

Investing in
Central Europe
Opportunity
knocks



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Introduction

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Introduction

The key drivers for investors making cross-border direct investments are usually either to gain access to new and growing markets, or to reduce costs. The countries of Central Europe ("CE") score highly on both. The countries of the CE region comprised in this publication include Bulgaria, Czech Republic, Hungary, Poland, Romania and Slovakia.

Over the past years, the countries of CE have made significant changes to their tax, accounting and legal systems in order to attract foreign investments. The governments in most CE countries are offering different types of incentives to make their country more attractive. Over the past few years, the volume of foreign direct investment in CE has grown significantly; the benefits are obvious – political stability, availability of highly skilled and inexpensive labour, attractive tax regimes, favourable macroeconomic indicators, growing markets and proximity to the customer base of "old" Europe, etc. The accession of 8 of the 17 countries of Central Europe to the European Union on 1 May 2004 and another 2 countries on 1 January 2007 has greatly accelerated the volume of foreign direct investment ("FDI") flowing into CE.

In addition to the political, economic and social factors that are differentiating the CE region, there are nuances specific to the CE business culture. The tradition of doing business in CE countries may be somewhat different from the "western" business style that most investors are used to and investors are often confronted with an approach not previously encountered in their home countries. Especially in the case of foreign investors looking for government investment incentives, building relationships, properly managing the negotiation process and communication with the relevant government bodies are often the key success factors.



The Investment Process

The stage of the investment will dictate, in large part, what issues are most relevant to the investor. Accordingly, this will also dictate the types of services that we seek to provide to the investor. This is the basic approach of our FDI service line.

Based upon our understanding of the foreign investor's investment, we try to pin-point where they stand on the investment timeline. We can then focus our attention on the issues we think are most relevant to the foreign investor right now. We have prepared a high-level summary of certain issues to give you an idea as to where you may need to focus. We have also indicated how we feel we can be of assistance.

Some of the most relevant issues facing a foreign investor during the start-up period are:

- Structuring the investment
- Establishing a legal entity to do business
- Determining the availability of investment incentives
- Analysing business processes from a customs and VAT perspective

1. Planning expansion/relocation

- Labor efficiencies
- Costs efficiencies
- Free access to the EU
- Growing local market
- Availability of Investment incentives

2. Consider the competitive advantages of CE region

- Bulgaria
- Czech Republic
- Hungary
- Poland
- Romania
- Slovakia

3. Select the most suitable country in CE region

- Regional analysis
- Access to your market – infrastructure
- Availability of workforce
- Industrial Parks/Office Space

4. Choose the best location based on important factors

- Legal structure
- Tax structure
- Investment incentive procedure
- HR issues
- Customs issues
- VAT issues
- Payroll/Bookkeeping issues
- Financing

5. Set up a legal entity for your investment

- Compliance with local laws
- Business Modeling
- Business relationship management
- Group Transaction

6. Continue with your operational phase

7. Plan further expansion of your production services

Why Central Europe?

The accession of 10 Central European countries into EU has created many opportunities for foreign investors. This section describes some of more significant factors that make this region attractive.

- European Union Membership
- Low Labour Costs
- Favourable Tax Environment
- Availability of Investment Incentives
- GDP Growth
- Improving Infrastructure

European Union (EU) Membership

CE – free access to the EU market

On May 1, 2004 eight countries from Central Europe joined the EU. In terms of the number of countries, this enlargement was the largest in the history of the EU. Within the enlarged EU, the new member states account for about 16% of the population, 9% of the overall GDP (measured in purchasing power standards) and 15% of total employment. There has been also the last enlargement on 1 January 2007, when Bulgaria and Romania joined the EU.

New member states in Central Europe are undergoing a rapid transformation process. The countries in this region such as Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovakia share common characteristics and, in many ways, can be considered as one Central European market. All of them are already members of the OECD, NATO and the EU, all of which are critical factors that many foreign investors, consider when deciding whether to locate their production facilities in this region. EU membership has transformed these countries into a customs free zone and in 2007 after joining the Schengen Area all remaining borders will be completely removed. It will allow total free movement of capital, goods, people and services within the 27 EU member states. As such, Central Europe is becoming a major part of the European and global business environment. The recent high inflow of foreign direct investment (FDI) is the result of the favourable location-specific conditions of Central Europe.

CE members of the EU:

Population

Country	Population (million)
<i>Bulgaria</i>	7.6
<i>Czech Republic</i>	10.4
<i>Estonia</i>	1.3
<i>Hungary</i>	10.0
<i>Latvia</i>	2.2
<i>Lithuania</i>	3.3
<i>Poland</i>	38.1
<i>Romania</i>	21.3
<i>Slovenia</i>	2.0
<i>Slovakia</i>	5.4

Source: Eurostat, 2010

Lower Labour Costs

Central Europe – access to a highly skilled and affordable workforce

One of the key economic variables considered in the context of competitiveness, outsourcing and production-location decisions is labour cost and its availability. With the EU accession and the related foreign investment into CE, labour cost competitiveness has become an even more important issue.

Economic surveys demonstrate that labour costs vary enormously among the EU member countries. In addition, bureaucratic rules for businesses, overstated regulation in many fields, excessive high labour costs, too strong unions and ineffective labour codes in Western Europe are driving factors for many companies to seriously consider relocating their operations into CE. The former low cost countries within the EU such as Ireland, Portugal and Spain are no longer considered as low cost countries. Given the new European mobility, companies in these countries are relocating some of their production activities to the cheaper part of the EU. Before 1989, there was a strong base of different industries spread through the whole region that had been supported by a competitive education system with major focus on technical fields such as electro-technics, math and chemistry. This has become an important argument for deciding to place new investment into CE that provides not just low cost but also skilled labour. In addition, multi – language-speaking youths in CE have incrementally been increasing. Major foreign companies have successfully established or relocated their shared service centers, customer and call centers, software and IT centers into CE. This demonstrates that CE is also a suitable place for services oriented activities.

