application of a 36-hour working week, instead of the standard 40 hours in a separate agreement. As a consequence, the temporarily unused working hours (i.e. 4 hours per week) may be "used" later on, when the parties may agree to increase the weekly working time to 44 hours, without amending the employee's salary.

Originally, such an agreement could only be concluded till 31 December 2011, but this limitation has been abolished and the new regulation sets out only one limitation: that such an agreement may only be concluded for a definite term of one year.

Allocation of holidays

Employers may now allocate holidays in more than two parts each year, if it is justified by their rightful economic interests. Nevertheless, employees are still entitled to 14 days of continuous holiday per year unless agreed otherwise.



If employees cannot use their holidays in a given calendar year due to illness or other hindrance lasting at least 183 days, then the untaken holidays may be rolled over by up to 183 days beyond the end of the illness or the other hindrance. Previously, holidays had to be used within 30 days.

Compensation for overtime work

Previously, employers were only allowed to offer extra holiday ("time off in lieu") as compensation for overtime work if it was expressly allowed by the employment contract. The new regulation allows the employer to decide unilaterally on the form of compensation for overtime work, i.e. the employer is free to choose between paying for the overtime work or providing holiday for the extra time worked ("time off in lieu").

Termination of executives' employment contract

According to the earlier legislation, the employer was entitled to terminate certain executive employees' (the so-called "senior executives") employment contracts by ordinary dismissal without giving justification. The recent amendment of the Labour Code has partly extended an already existing protection from ordinary dismissal (pregnancy or maternity leave) to these employees.

Contrary to other employees, whose employment may not be terminated by ordinary dismissal during the period of pregnancy or maternity leave, employers may still dismiss senior executives during these periods, but they will need to justify such dismissals in the future.



Gide Loyrette Nouel

Széchenyi István tér 7-8.
"C" Mag; 4th floor
1051 Budapest - Hungary
Tel. +36 1 411 74 00
Fax +36 1 411 74 40
E-mail: gln.budapest@gide.com

Contact

François d'Ornano
ornano@gide.com

For further information:
www.gide.com



Gide Loyrette Nouel

You can also find this Brief and our other newsletters on our website in the News/Publications section.

This Brief (the "Newsletter") is a free, periodical electronic publication edited by the law firm Gide Loyrette Nouel (the "Law Firm"), and published for Gide Loyrette Nouel's clients and business associates. The Newsletter is strictly limited to personal use by its addressees and is intended to provide non-exhaustive, general legal information. The Newsletter is not intended to be and should not be construed as providing legal advice. The addressee is solely liable for any use of the information contained herein and the Law Firm shall not be held responsible for any damages, direct, indirect or otherwise, arising from the use of the information by the addressee. In accordance with the French Data Protection Act, you may request access to, rectification of, or deletion of your personal data processed by our Communications Department (privacy@gide.com).