THE MERGERS & ACQUISITIONS REVIEW

ELEVENTH EDITION

Editor
Mark Zerdin

THE LAWREVIEWS

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For further information please email
Nick.Barette@thelawreviews.co.uk

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HUNGARY

József Bulcsú Fenyvesi and Mihály Barcza[1]

I OVERVIEW OF M&A ACTIVITY

Compared to 2015, in 2016 the number of published M&A transactions dropped by 15 per cent, to 110. Hence, after experiencing a peak in 2015, 2016 was the second-most-active period since 2012 in respect of the number of publicly disclosed transactions.[2]

Because transaction values tended to be published in significantly fewer cases in 2016 than in 2015, the value of the Hungarian M&A market can only be calculated based on estimates relying on publicly available information. Such estimates calculated the value of the Hungarian M&A market as US$1.61 billion, which demonstrates an increase of 6 per cent compared to 2015. As the number of deals dropped in total, the increase in the value of the Hungarian M&A market appears to have been triggered by an increase in the average transaction value of deals.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The main source of legislation governing M&A activity and corporate governance in Hungary is Act V of 2013 on the Civil Code (Civil Code), specifically Book Three, which contains the general rules applicable to all forms of legal persons, including high-level rules on the transformation, merger and demerger of legal persons, and sets forth definitions of the types of legal transformations allowed by Hungarian law.

The provisions constituting the legal framework of transactions in Hungary implemented by way of transformations, mergers or demergers may be found in Act No. CLXXVI of 2013 on the Transformation, Merger and Demerger of Certain Legal Persons (Transformation Act). The Transformation Act contains the prerequisites and procedures to be followed in the case of a company transformation, and the documentation, transparency and financial requirements of mergers, demergers and spin-offs, prescribing specific rules for companies limited by shares, especially in the field of audit and management reports.

In the event that a company involved in a merger is not domiciled in Hungary but in another country of the European Union, in addition to the provisions of the Civil Code

1 József Bulcsú Fenyvesi and Mihály Barcza are partners at Oppenheim Law Firm.

2 Business data and trends described based on Ernst&Young's M&A Barometer Hungary 2016: www.ey.com/Publication/vwLUAssets/M_and_A_Barometer_2016_Hungary/$File/EY_M&ABarometer2016_eng.pdf); M&A Barometer H1 2016 Hungary: www.ey.com/Publication/vwLUAssets/M_and_A_Barometer_Hungary_2016/$FILE/M&A_Barometer_Hungary_H1_2016.pdf); and M&A Barometer 2016 Central and Southeast Europe: www.ey.com/Publication/vwLUAssets/2017-MA-Barometr-CSE/$FILE/M&A2016_CSEl.pdf.

and the Transformation Act, the rules laid down in Act CXL of 2007 on Cross-Border Mergers of Limited Liability Companies (Cross-Border Mergers Act) shall also be observed. The Cross-Border Mergers Act serves the implementation of Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005.

The procedural aspects of registering mergers and acquisitions in Hungary are set forth in Act V of 2006 on Public Company Information, Company Registration and Voluntary Liquidation (Company Procedures Act). The Company Procedures Act lists the specific documents to be prepared and submitted to court to register a merger or acquisition, and sets out the applicable procedural requirements.

Part Three of Book Three of the Civil Code provides for the regulation of business associations, regulating in Chapter No. XV the aspects of the acquisition of majority interests (i.e., the direct or indirect purchase of 75 per cent of the voting rights) in limited liability companies and private companies limited by shares. These rules set forth a special 'statutory tag-along right' obliging a shareholder who acquires majority interest to purchase the shareholding of the other shareholders at least at equity value if such other minority shareholders wish to sell their stake after the acquisition.

Act CXX of 2001 on the Capital Market (Capital Market Act) contains essential rules on issuing and offering securities. Such rules must be observed if any of the target companies concerned with the M&A transaction is a company limited by shares. In respect of publicly traded companies, the Capital Market Act sets forth the specific provisions for the acquisition of majority interests in public companies limited by shares, such as reporting obligations, IPOs and minimum offer prices. Tender offers and M&A activity in the financial sector are controlled and approved by the Hungarian National Bank, which became the general supervising authority of financial institutions and markets in 2013. Act CXXXIX of 2013 sets out the scope of activity and the procedural rules applied by the Hungarian National Bank.