**Minimum wages in selected EU member states
as of 2009 and 2010 (EUR)**

Country	2009	2010
Bulgaria	122.71	122.71
Romania	149.16	141.00
Lithuania	231.70	231.00
Latvia	254.13	253.00
Estonia	278.02	278.00
Slovakia	295.50	307.00
Hungary	268.09	271.00
Czech Republic	297.67	302.19
Poland	307.21	320.00
Portugal	525.00	554.17
Slovenia	589.19	597.00
Spain	728.00	738.85
United Kingdom	995.28	1076.00
France	1321.02	1343.00
Belgium	1387.50	1387.00
Luxemburg	1641.74	1682.76

Source: Eurostat, 2010

Favourable Tax Environment

CE – low corporate tax rates attract foreign investors

Many Central European countries have sharply slashed their tax rates to attract foreign investment. These significant reductions in the corporate income tax rates in Central Europe are becoming one of the driving factors behind the relocation of manufacturing and service oriented business activities into this region. Independent economists praise these countries for the implementation of tax reforms by reducing companies tax burden as an effective way to attract foreign investment and to spur sustainable economic growth. According to independent economists further reduction of corporate tax in CE might continue as it has recently been expressed by national governments. Corporate tax rate cuts bring large benefits from attracting foreign investment inflows to the countries in CE. This continuing trend will make this region attractive for foreign investments in the long run.

Corporate income tax

Country	Corporate tax rate
Bulgaria	10%
Czech Republic	19%
Hungary*	10% / 19%
Poland	19%
Romania	16%
Slovakia	19%

Source: The Economist Intelligence Unit, 2010

Notes: *Corporate income tax for the first HUF 5 million is 10%, 19% for taxable income in excess.

Availability of Investment Incentives

CE – provides financial support to foreign investment

One of the key tools used by the new member states in CE to attract foreign investments is the provision of investment incentives. Since the countries of CE initially lacked financial resources to offer such direct incentives as subsidies, they have mostly focused their efforts on providing investors with fiscal incentives in the form of tax relief or favorable trade provision. In most cases they have offered combinations of trade and tax incentives and have recently begun offering direct incentives as well. In general, the trend in the CE region over the past years has been to offer the same level of tax incentives to foreign investors who meet the same criteria. It should be noted that all forms of investment incentives constitute state aid and before any incentives can be provided to investors, the European Commission in Brussels must approve them. Individual countries within CE have appointed their governmental bodies with administration and proper procedures and also to assist foreign investors with their requests.

GDP growth in CE

Over the last years before the financial crisis, CE experienced a remarkable economic transformation. The region underwent very dynamic developments and the industrial and agricultural sectors shrank in relation to GDP as the services sector grew rapidly.

Now, the economies are expected to recover modestly in 2010 from the deep recession in 2009, and to grow faster in 2011-2014, albeit at rates below those in 2005-2008.

GDP growth in CE

Country	Real GDP growth (2009)	Real GDP growth forecast				
		2010	2011	2012	2013	2014
<i>Bulgaria</i>	-5.0%	-0.1%	2.6%	3.8%	4.2%	4.0%
<i>Czech Republic</i>	-4.1%	1.4%	2.0%	3.3%	3.1%	2.9%
<i>Hungary</i>	-6.3%	0.3%	2.5%	3.5%	3.3%	3.1%
<i>Poland</i>	1.7%	3.4%	3.8%	3.2%	3.4%	3.6%
<i>Romania</i>	-7.1%	-2.0%	1.7%	4.3%	4.8%	5.0%
<i>Slovakia</i>	-4.7%	3.8%	3.3%	3.6%	3.8%	4.2%

Source: *The Economist Intelligence Unit, 2010*

Improving infrastructure

There is a good level of infrastructure in the CE region – favourable connections to the European-wide transportation network and the good internal rail and road network are key factors that attract foreign investors coming to this region. In addition major increase of air traffic has launched major expansion of capacities and services at international airports.

In addition, the large increase in air traffic has led to a major expansion in capacities and services at the international airports in the region.

Comparison of Selected Data

Comparison of Selected Data

All these factors may represent a great challenge to investors coming to CE and dealing with these can often lead to wasting valuable time and inefficiencies in the initial investment stages.

Basic facts

2010	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia
Population	7.6	10.4	10.0	38.1	21.3	2.1
Capital city	Sofia	Prague	Budapest	Warsaw	Bucharest	Bratislava
Main language	Bulgarian	Czech	Hungarian	Polish	Romanian	Slovak
Currency	Lev (BGN)	Czech Koruna (CZK)	Hungarian Forint (HUF)	Polish Zloty (PLN)	Leu (RON)	Euro (EUR)
Membership	EU, NATO, OECD, WTO	EU, NATO, OECD, WTO	EU, NATO, OECD, WTO	EU, NATO, OECD, WTO	EU, NATO, OECD, WTO	EU, NATO, OECD, WTO

Source: The Economist Intelligence Unit, 2010

Economic data

2010	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia
Inflation	2.8%	1.0%	4.2%	3.5%	5.6%	1.6%
GDP per capita	\$6.302	\$18.637	\$13.019bn	\$11.280bn	\$7.510bn	\$16.201bn
GDP growth	-5.0%	-4.1%	-6.3%	1.7%	-7.1%	-4.7%
GDP sources*	9.4%, 29.4%, 61.2%	2.2%, 37.7%, 60.1%	2.8%, 34.7%, 62.5%	4%, 31.1%, 63.7%	12.2%, 36.7%, 53.6%	2.6%, 34.4%, 63.0%

Source: The Economist Intelligence Unit, 2010

* Primary, secondary and tertiary sector respectively, Economist Intelligence Unit estimates

Foreign trade and investment

2009	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia
Export statistics	\$16.5bn	\$131.5bn	\$100.4bn	\$167.7bn	\$50.3bn	\$61.9bn
Import statistics	\$22.2bn	\$120.9bn	\$91.4bn	\$167.4bn	\$59.9bn	\$62.1bn

Source: The Economist Intelligence Unit, 2010

Labour environment

2010	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia
Unemployment rate*	9.5%	9.3%	11.5%	11.0%	7.8%	11.4%
Minimum wages (EUR)	122.7	297.7	271.0	320.0	141.0	307.0

Source: The Economist Intelligence Unit, 2010

Note: *EIU Forecast

Taxation

2010	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia
Personal tax	10%	15%	17% / 32%*	18% / 32%***	16%	19%
Corporate tax	10%	19%	10% / 19%**	19%	16%	19%
VAT	20%	20%	25%	22%	24%	20%
VAT reduced rate	9%	10%	12%	7%	9%	10% / 6%****

Source: The Economist Intelligence Unit, 2010

Notes:

*17% on income up to HUF 5 million and 32% on all additional income.

