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The International Comparative Legal Guide to:

Alternative Investment Funds 2014

2nd Edition

A practical cross-border insight into Alternative Investment Funds work

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The International Comparative Legal Guide to: Alternative Investment Funds 2014

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1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Act XVI of 2014 on the Collective Investment Trusts and their Managers and Amending Certain Finance Related Acts (the *Collective Investments Act*) came into force on 25 February 2014 and governs the establishment and operation of Alternative Investment Funds in Hungary. The regulatory regime created by the Collective Investments Act completely replaced the previous regulatory regime. It was passed to implement Directive 2011/61/EU of the European Parliament and the Council on Alternative Investment Fund Managers as amended by Directives 2003/41/EC, 2009/65/EC, 1060/2009/EC and 1095/2010/EU, generally known as the Alternative Investment Fund Managers Directive (the *AIFMD*).

The Collective Investments Act regulates, among others, the activities of investment fund managers and alternative investment fund managers (*AIFM*) and sets out general rules applicable to investment funds and alternative investment funds. Additional legislation applicable to AIFs includes Act CXX of 2001 regulating capital markets and Act CXXXVIII of 2007 regulating investment companies, commodity dealers and their activities.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

The Collective Investments Act requires management companies to obtain a licence before acting as fund managers. Licences are obtained from the Hungarian National Bank (the *HNB*) which acts as the Hungarian regulator of AIFs. The HNB, therefore, exercises a supervisory function over management companies of AIFs.

The Collective Investments Act sets out various personal, technical, operational and other requirements which must be complied with by AIFMs, including minimum capital requirements, the corporate form of the AIFM, how AIFMs may satisfy the “fit and proper persons” test, and where the management of an AIFM must be located.

Advisers to AIFs are not specifically regulated under the Collective Investments Act unless the action of the adviser qualifies as the provision of investment advice or another regulated service requiring a licence from the Hungarian regulator.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

AIFs are legal persons deemed to be established by their registration in the registry of the HNB. The registration procedure must be initiated by an AIFM, which must itself have obtained a licence from the HNB. A fund’s AIFM is the legal representative of the AIF and acts on its behalf.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds) and if so how?

There are numerous distinctions under Hungarian law between various types of AIFs, including between open-ended and closed-ended AIFs.

The Hungarian regulatory regime principally recognises and distinguishes between:

- (i) public and private funds – based on how investments are marketed and offered;
- (ii) professional and residential funds – based on the identity of potential investors;
- (iii) open-ended and closed-ended investment funds – based on whether investors have a right to redeem their investments;
- (iv) fixed term and indefinite term funds;
- (v) security funds, real estate funds, hedge funds and private equity funds – based on the nature of the underlying investment assets;
- (vi) UCITS and AIFs.

The nature and extent of the regulatory requirements applicable to a fund depend upon the nature of the fund and the way it is classified under the Collective Investments Act.

1.5 What does the authorisation process involve?

Different authorisation procedures apply to AIFMs and AIFs.

To be authorised, an AIFM must commence authorisation proceedings with the HNB. Various prescribed documents and other evidence must be filed with the HNB to obtain the licence. The authorisation application must include, among others, the following documents:

- (i) the company’s deed of foundation;
- (ii) a certificate confirming the AIFM has its main office and its registered seat in Hungary;

- (iii) a description of the investment activity to be carried out;
- (iv) a certificate confirming that the AIFM satisfies certain minimum capital requirements, initially EUR 125,000 (EUR 300,000 for real estate funds) with further capitalisation requirements if the net asset value of the fund exceeds EUR 250 million;
- (v) the AIFM's remuneration policy and standards;
- (vi) a certificate confirming compliance by the AIFM with certain stipulated criteria;
- (vii) a list of shareholders directly or indirectly holding a significant interest in the AIFM and the amount of their interests; and
- (viii) information on the outsourcing of the AIFM's activities.

In addition, AIFMs must supply additional information to the HNB as required by the Collective Investments Act, including the identity of the fund's custodian and other service providers. An AIFM may commence its activities immediately after receiving HNB authorisation.