In the field of M&A legislation, special rules apply to companies engaged in the following regulated industries: the energy, media and financial sectors. The acquisition and transformation of such companies may also require the prior approval of the competent regulatory bodies, setting further preconditions and documentation requirements for carrying out a successful merger. The competent authorities for these sectors include the Hungarian Energy and Public Utility Regulatory Authority, the National Media and Infocommunications Authority and the Hungarian National Bank, respectively.

Irrespective of the industry or sector concerned, mergers and acquisitions reaching a certain market threshold shall be reported to, or approved by, the Hungarian Competition Authority (GVH). The reporting obligations and the rules for approval are set forth in Act LVII of 1996 on the Prohibition of Unfair Trading Practices and Unfair Competition.

Besides the above acts and laws, significant parts of foreign investments in Hungary are also protected by way of bilateral investment treaties (BIT). BITs grant basic rights to foreign investors in compliance with international standards, and enable them to seek remedies before international fora if their right to fair and equitable treatment should be violated.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Amendments to the Civil Code

Amendments to the Civil Code aimed to clarify or eliminate ambiguities in the new act, as well as to achieve compliance of the act with other laws.

An essential amendment to the Civil Code eliminated concerns and ambiguous interpretations in respect of the unlimited liability of managing directors in relation to third parties. The amendment made it clear that (except for in the case of a managing director causing damage intentionally, which triggers the joint and several liability of the legal entity and its managing director) instead of a managing director's direct personal liability, a legal entity shall be liable in relation to third persons if its managing director caused damage to a third person when acting in his or her capacity as managing director. Such clarification has removed concerns about the unwanted personal liability of managing directors in relation to third parties, which undoubtedly should smooth the way for mandating appropriate managing directors for companies without specific indemnity terms or insurances.

A notable change in 2016 to be borne in mind by investors is that the rules regarding dividends were modified to comply with newly introduced accounting regulations. As of 2016, dividends may be paid from the untied retained earnings of the current year supplemented by the after-tax profit of the previous financial year. Accordingly, dividends shall now be taken into account for the financial year when payment was decided and not for the previous financial year (as was the rule before the change). This new method of accounting for dividends requires investors to elaborate transaction plans with a view to a change in disposing of the earnings of their investments.

The regulations concerning collateral also changed significantly. Changes affect pledge and independent lien in relation to the transitional period allowed after the coming into force of the Civil Code. Amendments were also introduced in respect of the transfer of contracts, where (unlike under the former rules) collateral securing the transferred claim shall now survive and remain available to the new obligee, while collateral securing the transferred obligation shall terminate unless the obligor of the collateral consents to the transfer. Changes in the rules regarding collateral should have a positive impact on the assessment of the value of potential targets that are dealing with collateral as part of their business.

ii Financial and banking regulations

The three most important drivers of recent changes in Hungarian financial regulations that can affect M&A transactions were amendments of the law in relation to implementing EU rules and the introduction of national rules to supplement directly applicable EU regulations; rules aimed at strengthening the resilience of the Hungarian financial regulatory framework in the aftermath of recent investment firm scandals; and the further elaboration of rules relating to consumer credits. This last is partially driven by the transposition of Directive 2014/17/EU on credit agreements for consumers relating to residential immoveable property, and partially by the central initiative to alter the consumer credit landscape after the foreign exchange consumer credit crunch.

Pursuant to Decree of the Government No. 284/2001 (XII.26) on the method of and security regulations relating to the registration and transfer of dematerialised securities, the person entitled to give instructions in relation to a client account may only give an instruction to transfer funds from the client account to another client account or bank account managed under the name of the account holder.