**Corporate income tax for the first HUF 5 million is 10%, 19% for taxable income in excess.

***Income of up to PLN 85,528 is taxed at a rate of 18%, whereas above this amount the tax rate of 32% applies.

****10% primarily health care related goods, 6% for basic commodities such as honey, milk, and meat.

Country guides

If yours is a multinational business, you need to have access to objective and informed insights for many jurisdictions.

Understanding the ins and outs of doing business around the world is a daunting task.

Deloitte Central Europe has developed these short country guides to help you find your way, covering important business and human resources topics like investment climate, personal and business taxation, labour law, legal entities etc.

Bulgaria

1. General Overview of Economy

Before the recent economic crisis, Bulgaria, a former communist country that entered the EU on 1 January 2007, had experienced macroeconomic stability and strong growth. Since a major economic downturn in 1996 that led to the fall of the then socialist government, the public policy became committed to economic reform and responsible fiscal planning. Minerals, including coal, copper, and zinc, play an important role in industry. In 1997, macroeconomic stability was reinforced by the imposition of a fixed exchange rate of the lev against the German D-mark - the currency is now fixed against the euro - and the negotiation of an IMF standby agreement. Low inflation and steady progress on structural reforms improved the business environment. In 2009 the GDP of Bulgaria shrank by 5% which was mainly the result of the decline in foreign direct investment due to the global economic crisis. Before that the economy of the country enjoyed a steady growth of over 6% for four consecutive years. In 2010 the GDP of Bulgaria is expected to have a modest growth of around 0.2%.

Political system

According to the Constitution of Bulgaria, adopted by the Great National Assembly on July 13, 1991, Bulgaria is a parliamentary democratic republic in which the sovereign power belongs to the people who exercise it through their representative bodies, elected by direct and secret ballot. Every Bulgarian citizen over the age of 18 has the right to elect or to be elected.

The National Assembly, elected for a period of four years, is the supreme body of state power. The National Assembly enacts, amends and rescinds the laws, appoints and dismisses the Government and the Directors of the Bulgarian National Bank, draws up the state budget, adopts the resolutions for holding referenda, constitutes, transforms and abolishes ministries.

2. Tax Structure

10% flat tax rate applies both to personal and corporate income.

Personal Income Tax for an Individual

Compensations received for work in Bulgaria or for provision of services performed in Bulgaria are considered income from Bulgarian source, regardless of whether delivered by a Bulgarian or a foreign employer and regardless of whether the remuneration is paid in Bulgaria or abroad. Therefore, such compensations are subject to personal income tax in Bulgaria, unless a Double Tax Treaty provides for an exemption.

Bulgarian tax residents are subject to Bulgarian tax on their world-wide income, whereas non-residents are subject to Bulgarian tax only on their Bulgarian source income.

According to the Tax on Income of Individuals Act (TIIA) effective as of 1 January 2007, the following individuals, irrespective of their nationality, are considered as Bulgarian residents for tax purposes:

- (i) individuals who have a permanent address in Bulgaria¹
- (ii) reside in the country for more than 183 days in any given 12-month period
- (iii) have been sent abroad by the Bulgarian State, by Bulgarian state bodies and organizations, by Bulgarian enterprises (the family members of the individual are also included); or
- (iv) whose centre of vital interests is in Bulgaria.

Bulgarian personal income tax on employment income as well as the statutory insurance contributions due by the employees is withheld and paid monthly by the employer through the payroll.

Bulgarian personal income tax return for the respective year should be filed with the revenue authorities by 30 April of the following year. If an individual files his/her annual tax return by 10th of February of the following year, he/she can utilize a 5% discount on the portion of his/her outstanding liability paid within the same deadline. In case they have not utilized this option, the same discount of the outstanding annual liability is available if: both the tax return is submitted electronically and the tax due is paid by 30 April of the following year. Certain individuals are exempt from filing an annual tax return.

Certain income of residents and/or non-residents is not taxed with the annual tax return. It is taxed separately, on a scheduler basis, with specific flat final tax which varies from 5 to 10%.

Subject to personal income tax is the gross taxable income including the basic compensation and all taxable benefits less the allowed deductions (Bulgarian and foreign mandatory social security and health insurance contributions due by the individual; voluntary pension contributions, life/health/unemployment insurance subject to certain conditions/limitations; standard flat deductions applicable to businesses, independent professions/activities, dependant services, etc).

¹ Individuals who have a permanent address in Bulgaria but their centre of vital interests is not in the country are not considered Bulgarian tax residents.

Corporate Income Tax

Bulgarian corporate income tax is charged on the basis of the financial result of the taxpayer as per its profit and loss account, adjusted with certain non-deductible items and tax allowances, as provided for in the law. Companies are liable for corporate income tax at the rate of 10% and are required to make monthly or quarterly advance tax payments during the year. Advance tax payments are calculated on the base of net income for the prior year.

Corporate income tax liabilities are reported annually through filing an annual tax return by 31 March of the following year. Companies are also obliged to prepare annual financial statements and statistical reports to be filed with the National Statistical Institute.

Certain expenses occurred by the taxpayers are subject to one-off tax - entertainment expenses; in-kind fringe benefits; maintenance, repair and exploitation of vehicles for management activities.

A special tax rate is applicable for budgetary institutions, ship operating companies as well as companies engaged in games of chance and gambling.

A discount of 1 per cent of the annual corporate income tax but not more than BGN 1,000 is available if: both the annual tax return is submitted electronically and the annual tax due is paid on or before 31st day of March of the following year.

3. Business Establishments

Bulgarian legislation allows for the following types of business organizations:

- an unlimited (general) partnership;
- a limited partnership;
- a limited liability company;
- a joint stock company;
- a limited partnership with shares;
- a sole trader;
- a branch;
- a holding;
- a co-operation;
- a representative office.

The most appropriate types for carrying out business in Bulgaria are: a limited liability company and a joint stock company. Companies may also open a branch office. All of these have to be entered into the commercial register.