An AIF is authorised once it is registered with the HNB. The criteria for registration depend upon the type of the fund, and different minimum equity subscription requirements apply to different types of funds. Real estate funds are required to retain a qualified real estate valuer. The HNB must accept or reject an application for registration within 10 working days from the date the application is filed unless the intended offering is to be a public offering, in which case the time limit is 20 working days.

1.6 Are there local residence or other local qualification requirements?

The Collective Investments Act requires an AIFM to operate from a main office located in Hungary. Local qualification requirements regulate those persons who may be managers of AIFMs, including the general requirement that two members of the management of the AIFM must be private persons and perform their activities as employees. In addition, at least two members of the executive of the AIFM must be resident and domiciled in Hungary. The minimum management requirements do not apply to certain AIFM managers, for instance whose investment portfolios are less than HUF 100 million or which have elected not to be subject to all provisions of the Collective Investments Act.

AIFMs registered in another EEA member country may operate in Hungary by establishing a branch office in Hungary or by offering cross-border services. In either case, non-Hungarian AIFMs must file the following documents with the HNB: (i) a copy of the licence obtained from their home country (granted under a licensing procedure compliant with AIFMD permitting them to manage a specified AIF); and (ii) an activity plan, which also includes the name of the AIF which the AIFM intends to manage. If the non-Hungarian AIFM wishes to establish a branch office in Hungary it must also file with the HNB: (i) details of the organisational structure of the branch office; (ii) a Hungarian address where the AIFM's constitutional and operational documents may be obtained; and (iii) the names and addresses of those persons who are responsible for the management of the branch office.

Non-EEA fund managers must establish a branch in Hungary if they intend managing an AIF in Hungary.

1.7 What service providers are required?

AIFMs must appoint depositaries to hold assets and documents of title on behalf of the underlying AIF to enable the AIF to conclusively

identify the nature and extent of its assets and to maintain a record of the AIF's transactions. The depositary is also responsible for general oversight and control relating to compliance with applicable law and with the rules set out in the fund's management policy. Depositaries execute the orders of the AIFs unless contrary to applicable law or the rules set out in the fund's management policy.

Real estate funds must also appoint a real estate valuer.

AIFMs are free to appoint advisers and agents and are permitted to outsource certain activities to third parties under the Collective Investments Act.

1.8 What co-operation or information sharing agreements have been entered into with other governments or regulators?

The HNB is obliged to co-operate with other EU regulators, with the ESMA and with other EU institutions. The predecessor of the HNB, the Hungarian Financial Supervisory Authority, entered into regulatory co-operation agreements in connection with the AIFMD which remain binding and in force, including with China, USA and Japan. These regulatory co-operation agreements provide a framework for: (i) the exchange of information; and (ii) undertaking formal investigations even if the location is in another country. The entry into a regulatory co-operation agreement is often a condition of a non-EEA IFM being authorised in an EEA Member State.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

AIFs are considered as legal persons under Hungarian law. They are established by their registration with the HNB. AIFs have no representative bodies. The legal representatives of AIFs are their fund managers (AIFMs). Different types of AIFs may be established, as set out in question 1.4 above, allowing investors to set up an AIF in the form most advantageous to them. Hungarian law does not limit investment in AIFs to any type or class of investor. However, the offering documents of a fund, such as a hedge fund, may restrict potential investors to professional investors.

2.2 Please describe the limited liability of investors.

The liability of investors is limited to the amount of their investment in the fund. Investors may not be held liable for the obligations of the AIFM or the AIF.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

AIFMs must generally be private companies limited by shares.