The Capital Market Act was amended to increase the minimum level of compensation available to investors under the investor compensation scheme. As of 1 January 2016, the minimum level of compensation under the Hungarian investor compensation scheme (BEVA) was increased from €20,000 to €100,000, and BEVA was integrated into OBA, the deposit guarantee scheme. In addition, the sanctioning powers of the supervisory authority

were extended. The Capital Market Act has also been amended to reflect the coming into effect of the directly applicable Market Abuse Regulation[3] on 3 July 2016 and to implement the Commission Implementing Directive[4] on reporting to the competent authorities actual or potential infringements of the Market Abuse Regulation. Under another amendment, stock exchanges may operate new platforms and require issuers to have a good business reputation: to facilitate an increase of capital market financing in the SME sector, the services a stock exchange may provide are extended to cover the service of operating platforms facilitating capital market funding (e.g., private or crowdfunding platforms) and advising issuers in matters relating to admission to a regulated market. Further, stock exchanges may require issuers to prove their good business reputation as a condition precedent for admission to listing and as an ongoing obligation once admitted to trading.

Amendments to the Investment Services Act include the requirement of an external expert to audit the compliance of IT systems of investment firms and commodity dealers, a prohibition on staff members (with a few exceptions) from being the signatory over client accounts as the representative of the client, more frequent reports to clients instead of reports sent every six months or annually, and the obligation of all investment firms to establish an audit committee. Besides the general tasks allocated to an audit committee, the audit committee of investment firms shall monitor the effectiveness of their internal control systems and risk management systems as well. In addition, rules on the mechanical, physical and electronic protection of investment firm premises were repealed.

Soft laws issued by the Hungarian National Bank for the regulation of investment services contain a regulatory guideline on recovery plans to be prepared by credit institutions and investment firms, a guideline on internal control mechanisms and governance of financial institutions, as well as regulatory guidance providing that only investment firms and commodity dealers may have exchange traders, whereas intermediaries (tied agents) are not themselves entitled to have exchange traders.

Amendments to the Credit Institution Act and other new rules introduced in relation to banking services regulate:

a the collateral value of arable land;

b the integrity of IT systems in credit institutions;

c the obligation of all credit institutions to set up an audit committee (except private company credit institutions, where the parent company's audit committee also performs the audit tasks in respect of the credit institution); and

d fair access to financial services being granted by credit institutions offering payment account management services to consumers (meaning that credit institutions may not discriminate against consumers who are entitled to reside in the EU on the basis of their citizenship or place of residence in respect of entering into a payment account contract or performing services under such contract).

The Mortgage Credit Directive was also implemented by government decrees. The Hungarian National Bank has issued decrees on the minimum liquidity coverage ratio requirement for credit institutions and relating to the Commission Delegated Regulation[5] supplementing

3 Regulation (EU) No. 596/2014.

4 (EU) 2015/2392.

5 2015/61/EU.

CRR with regard to the liquidity coverage requirement for credit institutions, as well as on the mandatory reserve rate, defined as zero per cent in respect of certain liabilities and as 1 per cent in respect of other liabilities.

iii Regulations on administrative obligations

Pursuant to changes introduced in 2016, administrative aspects of transactions have become simpler and more client-friendly. Under an amendment in the Company Procedures Act, changes in company data (including the deletion of a company from the company registry) are now reported to all the competent authorities by the Hungarian court of registry, instead of the company (or its legal successor) having to notify all the relevant authorities separately. Furthermore, certain changes in company data may now be reported to the court of registry free of any procedural fees.

On the other hand, to allow companies to prepare their accounting documents underlying their transformations within 90 days as of the effective date of the transformation, the Transformation Act was changed to harmonise it with other legal and accounting regulations.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

As in previous years, taking into account published transactions, the Hungarian transaction market was dominated by domestic transactions (where both the target and the buyer were Hungarian), which represented 54 per cent of all disclosed transactions in 2016, over foreign transactions. It was a notable trend that, for example in the banking and financial services sector, domestic actors tended to acquire shareholdings in domestic targets from foreign shareholders.

Regarding transactions related to foreign targets or buyers, inbound transactions were dominant. Inbound foreign investments came from Austria, Germany, the Czech Republic and the US, and in a smaller ratio from Italy and Romania.

Outbound transactions, although somewhat increased, remained at a rather low level (9 per cent of all disclosed deals). Among all 10 disclosed outbound transactions, more than 30 per cent were connected to Poland.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

Considering publicly disclosed transactions, the leading sector in terms of the number of deals was manufacturing, which was dominated by inbound deals involving Austrian, German and Italian acquirers.