Limited liability company - "OOD"

It is a commercial company with share capital owned by its shareholders whose liability is limited to the amount of the shares subscribed. A limited liability company may be founded by one or more persons, including foreign natural or legal persons. The minimum capital is BGN 2. Contributions to the share capital may be paid in cash or in kind. The statutory bodies of the limited liability companies are the general meeting of shareholders, which must be held at least once a year, and the managing director(s).

A sole shareholder limited liability company is called "EOOD". It is owned by a natural or legal person. The sole shareholder exercises the powers of the general meeting and (a) managing director is appointed to run the company. A limited liability company must prepare a balance sheet and financial statements each year.

Joint stock company - "AD"

It is a commercial company with share capital owned by its shareholders whose liability is limited to the amount of the shares they subscribe. A joint stock company can be founded by one ("EAD") or more persons, including foreign natural or legal persons. The minimum share capital of a joint stock company is BGN 50,000. A share capital higher in value is required for the establishment of special types of companies like banks, insurance companies, etc.

Branch

Foreign legal entities registered abroad and allowed to perform commercial activities in the country of their registration can register a branch office in Bulgaria. No authorized capital is required to open a branch. A branch is not a legal entity. Branches are obliged to maintain accounts as an independent company. A branch of a foreign company must prepare a balance sheet.

Representative Office

It is regulated by the Investment Incentives Law. Foreign persons who are entitled to engage in business activity under the legislation of their own countries may set up a representative office which is registered with the Bulgarian Chamber of Commerce and Industry. Representative offices are not legal persons and may not engage in economic activity.

Bulgaria

4. Labour and Wages

Regular Working hours: 8 hours a day. A 48 hour rest period is required during a 7-day period, normally the half of it is on Sunday.

Annual paid leave: not less than 20 working days.

Retirement age: An individual to claim Bulgarian pension for insurable length of service and age should comply with the so called point system, where: for male the total points should be 100 (age of minimum 63 years + length of service equal to the difference up to 100). For women the points are less - 94 (age of minimum 60 years + length of service equal to the difference up to 94). Entitlement to pension may be acquired with 15 years insurable length of service of which 12 years of actual service and attainment of the age of 65 years (both for men and women).

Minimum monthly gross salary: BGN 240 (approximately EUR 123).

Average monthly gross salary: BGN 640 (approximately EUR 327)²

Social security: All Bulgarian residents and non-residents working in Bulgaria are subject to statutory insurance contributions unless a bilateral or multilateral social security agreement applies and provides otherwise.

As of 1 January 2007 Bulgaria became a Member State of the European Union. Thus, the Community provisions on the coordination of the social insurance schemes apply with respect to residents of EU/EEA/Switzerland, as well as to some eligible third-country nationals in some cases. Also Bulgaria has a number of bilateral Social Security agreements with countries outside EU/EEA.

The social insurance contributions are calculated on the basis of the gross remuneration received by the employee subject to a maximum cap of earnings of BGN 2,000 per month (BGN 24,000 annually).

The aggregate rates of statutory insurance contributions are split up between the employer and the employee in a certain proportion.

As from 1 January 2010 the following rates apply for statutory social insurance contributions:

Type of contribution	Employer	Employee	Overall rate
Pension Fund Contribution*	7.1%	5.7%	12.8%
Universal Pension Fund*	2.8%	2.2%	5.0%
Labour Accident and Occupation Diseases**	0.4% - 1.1%		0.4% - 1.1%
Common Illness and Maternity Fund	2.1%	1.4%	3.5%
Unemployment Fund	0.6%	0.4%	1.0%
Health Insurance	4.8%	3.2%	8.0%
Total	17.8% - 18.5%	12.9%	30.7% - 31.4%

*Employees born before 1960 are liable for Pension Fund Contribution of 16% split between the employer and the employee as follows 8.9% : 7.1% and do not pay the contribution to the Universal Pension Fund of 5%.

**The rate for Labour Accident and Occupational Diseases Fund varies between 0.4% - 1.10% depending on the type of the economic activity performed.

Labour contracts

According to the Labour Code the employment contract may be concluded for an indefinite period of time or, alternatively, as an employment contract for a fixed term. An employment contract is considered to be concluded for an indefinite period unless explicitly agreed and stated otherwise. An employment contract concluded for an indefinite period may not be changed to a fixed-term contract unless explicitly requested by the employee, and stated so in writing.

An employment contract for a fixed term may be concluded only under circumstances and conditions explicitly provided for under Bulgarian Labour Code.

² As per the publicly available information provided by the National Institute of Statistics for the period April - June 2010.

Employment contract for a trial period

In cases when the work requires the ability of the employee who will perform it to be tested, his final appointment may be preceded by a contract providing for a trial period of up to 6 months. Such a contract may also be concluded in the case when the employee wants to make sure the job is suitable for him.

Termination

The employment contracts should be terminated in writing, grounded on explicitly provided by Bulgarian Labour Code termination grounds and following the applicable formal termination procedure. Most of these procedures could be regarded as employee protective ones. In any case, the dismissed employee has the right to file a claim against the employer in the state courts and claim the damages in cases of unfair dismissal. There are some categories of employees that enjoy protection against dismissal (for example absent employees (e.g. on sick leave, pregnant, nursing mothers, military assignment), employees suffering of explicitly listed diseases, mothers of children up to three years of age, etc.).

Termination notice periods may not be less than 30 days and may not exceed 3 months. The termination period for fixed term employment contract is 3 months but not more than the remainder of the employment term.

The employment contracts could be terminated upon mutual consent of the parties. In case that the termination of the employment contract is upon initiative of the employer, he could offer a compensation of not less than four gross monthly salaries of the employee.

In addition to other statutory compensations, upon dismissal due to closing down of the enterprise or part of it, staff reduction, etc., the employee is entitled to a special additional compensation from the employer. This compensation is due only if the employee is unemployed after the termination of the employment contract.

Upon termination of the employment relationship after the employee has acquired the right to a pension for insured service and age, irrespective of the grounds for the termination, he is entitled to compensation by the employer in the amount of his gross labour remuneration for a period of two months. However, if the employee has worked with the same employer for the last ten years or more, he will be entitled to compensation equal to his six months gross labour remuneration.

