

## **Business Advice Series Part Three: Ten typical mistakes investors make in Hungary**

### **Not the way things are back home... or are they?**

**In parts one and two of this series, we dealt with the basic aspects of buying into a Hungarian company or setting up a new one. This week I want to shed light on a fundamental psychological problem connected with doing business abroad: every investor tends to automatically apply experience from his home base of operations to Hungary. That is often both possible and appropriate, but sometimes it is absolutely the wrong approach. And rethinking these transactions is, without a doubt, a very difficult task.**

To transfer experiences with regulatory mechanisms and customs of an investment's country of origin to the situation in Hungary is, as I said, initially not problematic. The centrepiece of EU expansion was the ability of candidate countries to adopt the *acquis communautaire*, which meant the adoption of all EU law precepts, including the jurisprudence of EU courts, into their national legal systems.

Due to the predominance of EU directives in certain fields of law, the regulation of many subjects is largely uniform in the EU. I say "largely" because there are definite divergences from the norm. Since the EU does not have the power to regulate everything on the national level, member states still have a great deal of authority at their discretion. Furthermore because the main instruments of EU legislation - the EU Directives - by their very nature contain a great deal of room for manoeuvre, there are some matters that are regulated in a very different fashion.

In Hungary it is initially a good practice to adhere to certain basic legal principles which are already well established in the older member states. A good example of this is the pseudo-independent businessperson. Anyone working for a company, who is fully integrated into the workplace, who is subject to the most essential of the management's directives, and/or who dedicates all of his/her labour to this company is, by definition, an employee of that company. In particular the company is responsible for paying all social insurance contributions for this employee.

#### **No way around it**

Just as in other countries, this cannot be avoided simply because the employee does not have an employment contract and only works on assignment, getting paid on the basis of services rendered. If someone is trying to apply their experiences to Hungary, they should know that there are no loopholes in the labour regulations in this country either. Before Hungary joined the EU it managed to get exemptions and relaxations, some of them for its companies. Those days are over now. The authorities in Hungary, whether they be the tax office or the labour office, are to be taken just as seriously as those at home. Hungary is governed by the rule of law.

#### **What is different**

On the other hand, despite an abundance of scandalous parallels between "here" and "home," there are some significant differences, for example in corporate law. One should know these because, aside from the fact that entire transactions can be declared legally null and void due to formal errors, the Hungarian State Prosecutor's Office has the authority to subpoena all of a company's administrative records for inspection anytime it sees fit.

### **A few specific examples**

A known fact often overlooked is the Hungarian anomaly that single-owner companies cannot own other single-owner companies. To adjust to this one must give at least a small stake in the company to another person. A CEO can be the head of no more than three companies. In general a CEO cannot delegate all of his authority to a third party, nor part of his authority to the shareholders meeting. Only the officially registered managing director of a subsidiary has the power to make legally binding declarations about the company's activities in Hungary, or represent the interests of foreign-national shareholders to the local authorities. In a shareholders' company, only the board of directors has authority in matters of employment.

It is always tricky dealing with the differences between various types of companies in different countries. For instance, in contrast to many other jurisdictions in the world, stakes in limited companies can be transferred informally, specifically, without having documents notarised. And though that cuts the expense of the transaction, it removes the element of caution and the safeguard against hastiness imparted by the notarisation process. Even real property can be sold by virtue of a simple contract and the countersignature of an attorney. But then the mortgage needs to be notarised. A somewhat absurd arrangement.

### **Conclusion**

Doing business in a foreign legal environment is not exactly easy. Although the foreign entrepreneur naturally lacks thorough knowledge of the law, the tax system, and accounting practices, at least at first, it is advisable not to attempt circumventing regulations one already knows from the legal system of the home country. In short, what you cannot do back home you very likely cannot do in Hungary either. Companies beyond a certain size are well-advised to engage qualified consultants. They know the regulatory loopholes, and particularly the national anomalies.

*- the 'Advice to foreign investors' series points out recurrent pitfalls of doing business in Hungary, and gives helpful advice for running a successful business in Hungary.*