

Business Advice Series Part Nine: Ten typical mistakes investors make in Hungary

Restructuring: If you do it, do it right

The life of a business surely is not any choppy in Hungary than in the rest of the region. Membership of the EU has done away with some differences - especially legal differences - and in the future the social rules of play in Hungary will conform more and more closely to the practices of the neighbouring EU countries. Leaving aside the formidable language barrier (see part one of this series) - which presents the greatest obstacle to managing a company for the foreign investor - the “business world” has for years now been making serious progress in integrating itself into the EU market.

That's why restructuring a company in Hungary may be necessary in order to integrate “the Hungarian unit” into the business legally and also with regard to tax matters, whether the umbrella business is European or global. However, quite often legal and tax problems are the prime motivation behind the restructuring of a company. This, too, calls for a thorough and, most of all, decisive course of action. And this is often where the exercise falls short.

The need for restructuring can arise naturally as a result of the company's history. Certain patterns got built into the company at its founding, during operations, and during crisis management. Structures were established with consideration of the market and to take advantage of special forms of financing. Now some of these structures are no longer optimal as regards business administration, or are legally no longer tenable.

In the aftermath of a crisis, do not confine yourself to dealing with the administrative symptoms of the company's ills. Search for their causes, and if possible, root them out. If the restructuring is being compelled by new legislation or regulations, .i.e. certain of the company's activities are subject to stricter conditions (authorisation requirements, qualification standards for personnel, stricter financing requirements) then the restructuring will have to be implemented fairly quickly.

But all of this should be taken as an opportunity to go over the company with a fine-toothed comb and to put it back on its feet. There are two areas that are of particular interest: taxation and personnel.

Taxation

As far as taxation is concerned, one should pay close attention to dividend tax and corporate tax, as well as making use of loss carryforward. Ask if restructuring can be expedient from an international perspective. Double taxation treaties have often set out different schemes for dividend payouts from the various company forms (Kft., Bt., etc.). Transforming the company to a different form, or arranging for a different relationship between the companies in an international group, and therefore having the dividends paid out to a different country (ergo: subject to a different treaty), can be very financially beneficial.

It's often the case that the Hungarian stake in the company was financed by a loan from the foreign investor. Considering that it may never be paid back again, it might be wise for the creditor to simply forgive the debt. The extraordinary profit that results in the Hungarian subsidiary is, under certain circumstances, not subject to corporate tax.

When considering restructuring, do not forget the utilisation of loss carryforward.

Anyone who owns stakes in several companies in Hungary (one of which makes profits subject to corporate tax and another is making losses) may offset, for instance, the losses of the one with the profits of the other by merging the two.

Personnel

When overhauling essential operations, it is crucial to ensure that personnel matters are conducted in line with labour law. Management should make use of this process to bring all the company's labour contracts legally up to date as some provisions in the contracts can be outdated. Others might even be unallowable or void. This can particularly be the case for collective agreements, such as wage agreements. If there are people working for the company who are, in fact, employees, but are nominally "independent contractors" these legal relationships must be formally changed. At this point the employees' contractual job descriptions also have to be re-evaluated. It is possible that an employee has been given new tasks, which the employer never defined clearly in a written document. This could lead to legal liabilities for the employer.

And if you have the opportunity to bring your company up to date with current labour law, then you should extend that to a revision of all the company's legal relationships. Frequently the general conditions under which the company does business with its most important clients are outdated. This can be a serious danger. The newly arranged company can operate more successfully on the market.

Now that this series has dealt with mistakes made when founding a company, when handling day-to-day administration, when managing crises, and proceeding to questions surrounding restructuring, the concluding installment is certainly not about winding up or liquidating the company. Next week, I will cover selling a stake in the business. In this instance, too, it pays to apply the necessary prudence regarding taxation.

The 'Business Advice Series' points out the recurrent pitfalls of doing business in Hungary and gives advice aimed at making your business more successful.