AIFMs may also be operated as branch offices of foreign companies set up and existing pursuant to Act CXXXII of 1997 on Hungarian Branch Offices and Commercial Representative Offices of Foreign-Registered Companies.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

There are specific restrictions applicable to the suspension of the

redemption of investments in AIFs offered continuously. The investment manager may only suspend the sale or redemption of continuously offered investments if: (i) the net asset value of the underlying assets cannot be established or if the sale relates to more than 10% of the equity of the AIF; (ii) sale and redemption may not be conducted for reasons relating to the AIFM, the depositor, the distributor, or the central counterparty for a longer term; or (iii) the net asset value of the fund is negative. In addition, the fund manager may also suspend redemption if the volume of redemptions is so great as to adversely affect the liquidity of the AIF. The fund manager must immediately inform investors, the HNB and each relevant EEA-supervisory authorities of any suspension of redemptions.

The sale of investments in closed-ended or open-ended funds may also be restricted by the terms of the fund's offering memorandum or constitutional documents.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no general legislative restrictions on the transfers of investments by investors. However, certain AIFs may restrict the transfer of investments to particular classes of investor, such as professional investors, or may prohibit the transfer of investments altogether.

3 Marketing

3.1 What legislation governs the production and offering of marketing materials?

The Collective Investments Act contains provisions governing the content and publication of marketing materials. Certain provisions of Act CXX of 2001 on the Capital Markets (the *Capital Markets Act*) also apply. The Capital Markets Act contains detailed rules on the public offering and private placement of securities, the preparation and publication of a prospectus, and the creation and offering of securities to the potential investors. Act CXXXVIII of 2007 on Investment Firms and Commodity Exchange Service Providers, and Rules Concerning the Activities They Are Authorised to Pursue (the *Investment Services Act*) also regulates the provision of investment advice. Various EU directives and regulations also apply, such as the Commission Delegated Regulation (EU) No 486/2012 of 30 March 2012 amending Regulation (EC) No 809/2004 which governs the format and content of prospectuses, base prospectuses, summaries and final terms and sets out content and disclosure requirements). General legislation governing marketing activities and consumer protection may also be relevant.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

Content requirements differ for open-ended and closed-ended funds. For open-ended funds, the Collective Investments Act requires the authorisation of the marketing materials by the HNB. Prior to marketing, the AIFM must file the management regulations, the prospectus, any information for privileged investors and any advertisement with the HNB for approval. The content of these documents is prescribed by the Collective Investments Act, which requires, for example, management regulations to include:

- (i) basic information concerning the AIFM;
- (ii) decisions on the investment fund;
- (iii) the procedure for amending the management regulations; and
- (iv) risks, costs and expenses, etc.

The Collective Investments Act regulates the contents of a fund's prospectus, which must contain information relating to:

- (i) the investment fund;
- (ii) the marketing of the interest notes; and
- (iii) the service providers.

An AIFM must upload the required documents to its website and also publish them on the HNB's website. Different rules apply to closed-ended interest notes and are set out in Part 2 of the Capital Markets Act. A private fund's AIFM must make the fund's management regulations available to investors at least 7 days prior to the distribution of any investments. The Investment Services Act contains further regulations under which marketing materials must contain investor warnings and disclosures.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Yes. As noted in question 3.2 above, certain fund documentation must be approved by the HNB.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Interests in an AIF may not be marketed until it has been licensed by the HNB. In addition, depending on the type of the fund, the AIFM may restrict the identity of offerees and/or the amount or value of the interests which may be marketed.

3.5 Can Alternative Investment Funds be marketed to retail investors?

Under Hungarian law AIFs may be marketed to any type of investor without any regulatory restrictions, unless the AIF is restricted to offering investments to a restricted or particular class of investors under the laws of another jurisdiction, for example where an AIF licensed in another EEA is marketed in Hungary by a Hungarian AIFM.

3.6 What qualification requirements must be carried out in relation to prospective investors?

Qualification requirements largely depend on the type of fund and are self-imposed by the fund. Certain AIFs limit their "client base" to "professional investors" satisfying minimum capital requirements and with a suitable risk-return profile, or to wealthy private clients. Non-professional investors are classed as retail investors. There are no restrictions on the maximum or minimum numbers of investors.

3.7 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are no specific laws containing particular restrictions on marketing AIFs to public bodies.

