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„The mandatory minimum initial capital requirement was lifted from the current HUF five hundred thousand to HUF three million for the Hungarian Kft..”

Legal newsletter

New Provisions of the Civil Code on Internal Corporate Financing

Dear Sir/Madam,

Deloitte Legal Szarvas, Erdős and Partners Law Firm, a member of Deloitte Legal's international network, provides its clients with a monthly newsletter on the most recent changes and newly adopted regulations in economic law and the most notable legal cases.

As the new Civil Code, the first one drafted since the regime change, will enter into force as of 15 March 2014 and will affect nearly all areas of the economy, in the coming months we will devote several editions of our newsletter to the rules of the new Code.

In case our legal newsletter is not relevant to you, please indicate to which expert at your company we may send our summary of current legal matters in the future.

This summer we informed our clients that the Companies Act currently forming a separate set of regulations will be incorporated in the New Civil Code. **In this newsletter we will outline the changes made to internal corporate financing under the New Civil Code.**

HUF Three Million Subscribed Capital for the Hungarian Kft.

Perhaps the most significant change in the New Civil Code concerning **limited liability companies** is that **the mandatory minimum initial capital requirement was lifted from the current HUF five hundred thousand to HUF three million**. LLCs founded newly as from **15 March 2014** will have to satisfy this new capital requirement. **A grace period of 2 years** will be allowed for existing companies to ensure the mandatory minimum capital, i.e. they will have to raise it to HUF three million by the deadline of **15 March 2016**.

It is not obligatory for companies operating with lower capital to raise it parallel to the first modification of their articles of association. Instead, they are allowed to wait until the above deadline. Accordingly, if after the entry into force of the New Civil Code companies with an initial capital below this amount wish to modify their articles of association for any reason whatsoever (e.g. in the case of new managing director or registered office) they will not be required to raise the capital concurrently. However, these companies will remain subject to the provisions of the current Companies Act,

i.e. they will not be entitled to apply the non-binding regulations set forth in the New Civil Code concerning companies. Companies wishing to apply the new rules will be required to raise their capital prior to the expiry of the above deadline.

Change in the Minimum Amount of Capital Contribution

The provision in the Companies Act stipulating **that the capital contribution of each member must be divisible by ten thousand** currently makes it difficult to determine the share members own in multi-member companies. **This provision is not included in the New Civil Code. The lowest amount of each contribution, however, remains HUF one hundred thousand.**

Share Capital Top-Up from Profits

In order to help companies entering the market, the New Civil Code will offer members the **option to replenish the share capital from the distributable profit**. In this case, members shall specify the amount of the initial capital and the members' initial contributions in the articles while these amounts will not be paid up (in full). Instead, the share capital will be topped up from the profit generated subsequently through the company's activity. Until the profit covers the full amount of the share capital, the company may not distribute dividend to its members and the members will be personally liable for any debt owed by the company to the extent not paid up. **The exact accounting treatment of this new obligation is yet unclear.** The amendment of the Accounting Act is expected to shed light on the issue.

Supplementary Capital Contribution as In-kind Contribution

The provision of the effective Companies Act concerning supplementary capital contributions was unclear about whether supplementary capital contribution may be provided only in cash or also in-kind. The New Civil Code clarifies this question by stipulating that **supplementary capital contribution may also be provided in the form of in-kind contribution in line with the rules applying to in-kind contribution.**

Debt/Equity Conversion Remains Unregulated

The corporate laws of several Western European countries have special rules for cases where **the loan granted by the member to the company is converted to capital, i.e. the member's loan becomes part of the shareholders' equity**. Next to the definition of the member's loan, the Hungarian Companies Act fails to discuss this form of financing, as well. In practice, this "debt/equity conversion" appears as an in-kind contribution of receivables: the member provides the loan as receivables due from the company in the form of in-kind contribution where the in-kind contribution transfers title to the receivables to the obligor and thus these receivables cease to apply. **The New Civil Code failed to incorporate this practice and neither the draft amendment of the Accounting Act with respect to the entering into force of the New Civil Code contains rules in this respect.** Due to the recession, companies would increasingly need such interoperability between the financing methods although, unfortunately, legislators failed to respond to that need during re-codification.

Detailed Rules on Interim Dividend and Equity Loss Omitted

We informed you earlier of two amendments of the Companies Act concerning the

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interim dividend and the equity loss which entered into force last year.

Since 1 January 2012, companies have been allowed to pay interim dividend based on balance sheet figures within six months of balance sheet date (defined for annual financial statements) and so avoid being required to prepare an interim balance sheet for the distribution of the interim dividend for the period of six months following the endorsement of the balance sheet. Companies nevertheless preparing an interim balance sheet may use the figures of the interim balance sheet also within six months of balance sheet date. This period had not been specified previously. **Now, it has also been left out from the New Civil Code.**

Similarly, **the New Civil Code neither includes the provision effective as from last October which stipulated that companies establishing equity loss based on balance sheet figures**—i.e. where the shareholders' equity declines below the mandatory minimum defined by law—**may prove, supported by an interim balance sheet, that contrary to the figures of the financial statements the conditions of equity loss no longer apply.** This way companies can avoid needing to decide on transformation into another form or dissolution without legal successor.

The above provisions of the Companies Act introduced last year have been omitted from the New Civil Code. Since these are relatively new changes, **it is possible that they were left out only by mistake.** We hope that the legislator will subsequently include these latest changes of the Companies Act into the new law.

We hope you will find our newsletter thought-provoking, and we look forward to receiving your remarks. **Please address any questions or comments to our experts on the left.**

Best Regards,

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