Immigration regulations

Bulgarian immigration legislation divides the expatriates in two categories: EU, EEA or Swiss nationals, and third-country nationals.

Third-country nationals

The work and residence regimes for third-country nationals are more restrictive and aim at protecting the internal labour market. Not all third-country nationals are allowed to enter Bulgaria and remain in the country without a valid entry visa (a so called "visa-less stay"). To work and reside in Bulgaria they need a work permit, a long-term visa D and a residence permit.

Employment: third-country nationals need Bulgarian work permits to legally work in the country. A work permit is required for the expatriate both to be employed under local (Bulgarian) labour agreement and to be seconded to the country by a foreign employer. To approve a work permit the employment authorities have to be convinced that the employees who are foreign citizens are not over 10% of the total work force of the Bulgarian employer. A work permit is valid for a maximum term of one year and may be subsequently renewed under certain conditions.

There are several categories of third-country nationals, who are exempt from the work permit requirement, namely: individuals who are registered with court resolution as executives of a Bulgarian company/Branch office, general managers of representative offices, expatriates who have a Bulgarian permanent residence permit etc.

Residence: upon obtaining a Bulgarian work permit or being registered as an executive / general manager, the expatriate should apply for a long-term visa D (immigration visa). Such visas are issued by the Consulate Sections to the Bulgarian Embassies abroad. The visa D is a multiple entry visa and may be valid for a period of 180 days within 6 months. When the expatriate obtains his visa D, he/she is entitled to apply for a Bulgarian long-term residence permit. The residence permit is issued for a maximum term of one year and can be subsequently renewed.

In certain specific cases, third-country nationals may obtain a business visa. The business visa is a special type of multiple entry visa, issued to third country nationals, who need to visit the country for attending business meetings or project implementation. It is valid for a maximum period of 90 days within 6 months, 1 year or in exceptional cases 5 years. The business visa does not allow third-country nationals to legally work in the country.

Bulgaria

EU, EEA or Swiss nationals

Employment: expatriates and their family members, who are EU, EEA or Swiss nationals, do not need a work permit to be legally employed in the country.

Residence: EU, EEA or Swiss nationals may enter and reside in Bulgaria only with their national passport or ID card for a period of up to three months. Upon expiry of the said three-month period, they should apply for a Bulgarian long-term residence certificate. The latter may be issued for a maximum term of five years, depending on the duration of the assignment of the respective individual in the country.

Family members of EU, EEA or Swiss nationals, who are third-country nationals, follow the status of their family member and can exercise their right of free movement. Such persons need a long-term visa D, but the procedure for its obtaining is simplified and currently is free of charge. Upon obtaining visa D, the expatriate is entitled to apply for a Bulgarian long-term residence permit. The latter will be valid for a term, equal to the term of their EU family member Bulgarian long-term residence certificate.

5. Education

The educational system, traditional in style, has generally been considered a national asset. However, inadequate funding and low teacher morale in the post-communist period have led to some erosion in its quality. Furthermore, the shortage of Western-style business education, particularly in finance and marketing, has generally been more serious than in the more advanced transition countries, although this is progressively being corrected. The country's elite foreign-language secondary schools, especially the English-language schools of Sofia and Plovdiv, have produced a steady supply of fluent and well-educated linguists for foreign companies and have provided much of the country's political elite.

The number of teaching staff has gradually declined, dropping from 126,048 in the system as a whole in the 2000/2001 educational year to 106,024 in 2009/2010. A further drop can be expected: teachers have been involved in pay disputes with the Ministry of Education and Science in recent years, and gradual pay rises are to be accompanied by a restructuring program. The number of students in technical colleges and institutions of higher education rose considerably in the post-communist period, from 183,500 in 1990/91 to 283,236 in 2009/10. The annual number of university graduates rose strongly up to 2002, when there were around 45,500 graduates and then fell back to 41,500 in 2005. Since then there was a new sharp increase with the number reaching 50,400 in 2009.

Private education at primary and secondary levels, although not significant in numerical terms, is growing fast: in 2009/106 there were 129 private schools, with 11,861 pupils.

6. Infrastructure

Bulgaria's transport infrastructure is reasonably well developed, but has suffered from low spending and poor maintenance in the post-communist period. Gradual improvement in communication routes should arise from two factors: first, the development of European transport corridors (four of which are set to pass through Bulgaria); and second, investments aided by an influx of EU funds (€6bn is to be invested in transport under the infrastructure programs for 2007-2015).



Roads

Bulgaria had 37,300 km of roads in use at end-2001—an increase of 400 km since end-1994. All but 3,000 km were hard-surfaced, with motorways accounting for 324 km. The proportion of road surfaces categorized as “good” decreased significantly in 2004 and 2005, and at end-2005 only 70.1% of motorways and 34% overall of roads were rated above Category IV. At the end of 2009 there were 19,435 km of roads rated above Category IV, 418 km of which motorways. Development plans focus on upgrading and on investments—especially in motorways—to integrate the country's road system with the international network, although implementation has so far been slow, owing to policy and legal disputes. An infrastructure strategy adopted in 2006 envisages the construction of 717 km of motorways in the 2006-15 period. Bulgaria's government is planning a total investment of about BGN 1.7 billion in infrastructure construction in 2011. The BGN 1.7 B in question will come from EU funds and the state budget. Of those, BGN 1.2 billion will be

invested in the construction of roads and highways, and the rest will be invested in municipal infrastructure projects. Currently the government is emphasizing on the construction of Trakia, Lulin, Maritsa and Struma highways. The construction of 120 km of new highways is in progress.

Railways

Rail is a significant domestic mode of transport for freight, although road transport now accounts for a larger (and increasing) share of the total. In 2009 there were 4,150 km main lines (of which, in turn, 68.3% were electrified). For the period 2000-2009 the State has invested more than BGN 2.1 billion (EUR 1.074 billion) in the sector. However most of this money was needed to support the operations of the state-owned company in charge of the system. Investment, planned at around €1.2bn in 2007-15, will focus on the continuing overhaul and repair of existing infrastructure, on upgrading rolling stock, and on modernization work, such as further electrification of track and double tracking. Both business and railway officials have been vocal about the system's problems: in late 2006, around two-thirds of main track was deemed to be in unsatisfactory condition and the 7,083 rail cars at the disposal of Bulgaria State Railways (BSR) are reckoned to be around 1,470 short of the number needed to meet freight needs in 2007.