3.8 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

If an AIFM appoints an intermediary it must set out the terms of the appointment in a written contract and inform the depositary. All intermediaries must be properly licensed and supervised by the HNB. Any intermediary must have the appropriate expertise, accuracy and skill, and must satisfy the requirements of the Investment Services Act. The AIFM must ensure that the use of intermediaries does not expose investors to additional risks. The AIFM must supervise and control the activities of its intermediaries.

3.9 Are there any restrictions on the participation by financial institutions in Alternative Investment Funds (whether as sponsors or investors) arising from the 2008 financial crisis?

We are not aware of such restrictions.

4 Investments

4.1 Are there any restrictions on the types of activities that can be performed by Alternative Investment Funds?

Yes. A Government Decree differentiates between and imposes restrictions on private and public investment funds. It also contains provisions applicable to real estate funds. A public investment fund may invest only in those assets set out in a list attached to the Government Decree and imposes limits on the amounts of these assets which a public investment fund may hold. Similar limitations appear in the Government Decree concerning private investment funds, which, for example, limits investments to assets such as transferable securities and financial market assets, collective investment securities and/or foreign exchange transactions. The Government Decree sets out further limitations applicable to real estate investment funds, limiting them to investing in real estate and related rights and assets.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio whether for diversification reasons or otherwise?

AIFs are generally free to invest in any type of financial instruments specified in their prospectus and are free to adopt any investment strategy. The Collective Investments Act requires specialised funds, such as securities funds, real estate funds, private equity funds or venture capital funds, to invest their primary assets in those financial instruments which relate to their specialisation. Government Decree 78/2014 (III.14.) on the Rules of Investing and Borrowing by the Collective Investment Forms (*Government Decree*) sets out further limitations on the permitted investments of different types of AIFs.

4.3 Are there any restrictions on borrowing by the Alternative Investment Fund?

Although the Collective Investments Act currently does not contain any specific restrictions on borrowing, it requires an AIF's management regulations to set out the AIF's borrowing rules. Applicable legislation authorises the Government to regulate borrowing by AIFs by adopting further laws in the form of government decrees. One such Government Decree permits AIFs to borrow up to 60 per cent of the value of the assets of the AIF for a maximum 3-month term.

5 Disclosure of Information

5.1 What public disclosure must the Alternative Investment Fund make?

Public AIFMs must prepare and publish, amongst other things (with the content depending on the type of the fund), a prospectus, an annual report for each financial year, a half-yearly report covering the first six months of the financial year, as well as a monthly portfolio. These reports must contain details of the public information of the management company and the fund, such as the basic data of the fund, management regulation, interests in other investment funds, information on the invested capital, the depositary and identities of the advisers.

5.2 What are the reporting requirements in relation to Alternative Investment Funds?

The prospectus, the annual report for each financial year, the half-yearly report covering the first six months of the financial year and the monthly portfolio report are all subject to the disclosure requirements of the Collective Investments Act. These reporting materials must be made available to each investor of the fund by publishing the documents on the management company's website or by making available to the public such documents, in the place and manner specified in the prospectus or, if requested by the investor, by sending a printed copy to his/ address. Copies of these reports must be filed with the HNB at the same time they are provided to investors.

5.3 Is the use of side letters restricted?

The Collective Investment Act does not restrict the use of side letters. However, it prevents an investor from being given preferential treatment unless the preferential treatment is disclosed in the management regulations of the AIF (and, therefore, made available to investors generally).

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds?

AIFs are a pool of assets which have legal personality but are not subject to corporate income tax in Hungary. The profits of an AIF are taxed on the level of the investors (i.e. individual and corporate holders). See our answer to question 6.4 below.

6.2 What is the tax treatment of the principal forms of investment manager/adviser?

Management companies (handling the AIF) may operate in the form of a company limited by shares or as a branch office. They are subject to corporate income tax in Hungary on their profits.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

Currently, there are no transfer taxes levied with respect to the sale of an investor's interest in an AIF. Nor do any stamp duties apply.

The gifting or inheritance of investments in AIFs may be subject to transfer tax.

