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## INTRODUCTION

Hungary has a long history with non-profit organizations or voluntary associations. They appeared in the late eighteenth century and played a critical role in the cultural and political life of the country.

Over the past decade a great deal of attention has been dedicated to improving the general regulatory environment for NGO-s in Hungary.

The purpose of this report is to provide information on the legal regulations that affects the business activities for Public Benefit Organizations, especially legal activity for a future Public Benefit Company.

### *Chapter I.*

#### THE LEGAL ENVIRONMENT FOR PUBLIC BENEFIT ORGANIZATIONS

##### *Section 1.*

**The following organizations, registered in Hungary, may be qualified as public benefit organizations: /Act CLVI of 1997/**

- Non- governmental organizations
- Foundations
- Public foundations
- National associations of specific sports
- Public benefit companies /Act Civil &57-58/

*Public benefit companies are legal persons, serving the common interests of society on a regular basis, without aiming to acquire profits or accumulate assets. Public benefit companies may carry on business-type economic activities (i.e. entrepreneurial activities) in the interest of promoting their Public benefit activities. Profits generated by a company's activities may not be distributed among the members.*

*In respect of Public benefit companies, the common regulations pertaining to business associations and the provisions on limited liability companies*

*prescribed in the Act on Business Associations shall be duly applied, with due regard to the differences set forth in this Act.*

*The articles of incorporation of Public benefit companies shall specify the public service activities and, when applicable, any business-type economic activities performed by the Public benefit company. The articles of incorporation shall also prescribe the mode of utilizing the assets, for public purposes in the event of the company's termination.*

*Public benefit companies may also be established as the companies of certain artificial persons, including companies whose names includes the term "institution", or if a business association is transformed into a Public benefit company. In this case, the Public benefit company shall become the legal successor of the company (institution) of said artificial persons or of the business association.*

*In respect of the foundation of Public benefit companies the provisions on the transformation of business associations shall be duly applied, unless the legal predecessor is a limited liability company that may be transformed into a Public benefit company by having its articles of incorporation amended accordingly.*

*Public benefit companies come into existence on the day on which they are entered into the register of companies.*

*The designation "Public benefit company" or its abbreviation ("kht.") shall be included in the company's registered name.*

*Members may also be invited to join Public benefit companies through public announcements.*

## **Section 2.**

**To get the Public benefit status, the organization must meet certain conditions outlined in the law of PBO-s. /Act CLVI of 1997/**

**The organization's instrument of constitution shall include:**

- a) the list of public benefit activities, conducted by the organization and, if the organization has members, that it does not preclude parties other than its members from benefiting from its public benefit services. These activities are:

- 1. health preservation, disease prevention, therapeutic and medical rehabilitation activities,*
- 2. social activities, family counseling, care for the elderly,*
- 3. scientific activities, research,*
- 4. school instruction and education, personal ability development, dissemination of knowledge,*
- 5. cultural activities,*
- 6. preservation of cultural heritage,*
- 7. preservation of historical monuments,*
- 8. nature preservation, animal protection,*
- 9. environmental protection,*
- 10. children and juvenile protection, children and juvenile advocate services,*
- 11. promotion of equal opportunity within society for underprivileged groups,*
- 12. protection of human and civil rights,*
- 13. activities in connection with ethnic minorities living in Hungary and with Hungarian nationals living outside of Hungary,*
- 14. sports, not including sports activities involving professionals and those performed under contract within the framework of a civil law relationship,*
- 15. protection of public order and traffic safety, voluntary fire fighting, rescue, and disaster preparedness and response activities,*
- 16. consumer protection,*
- 17. rehabilitative employment,*
- 18. promotion of employment and training for underprivileged groups in the labor market, and associated services,*
- 19. promotion of the country's Euro-Atlantic integration,*
- 20. services provided to and available solely for non-profit organizations;*
- 21. activities associated with flood and water damage control;*
- 22. activities associated with the construction, maintenance and operation of roads, bridges and tunnels;*

*b) a clause stating that the organization conducts entrepreneurial activities solely in the interest of and without jeopardizing its public benefit objectives;*

c) a clause stating that the organization does not distribute its business profits, but rather utilizes such profits for the activities defined in its instrument of constitution;

d) a clause stating that the organization is not involved in direct political activities, furthermore, that it is independent from and does not provide financial aid to political parties.

**For registration under priority non-profit status**, an organization's instrument of constitution shall include the following:

a) a clause stating that the organization performs public duties which, by virtue of law or in accordance with the provisions of other legal regulations based on the authorization granted by law, are to be provided by a state agency or by a local government, and furthermore

b) a statement that the organization publishes the principle data and information on its activities set forth in its instrument of constitution in a media publication with local or national circulation.