Shipping

Bulgaria has five main ports, of varying degrees of modernity. The largest are Varna and Burgas, both on the Black Sea; Varna mainly handling containers, grain and bulk goods, and Burgas crude oil and some bulk commodities. There are three sizeable ports on the Danube (Ruse, Lom and Vidin), and 24 smaller sea and river ports. Of all modes of transport, sea transport has declined the least since 1989, perhaps because it is the least dependent on the vagaries of the domestic economy. The geographic position of the ports is their key advantage. However all of them need renovation. There has been some modernisation of the ports, but much more needs to be done if the sector is to become more internationally competitive. Varna has ambitions to rival Romania's Constanta, but its plans include a very costly relocation of Varna East port and the construction of three new terminals; Lom already upgraded its South Pier and is seeking to exploit its position on the EU's north-south Corridor IV by investing in two new terminals. A system of 25- or 30-year concessions is intended to play an important role in upgrading ports and terminals, with concessions on a few of the country's smaller ports already awarded or in the pipeline.

Air transport

Air is the least significant mode of freight transport, carrying just 21,000 tonnes in 2005 (although the total was three times higher than in 2002). Currently there are five air carriers engaged

in the State Aviation. Bulgaria Air (the carrier that emerged from the sale of national carrier Balkan Airlines) handles most business. Recently it bought four new airplanes aiming to improve its image. Sofia airport, which handled 1.6m passengers in 2004, has undergone a €210m upgrade to provide it with the capacity and modern facilities needed to deal with the expected rise in demand for international air travel. Bulgaria has two other major airports, at Varna and Burgas. A €400m investment across both airports is planned to cope with an expected rise in passengers to 8m in 2040, from 2.7m passengers in 2004. In response to demand for both cargo and tourist-oriented low-cost passenger transport, the government recently added Gorna Oryahovitsa and Rousse (in northern Bulgaria) to its list of airports able to accept international air traffic. Some of the airports or parts of them are to be awarded concessions.

Telecommunications

Bulgaria entered the post-communist era with one of the highest densities of analogue fixed telephone lines in the former Soviet bloc. Although the quality of the equipment which used to support the network was less impressive than its density, it has improved greatly in recent years. The fixed-line monopoly of the Bulgarian Telecommunications Company (BTC) ended in 2005, when alternative fixed-line operators were given access to its network. Over ten alternative operators had been licensed by late 2006 but their market share is small.

Mobile penetration has risen rapidly in recent years, with subscriber numbers at over 10.5m at end-2010, compared with 0.7m at end-2000 and 4.73m at end-2004. The penetration rate was 80% at end-2005 and in 2010 it was reported to have risen to 140% (greater than the average for the EU). Each of the three mobile operators has a licence for universal mobile telecommunications service (UMTS, or "third-generation" mobile). Heavyweight foreign firms are playing an increasing role in Bulgaria's telecoms sector.

The Internet

Internet penetration is rising and has already reached half of the population of the country. Of the people aged between 16 and 74, 40% use Internet regularly (every day or once in a week). Above 20% of the employees in the companies used computer on their workplace at the end of 2009. The shift from dial-up connections to high-speed local area networks (LANs), cable networks, and asymmetric digital subscriber line (ADSL) connections is supporting higher Internet usage. In the coming years, increasing digitalization of the network, better regulation, increased competition and higher foreign investments should improve the country's ability to take advantage of the Internet.

Bulgaria

The media

High levels of literacy and of television and radio ownership have boosted the influence of the media. There are six television channels that are at present licensed as national terrestrial broadcasters. Two state radio channels broadcast nationally, and the private sector has several national licensed radio channels. The range of newspapers available is wide for a market of Bulgaria's size (none of the papers are state-owned). At national level these include: 24 Chasa (24 Hours) and Trud (Labour), the two largest-circulation dailies owned by German WAZ Group; Standart, Monitor, Sega, a popular left-of-centre daily; Duma, a daily, which has a relatively low circulation and is affiliated to the Bulgarian Socialist Party (BSP);, Pari, a financial daily; Dnevnik, a financial daily; and the weekly Capital, which is widely regarded as the most intellectually serious publication.

As of early 2010 importance of the state owned electronic media is limited. State-owned national channel BNT has a share of 8-10% among viewers. Nova TV (owned by the MTG Group) is second with 16-18% being well behind the leader BTV (part of CME Group) which currently has over 35% of the market. Apart of the top 3, there are numerous cable and regional TV operators with various political and content focuses, which provide wide choice for domestic audience. Similar is situation on radio market.

Since 1989 senior-level appointments in the state-owned electronic media have been politicized and subject to various forms of government pressure, although the cruder forms of control and censorship have been absent. Privately owned electronic and print media have not been subject to systematic state control, but journalistic standards are uneven and self-censorship is perceived as widespread. The fact that most newspapers are affiliated either to political parties or to business groups has been a further complication; regulatory bodies for the electronic media have sometimes taken intrusive or eccentric decisions; and the legal environment is not always conducive to robust expression.

7. The Most Active Industries/Sectors

Agriculture

Bulgaria had 5.3m ha of utilised agricultural land in 2005, down from 5.7m ha in 1999. Of this, 3.1m ha was classified as arable. Land prices in Bulgaria are far lower than those in the European Union. The average price per decare in 2010 varied between BGN 220 and BGN 320 (EUR 112 – 164).

Bulgaria's chief grain crop is wheat, grown mainly in Dobrudzha in the north-east. The country's harvests of barley and maize are also substantial. Major industrial crops include sunflowers, tobacco and sugarbeet. Tomatoes, cucumbers and peppers are important exports. Apples and grapes are significant fruit crops,

but production continues to suffer from the long-term effects of post-communist neglect of many orchards and vineyards. Grapes are used mainly for wine, a major export oriented mostly to European markets and Russia. Europe represents a potentially promising market for poultry and other meat exports, but difficulties in meeting EU sanitary regulations remain a constraint.