Services was the second-most dominant sector, especially in the second half of 2016, experiencing growth of more than 50 per cent as compared to 2015. Services were mostly dominated by domestic deals.

The leading sector of 2015, IT and technology, still saw a remarkable level of activity in 2016, but dropped to third place in terms of number of deals, showing a decrease of more than 50 per cent as compared to 2015. However, the average deal value increased significantly at almost triple the average deal value of 2015.

Further notable sectors were real estate, media and telecom, and banking and financial services. In the banking and financial services sector, the number of deals increased by 100 per

cent as compared to 2015. With 58 per cent of the deals being domestic transactions, it was a visible trend that domestic actors tended to acquire shares in domestic targets from foreign shareholders. The value of the media and telecom and banking and financial services sectors could not be estimated well, because actors were especially reluctant to disclose transaction values in these sectors.

Activity in the transportation, logistics, retail and wholesale sectors was rather low, each comprising 1 or 2 per cent of all disclosed deals.

As a trend continuing from 2015, in 2016 strategic investors dominated over financial investors. A notable driver of this trend could be that the JEREMIE investment period came to an end. An exception to this was the IT and technology sector, where strategic and financial investors were almost equally active.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

In the past couple of years, financial institutions have cleared significant parts of their non-performing loan (NPL) portfolios from their balance sheets either by selling these portfolios to third-party bidders, or by restructuring them into subsidiaries to operate and manage the NPL portfolios separated from the parent financial institution. Consequently, in recent years, many transactions have focused on the restructuring of currently existing debts and portfolios. In the Hungarian banking M&A sector there were sizable transactions in Hungary: *inter alia*, one of the largest Hungarian credit institutions, MKB Bank Zrt, was acquired by certain Hungarian investors. These recent changes and transactions fit with the government's aim that over 50 per cent of Hungarian credit institutions should be owned by Hungarian persons or entities.

Due to the divestment of the NPL portfolios and the financial crisis, several Hungarian financial institutions have adopted a more specialised focus and policy in relation to the projects and investments they are willing to finance. Knowing these policies and the drivers of credit institutions can be a key factor when selecting a financier. Therefore, choosing experienced advisers on the borrower side who can also support investors in selecting the right financier for their project has become even more important. Nevertheless, in general banks are competing for good projects and investors after years of deleveraging in the Hungarian economy. Subsidised loans and financing are also available to certain investments and projects, for example, renewables. However, access to these is rather limited.

Equity funds are also active in Hungary. Such funds are mainly either financed by the state, state-owned institutions and entities, or the European Union. Although private equity funds are present in Hungary, their activity level and net investments are still low in the whole CEE region. The activities of private equity funds have not significantly developed in recent years.

To facilitate the lending activities of private equity, the Hungarian National Bank and the state-owned Exim Bank have launched several equity funds, including hedge funds. These funds have clear investment policies to support and promote projects and transactions that are beneficial for Hungary's public affairs.

Furthermore the government, co-financed by the European Union, is making new funds available to the investment market. Such new investment funds will support mainly SMEs and research and development projects.

VII EMPLOYMENT LAW

There have been no major legislative changes in the employment rules in connection with corporate transformations in Hungary in the past couple of years. However, we are experiencing a slight change of focus when it comes to mergers or acquisitions of businesses also involving a transfer of personnel. The Hungarian labour market has always been sensitive to such changes. Corporate changes and reorganisations have often been associated with mass layoffs, and recently, in several instances, the closure of plants and business units as well. In general, trust of employers is usually lower than it is in Western Europe. Consequently, this may cause loss of talent or key personnel even before the conclusion of a transaction. Therefore, in the course of a transaction, communication is of paramount importance, and it is similarly vital to maintain good relationships with employee representatives and to pay attention to retain key personnel to safeguard operations and preserve the business potential of the target.

It is usual to decide early in the planning phase of a transaction whether the employees of the target will be retained by the purchaser or not. Rules pertaining to mass layoffs and transfers of undertakings, including the protection of employees' rights, are harmonised with the respective EU directives and remain unchanged in 2017. However, beyond the general rules on the protection of employees, and consultation and announcing obligations, individual communication with employees is just as important both in the case of a mass layoff and in an M&A transaction in which the employees of the transferred business unit are intended to be retained.