6.4 What is the tax treatment of (a) resident and (b) non-resident investors in Alternative Investment Funds?

Resident individual holders are subject to taxation in Hungary based on their worldwide income, while *non-resident individual holders* are subject to taxation based on their Hungarian sourced income (provided this income is taxable in Hungary under the provisions of an applicable double tax treaty). If fund investments are publicly offered and traded, any capital gain on a transfer may qualify either as (i) interest income, or (ii) income from a controlled capital market transaction (if the transfer is made through a regulated market). Redemption gains and the yields of fund investments are deemed to be interest income. Expenses related to the acquisition of fund investments and other ancillary expenses may be deducted from the income received (except in the case of dividend income). If fund investments are privately placed, any capital gains on transfer qualify as capital gain income and any yield or gain on redemption qualifies as other income. As an exception to this rule, the yield of a venture capital fund investment qualifies as a dividend. Expenses related to the acquisition of fund investments and other ancillary expenses may be deducted from the income received (except in the case of dividend income). In addition, a health contribution is payable on interest, dividend, capital gain and 'other income' at various rates. Certain exemptions are available for health contributions payable on dividends or interest. In general, the domestic payor of the income (e.g. the investment service provider or the commercial bank) must assess, deduct and pay the tax and health contribution to the tax authority. In the absence of a domestic payor, the private individual must carry out these functions himself.

Any income realised by *Hungarian resident corporate holders* is taxable in the same way as the company's general income and is subject to corporate income tax. *Non-resident corporate holders* will be subject to taxation in Hungary based on their income attributable to a Hungarian permanent establishment. If there is no permanent establishment in Hungary, income paid to foreign resident corporate holders is not subject to withholding tax in Hungary.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

It is not necessary to obtain a tax ruling prior to establishing an AIF. However, depending on the magnitude of the investment, the volume of the assets to be managed and the type of the structure, it may be advisable to obtain a binding ruling from the Ministry of National Economy. Any application is subject to a filing fee.

6.6 What steps are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA)?

An intergovernmental agreement was concluded between the Government of Hungary and the Government of the United States of America on 4 February 2014 under the Model 1 FATCA approach. The enactment of the intergovernmental agreement into Hungarian law is currently in progress. The implementing Act was submitted to the Hungarian Parliament on 15 April 2014. For the year 2014, the information exchange will comprise (i) the name, (ii) the address, (iii) the U.S. tax number of the persons concerned, (iv) the bank account number and the balance of the bank account, and (v) the name of the Hungarian financial institution where the account is kept. From 2015, further data will be reported (e.g. gross interest and dividend income, gross income derived from property sales, etc.).

6.7 Are there any other material tax issues?

It is unclear whether an AIF will be subject to local business tax in Hungary. According to a non-binding interpretation of the competent Hungarian authorities, an AIF is not subject to local business tax, since all entrepreneurial activities are undertaken by the AIFM, not the AIF.

7 Reforms

7.1 What reforms (if any) are proposed?

The Hungarian regulatory regime applicable to the alternative investment funds has only recently been adopted in Hungary. We are not aware of any proposed reforms.

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The Budapest office of the international law firm Freshfields Bruckhaus Deringer re-established itself as an independent law firm under the brand name "Oppenheim" as of 1 November 2007. Whilst being independent, it maintains a co-operation agreement with Freshfields Bruckhaus Deringer and is the correspondent partner of Freshfields Bruckhaus Deringer in Hungary. Oppenheim currently consists of more than 40 lawyers and legal experts who provide advice on all areas of Hungarian business law, through a combination of specialised practice groups. Oppenheim – being a fully Hungarian law firm – has accumulated a considerable expertise in cross-border transactions. Indeed, all of Oppenheim's staff have been trained through multi-jurisdiction transactions both in the Freshfields era and ever since the establishment of the Oppenheim operation. The experience of our staff is built on numerous cross-border transactions serving international clients, which has also enabled us to build up strong regional co-operation with leading independent law firms in Central Eastern Europe.