Agriculture is dominated by the private sector, which accounted for 98.4% of the sector's gross output in 2004. The private sector includes a sizeable number of co-operatives operating on privately owned land-although at around 1,520 in 2005 these numbered 23% fewer than two years earlier. These now have more in common with Western-style co-operatives than with the post-communist co-operatives that were in operation for much of the 1990s. According to official statistics, the labour force in agriculture (including fisheries and forestry) averaged 801,900 in 2005, with the sector accounting for a little less than one-quarter of total employment: those employed under labour contract, however, accounted for only 8.4% of the total-no doubt a reflection of the continued importance of small family farms. Currently over 60% of the people working in the sector are over the age of 55.

Mining and semi-processing

Bulgaria has a wide variety of metallic and non-metallic mineral resources. Lead-zinc and copper deposits are sufficient to support large non-ferrous metallurgical works, notably at Kurdzhali and Pirdop. Several significant gold deposits exist and have attracted foreign investors. Proven deposits of more than 50 non-metallic minerals exist, among them refractory dolomites, quartzite, kaolin, marble, refractory clay and gypsum.

In recent years mining experienced revival from the low base achieved in the course of post-communist era restructuring. This development is underpinned from high prices of non-ferrous metals, as well as increased demand for building materials and quarrying products by booming construction industry.

Iron and manganese ore are extracted, although output of iron ore covers only a fraction of the steel industry's requirements.

Manufacturing

Bulgaria's manufacturing industry is the product of heavy industrialization in the socialist period. Bulgarian industry was therefore hit particularly hard by the disintegration of the Council for Mutual Economic Assistance (CMEA, or Comecon, the communist states' economic bloc) and sudden exposure to a world market in which many of its specialist products were uncompetitive. The manufacturing sector returned to growth in 2000, with exporting industries performing most strongly.

The sector recorded very strong growth in output in the period 2003 – 2005. However in the last few years the manufacturing levels decreased and in November 2009 the manufacturing output was 10.8% less than in November 2008.

Performance across individual sectors has been highly uneven. Food-processing, including tobacco-processing, was important historically, but has suffered from the shrinkage of former Soviet markets. There have been several successful foreign investments in the sector, although these have so far been oriented mainly to the internal market. Significant foreign investment helped clothing exports, largely to the EU, boom until 2004. However, these fell back in 2005 as the EU removed restrictions on imports from China, before a mild revival began in 2006. Increased competition from low-cost producers appears to be reinforcing Bulgarian firms' tendency to move up the value-added chain by positioning themselves as flexible and logistically convenient producers, rather than relying purely on price competitiveness. In 2009 both the import and export of clothing products fell by 20%.

The oil refining industry has developed on the basis of exports and a domestic market that, until recently, was fairly well protected. The chemicals industry was the beneficiary of heavy investment in the communist period, but was vulnerable thereafter to the cyclical nature of the branch, to international competition and, in some cases, to rises in the price of natural gas-which is used as both feedstock and fuel. Ferrous metallurgy, an industry in which the giant combine at Kremikovtzi, which is now in liquidation, used to account for 90% of Bulgaria's production, has suffered from delayed privatisation and technical obsolescence.

Underpinned by foreign investments, transport machinery and electrical & optical industries are leading recovery in machine building in the recent years. Among sub-sectors, stronger growth was recorded by ship-building, production of spare parts and components for automotive industry, etc. Production lines in which the country is strong are hydraulic machines, fridges, optical equipment, etc. The defense industry was hit hard by the demise of the Warsaw Pact and the closure of lucrative markets in the developing world-in some cases reacting to the latter by murky and politically damaging deals with objectionable regimes. Currently it is downsized, mostly privatized, mostly by management-employee buy-outs (MEBOs) of dubious value, and its overall importance for manufacturing is limited. Some plants have found new uses in civilian and NATO-oriented production, and ongoing modernization of Bulgaria's armed forces in accordance with NATO requirements will lead to work for others in the roles of subcontractors or offset partners. Disputes over the use of Russian technologies have bedeviled many plants for much of the post-communist period.

Construction

Construction was the economic branch worst affected, in volume terms, by post-communist decline, collapsing in 1991 to less than one-third of its 1989 level of activity, and reaching a low point of less than one-quarter of its 1989 level of output in 1997. Construction activity has grown consistently since then. Gross value added (GVA) in construction rose by over 14% in both 2004 and 2005. Construction activity has contributed significantly to recent economic expansion in Bulgaria. From an expenditure perspective, much of the high level of stockbuilding in the national accounts represents construction projects.

Until 2009 the sector was undergoing a boom, with housing, industrial and commercial construction all growing strongly. The financial crisis put an end to this leaving many small construction firms struggling to survive. Worst affected was the construction of buildings which is due to the lack of investment. During the second quarter of 2010 576 buildings were finished and ready to be used which is 20% less than the number for the same period of 2009. Infrastructure projects, financed by the State are becoming a significant part of the contribution sector and are likely to become more important in the next couple of years.

Financial services

Until 1996 the banking system was weak. State banks lend to loss-making state industries, and these credits grew steadily as loans were rolled over and unpaid interest was added. In the private sector, collusive relations between banks and entrepreneurs resulted in the granting of large loans with little or no collateral and no prospect of repayment. As part of the program of reforms linked to the introduction of the currency board in 1997, the Bulgarian National Bank (the BNB, the central bank) introduced stronger banking supervision and tighter prudential rules. A bank privatisation program was executed with buyers being mostly respectable international groups and, till the end of 2004 the state controlled only one bank with negligible market presence.

Process of banking consolidation began. The merger of Bank Austria Creditanstalt (BA-CA) German parent HVB Bank with Bulbank's Italian owner UniCredit resulted the merger of their local subsidiaries Bulbank, HVB Bank Biochim and Hebros Bank and creation of the biggest local bank Unicredit Bulbank. DSK Bank (OTP Group, Hungary), UBB (NBG Group, Greece) and the new bank emerging after Greek EFG Eurobank merges Postbank with recently acquired DZI Bank are other large banks in the country.

The share of foreign banks in the domestic credit market has increased from 38% in 1999 to 83.5% in 2010. With foreign banks able to open branches in Bulgaria subject to notification rather than approval of the central bank, in line with the *acquis communautaire* (the body of EU law), the EU membership process has anchored external interest in the Bulgarian banking sector.