Taking into consideration that for several key positions, workforce shortages can be experienced on the Hungarian market, retention can sometimes be more challenging than layoffs. In several cases, interim loyalty, or other type of incentive schemes may be of great help for the purchaser to retain experienced and valuable staff. Sometimes, putting restrictive covenants in place specifically for the purposes of a transaction may also work well.

VIII TAX LAW

Under Hungarian law, specific rules regarding M&A, spin-offs and divisions of companies are regulated by Act LXXXI of 1996 on Corporate Tax and Dividend Tax (Corporate Tax Act), which has to be interpreted together with the general rules of the Hungarian Civil Law on business associations.

i Tax rate

The biggest recent change in the legislation relevant to M&A and companies in Hungary is the change in the corporate income tax rate. Until the end of 2016, the corporate income tax rate was 10 per cent of the positive tax base (accounting profits adjusted with certain items) up to 500 million forints, and 19 per cent above 500 million forints. From the beginning of 2017, the corporate income tax rate is 9 per cent of the positive tax base, regardless of any threshold.

ii Revaluation of assets and tax base adjustments

In the case of a transformation of a company structure, fixed assets (+/-), liabilities (+/-), receivables (-) and provisions (+/-) can be revaluated.

The corporate tax base normally has to be adjusted (1) by the revaluation difference mentioned above at the predecessor and (2) by the difference between the accounting net book value and fiscal net book value of tangible and intangible assets at the predecessor and in the case of a spin-off at the successor (in the tax year of the transformation).

However, in the case of 'preferential company transformations' it is possible to avoid corporate tax adjustments. The conditions for the preferential company transformation status are that both the predecessors and successors must be companies, none of the shareholders of the predecessors acquire more than 10 per cent cash over the acquisition of shares of the successor and there is no change in the proportion of the shareholders in the case of a spin-off (a merger into the only shareholder of a one-person company is also considered to be a preferential transformation).

In the case of a preferential company transformation, corporate tax adjustments may be avoided if the following conditions are met: the successor keeps a record of all assets and liabilities taken over from the predecessor as if no reorganisation had taken place (it has to continue the records with the same purchase value, and accounting and fiscal net value); the deed of foundation of the successor refers to this liability; and the preferential company transformation status is referred to in the corporate tax return of the predecessor.

iii Asset deals

A sale of assets of a company is usually subject to corporate tax. The taxable profit is the difference between the selling price and the fiscal net book value of the assets. However, it is possible to avoid corporate tax impacts in the case of a 'preferential asset deal' where an independent division of the company (with its own structure, assets and ability to operate) is sold to a buyer in exchange for the acquisition of shares.

Similar to a preferential company transformation, the special rules can be applied if the asset transfer agreement lists all assets, liabilities and accruals (including purchase values, net accounting and fiscal book values), and has a declaration to apply special accounting rules; the buyer keeps all assets taken over in its books as if no asset deal had taken place (e.g., it continues the records with the same purchase value, accounting and fiscal net value as taken from the seller); and the seller reports the preferential asset deal status in its corporate tax return.

iv Real estate companies

A transfer of real estate may be subject to property transfer duty not only in the case of an asset deal but also a share deal, if the company is considered to be a 'real estate company' having at least 75 per cent real estate property within its total assets (not including cash, receivables and accruals). The general transfer duty rate payable by the buyer is 4 per cent up to 1 billion forints and 2 per cent over such amount. This regulation is applicable to indirect owners as well, but there are exemptions for related companies having a registered principle business activity of real estate property selling, leasing or management.

IX COMPETITION LAW

i New turnover thresholds

As of 15 January 2017, new turnover thresholds were introduced into the Hungarian merger control law. According to these, a concentration shall be notified to the GVH if the aggregate

net turnover in and from Hungary of all undertakings concerned exceeded 15 billion forints in the last audited financial year, and the net turnover in and from Hungary of each of at least two of the undertakings concerned exceeded 1 billion forints in the last audited financial year (this latter threshold was raised from previously 500 million forints).