## *Chapter II.*

### **TAX TREATMENT FOR NGO ECONOMIC ACTIVITIES**

Taxation regulations are contained in the Act on Accountancy. Every PBO has to report according to the new regulations. Those NGOs that did not apply for the public benefit status -or have not received it- remain NGOs but will not qualify as public benefit and therefore will be subject to the old regulations. According to the variances in tax regulation, PBOs are categorized into the following types of organizations:

Category I.: Foundations, public foundations and associations and other social organizations

Category II: *Public benefit companies:*

*PBCs are more like limited companies because they can have both business and public benefit activities. However, they cannot distribute any profit. If a PBC does only public-benefit activities, it is tax exempt. If, however, it conducts business activities as well, than income from entrepreneurial activity at or above the threshold limit is taxed at a proportional rate.*

If an NGO sets up a business venture as a separate legal entity, the business does not receive any tax advantages.

*Chapter III.*  
**REPORTING RULES**

As outlined in the Act on Accountancy, NGOs must file an annual tax form to the tax office by May 31. The form of accounting is determined by the amount of group's annual budget and by whether it carries out entrepreneurial activity. Income and expenses related to the PBO's purpose-related activity and those from entrepreneurial activity must be clearly separated. The report can be: 1. simplified annual report /containing a balance sheet and a statement of activity/ or 2. simplified balance of accounts /containing a balance sheet and a demonstration of activity/.

*Chapter IV.*  
**FINANCIAL AND ECONOMIC FACTORS**

Over 50% of the revenue to the NGO community is derived from related and unrelated economic activity. Many organizations develop their business activities that will support their mission and create profit. They must demonstrate that business activity is related to their goals and objectives.

Non-profit organizations shall register their revenues and expenses derived from non-profit and business activities separately.

*Section 1.*

**The following shall be deemed revenues of a non-profit organization:/Act CLVI of 1997/**

- a) contributions and donations received from its founder, from the subsystems of the state budget or from any other sponsor for its public welfare objectives or to cover operating expenses;
- b) revenues generated by its non-profit activities or revenues directly associated with such;
- c) revenues generated by other designated activities or revenues directly associated with such;
- d) revenues from investment of the organization's assets;
- e) membership fees;

f) other revenues defined by law;

g) *revenues from entrepreneurial activities.*

*What is an entrepreneurial activity? Economic activity aimed at or resulting in the acquisition of income or property, not including statutory activity involving income and support granted for public benefit activity. The type of the entrepreneurial activity must be chosen from the "TEÁOR". The activities and work types that cannot be carried out by business associations in general mustn't be done by PBOs either, for example: pharmacological retailing, legal activity ...ect. Legal activity is allowed only for certain type of businesses, e.g. those registered with the Bar Association, at the Ministry of Economic Development etc. The "TEÁOR" enumerate the domains of legal activity such as :*

- *appearance by solicitor, defense in juridical, judicature proceedings or in similar cases*
- *advisory function and legal appearance in civil action*
- *advisory function and legal appearance in criminal action*
- *legal advisory function and representation in trade dispute*
- *general legal consultation, advisory function, preparatory activity of documents*
- *preparatory activity of documents on incorporation of a company, foundation of a company, letters patent, authors' right ...*
- *notarial document, testament, delegation of authority...*

***Based on the above legal activity is not allowed for PBCs. In case you insist on doing so other company form should be decided on.***

## *Section 2.*

**The following shall be deemed expenditures of a non-profit organization:**

- a) direct costs incurred in connection with public welfare activities (expenses, expenditures);
- b) direct costs incurred in connection with other designated activities (expenses, expenditures);
- c) direct costs incurred in connection with business activities (expenses, expenditures);



d) indirect costs incurred in connection with public welfare activities and other business activities (expenses, expenditures), which shall be divided in proportion to the respective revenues.

As for other aspects, the relevant provisions on accounting shall be observed regarding the books and records of non-profit organizations.

#### *Chapter V.*

### **SUPERVISION OF PBOs**

Non-profit organizations shall be supervised for tax purposes by the tax authority responsible for the place where the non-profit organization is established, by the State Audit Office for auditing the utilization of budgetary subsidies and for compliance with the requirement to file declarations of personal wealth, and by the public prosecutor's office for judicial purposes, in respect of public welfare activities, according to the applicable provisions.

Pursuant to the provisions of the Act on Company Registration, Public Company Information and Court Registration Proceedings, legal supervision of business associations shall be carried out by the court of registration competent for the registered office of the business association.

### **CONCLUSION**

In Hungary, the lack of clear and express rules that govern entrepreneurial activities carried out by NGOs leads to uncertainty and causes doubt with some NGOs on whether they can conduct entrepreneurial activities.

In this specific case, because PBCs are a hybrid form between a limited partnership and a non-profit organization, they have to enumerate both the types of public benefit activities that they intend to undertake and the exact category of economic activity that they are going to conduct (based on the TEAOR).

Since Hungarian regulations do not permit the conduct of legal activity, as defined in the TEAOR, for *any* business association, only to those that are registered with the Bar Association or meet other criteria, a PBC is not allowed to conduct legal activity (it cannot be included in its Articles of Association).

Interestingly, foundations or associations are allowed to conduct legal activities because they only need to include the type of public benefit activity in their founding

documents, while they are not required to specify the exact TEAOR category. In this way they are not bound in their activities to the TEAOR definition.

The above example shows that NGOs in Hungary, although they exist in a relatively favorable legal environment, are not always clearly allowed to enjoy the advantages the legal framework provides them.