Even if the above thresholds are not met, the GVH may investigate a transaction within six months after its implementation if it is not obvious that the merger would not have a significant impediment on effective competition, in particular by creating or strengthening a dominant position, and the aggregate net turnover in and from Hungary of all undertakings concerned exceeded 5 billion forints in the last audited financial year. In such cases, however, no suspension obligation applies.

According to the GVH's relevant notice, a concentration shall be regarded as 'obviously' not significantly impeding effective competition if the parties' combined market share does not reach 20 per cent on any overlapping (horizontal) markets or 30 per cent on the vertically related markets (or, where such market shares are reached, the market share increment stemming from the concentration is below 5 per cent).

ii Calculation of turnover

The recent amendments have introduced a change in the calculation of turnover of Hungary-based companies. Prior to the amendment, in the case of entities incorporated in Hungary, all of their net turnover, whether from sales within or outside of Hungary, had to be taken into account. As of 15 January 2017, again in the case of Hungary-based entities, it is only the net turnover from sales into Hungary that shall be taken into account for the purposes of the turnover calculation (i.e., export sales shall be deducted).

iii Procedure and filing fee

Transactions that 'obviously' do not significantly impede effective competition will be cleared within eight calendar days ('fast track procedure'). A formal merger control procedure will only be initiated in cases where, on the basis of the notification, such impediment on effective competition cannot be obviously excluded, where the notification is regarded as incomplete by the GVH or where the special authority approval of the Media Council is required.

In the case of fast track procedures, the filing fee is reduced to 1 million forints. The filing fee of regular Phase I and Phase II proceedings has remained unchanged (altogether 4 million forints for Phase I, and altogether 16 million forints for Phase II procedures).

iv Recent developments in case law

Since 2016, the GVH has started to impose significant procedural fines in merger control proceedings for incomplete or incorrect data supply. In Cases Vj-33/2016 and Vj-1/2017, following the issuance of the clearance decision, the GVH discovered that the notifying parties had provided incorrect information regarding the group structure or the relevant markets. The clearance decisions were therefore revoked, and substantial procedural fines (7 million forints to 75 million forints) were imposed. A new merger control procedure had to be conducted to clear the transactions.

X OUTLOOK

The modifications of the Cross-Border Mergers Act implemented in 2017 aim at the transposition and further harmonisation of national law with EU law, including Directive 2005/56/EC of the European Parliament and of the Council, Directive 2009/109/EC of the European Parliament and of the Council and Directive 2012/17/EU of the European Parliament and of the Council in respect of cross-border mergers and the related registers, reporting and documentation obligations.

Appendix 1

ABOUT THE AUTHORS

JÓZSEF BULCSÚ FENYVESI

Oppenheim Law Firm

Dr Fenyvesi graduated from the Janus Pannonius University of Pécs in 1998 and pursued postgraduate studies in EU law at the University of Pécs. He obtained an LLM in international economic law at the University of Warwick in 2004, and attended the University of Oxford as a Chevening scholar and received a *Magister Juris* degree in 2006. Mr Fenyvesi joined the Budapest office of Freshfields Bruckhaus Deringer in 2005. He became an associate of Oppenheim in 2007, and has been a partner at the firm since 2010. Mr Fenyvesi has been the head of the corporate practice of Oppenheim since 2014

MIHÁLY BARCZA

Oppenheim Law Firm

Dr Barcza graduated from the József Attila University Szeged in 1994 and studied at University of Economics Budapest between 1995 and 1997. He was a trainee at the Budapest Stock Exchange and later was inhouse counsel at CO-Nexus Investment House. He was a trainee, then attorney and later partner with a reputable Hungarian law firm, Réti Szegheő and Partners, from 1995 to 2004, spending seven months at Clifford Chance, London, on a scholarship. He was senior counsel and co-head of corporate with international law firm Freshfields Bruckhaus Deringer from 2004 to 2007. He is a founding partner of Oppenheim. He has been a member of the Money and Capital Market Arbitration Court since 2000.

OPPENHEIM LAW FIRM

Károlyi Utca12
Budapest 1053
Hungary
Tel: +36 1 486 22 00
Fax +36 1 486 2201
jozsef.fenyvesi@oppenheimlegal.com
mihaly.barcza@oppenheimlegal.com
www.oppenheimlegal.com

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