Bulgaria

Foreign investment has improved the management of local banks and increased their profitability. Improvements in the banking system have bolstered confidence, and money that had been kept outside of the banks in hard currency has returned.

Although the banks were very cautious in their lending decisions after 1997, they have become much more willing to lend since 2003, leading to concerns in the central bank and the IMF that credit has been growing too rapidly. Factors behind the increase in loan availability include improved bank capacity for assessing creditworthiness, a more stable business environment and the ability of some banks to attract foreign funds on the back of relatively high Bulgarian interest rates. The central bank's measures to restrict lending growth were removed with EU accession in January 2007. The recent worsening of the macroeconomic environment made the banks in Bulgaria more cautious especially when lending to the construction sector. They, however, remained stable during the crisis despite the increase in the bad debts account.

The insurance market is still relatively underdeveloped, but is growing quickly. Foreign involvement was severely limited until a Western-style insurance law passed in mid-1997 opened up the market. In 2005 – 06 insurance sector underwent structural change, with key players on the local market being bought by KBC, Generali, Wiener Staedtische and Uniqa. Commitments made by Bulgaria during the EU membership negotiation process have also helped to create demand for products such as compulsory motor insurance, and forecasts of strong personal income growth are supporting expectations of further growth in demand for insurance. As of 1 January 2011 a new tax on insurance premium will start to apply.

After reaching 2.4 billion in 2008, the pension funds dropped to 1.6 billion at the end of 2009. A pension reform is being debated which includes increasing the mandatory contribution rate and the retirement age.

The capital market is small and is likely to remain so. With the increased attractiveness of the market around EU accession, in late 2006 – early 2007 the market experienced boom. Initial Public Offerings (IPO's) became a viable source for fund-raising and many local companies turned to it. The market is promising, providing investors with exposure to economy from the one hand regulated up to the EU standards and from the other hand with significant catch-up potential.

8. Industrial Parks

After the residential property boom in Bulgaria of 2003 and 2004, the end of 2005 and 2006 were registering increased activity and interest in the industrial property market.

The major difficulty in the industrial property market is the size of the available plots. Most plots for sale are small and acquiring a larger than 10 acres plot close to major roads and with appropriate infrastructure proves to be very difficult.

The demand of industrial plots close to major cities and/or major motorways is several times higher than the supply. Because of its economic importance the major interest is for plots around Sofia where a number of international companies and manufacturers are building productions and warehouse facilities for their Bulgarian and regional operations. Most plots around the round ring (the Sofia M25) are already acquired by various companies and the market is looking at the western parts around the capital, as well as poorly developed northern surroundings of Sofia. Most attractive seem to be the areas around the motorways going south towards Greece and north-west towards the Serbian border. The decrease in the construction activity as a result of the economic downturn, however, has lowered the interest for industrial plots.

Out of the capital most dynamics in the Bulgarian industrial property market are the cities of Stara Zagora, Plovdiv with the new Kuklen industrial zone and Russe with the options for cheap transportation along the Danube river.

Even more companies are interested in building up their warehouse for their regional and European operations. With its strategic geographical location Bulgaria attracts many companies setting up their distribution centers to operate in the Balkans. Warehouses occupancy varies between 50-70% for the old warehouses and 95-97% for the newly build ones. In Sofia only 2% of the warehouses are not occupied and the average rent is €5/sq.m.

9. Investment Incentives

The main thrust of the government's incentive policy is to manage the development of a free-market economy. Foreign investors have free access to the privatization program, which comprises both the privatization of state-owned companies and the granting of concessions for the use of state-owned assets.

Tax incentives

Under the provisions of Corporate Income Tax Act some general tax incentives are applicable. They are mainly related to investment in depressed regions and employment of disable and unemployed people, namely:

- Manufacturing companies operating in depressed regions with high level of unemployment are entitled to corporate income tax exemption subject to certain conditions, provided in the law.

- Companies are entitled to certain deductions for hired employees: (i) who have been registered as unemployed for a period exceeding one year prior to their current employment; or (ii) have been unemployed and are of more than 50 years of age; or (iii) are disabled unemployed persons.
- Companies employing disabled individuals are entitled for corporate tax exemption upon meeting the requirements set in the law in proportion to the number of people with disabilities to the total of number of employees.

Companies may apply for obtaining EU grants for some eligible investment projects.

VAT Act provides for beneficial treatment with respect to input VAT deduction for import of goods under special investment projects, subject to meeting certain requirements.

Free-trade zones

Free-trade zones offer some tax and customs benefits to foreign investors.

Free-trade zones have been established at Ruse, Burgas, Vidin, Plovdiv, Svilengrad, and Dragoman.

The import and export of goods to and from, as well as between, these areas could be exempt from customs duties, VAT, excise duties upon meeting certain conditions.

Incentives and foreign investment strategy

Bulgaria's government is committed to the development of a free-market economy; the following are designed to attract foreign investments in the country.

1. Opportunity for foreign investors to tender for concessions to use state-owned assets.
2. Liberalization of the import and export regimes.
3. Guaranteed repatriation of profits.
4. Foreign investors enjoy the same rights as domestic investors.
5. Internally convertible currency.

Doing business in Bulgaria, however, has its challenges. The country must deal with still low living standard of most of its residents and the uncertainties that have accompanied economic reforms. New legislation affecting business life is rapidly developing, and it is therefore essential that foreign investors plan carefully and obtain expert advice from the very beginning of their business dealings in Bulgaria.

10. Foreign Direct Investment (FDI)

Foreign Direct Investment in Bulgaria for the period January – June 2010 amounted to EUR 358.5 million (1% of GDP) compared to EUR 1,600 million (4.8% of GDP) attracted in January – June 2009.

11. Expatriate Life

Now that Bulgaria is a fully fledged member of the European Union, greater numbers of international businesses have established operations in the nation's capital Sofia and as a result the levels of inward migration from international professional expatriates has stepped up a gear.

There are now many expats living in Sofia who herald from the UK, Ireland, America and Germany for example, and if you're considering going to join them you're going to want to know all about the things to do for expatriates living in Sofia outside of working hours.

There are no special rules regarding taxation of expatriates in Bulgaria. They are taxed according to the general rules applicable.

12. Weather and Climate

Bulgaria's most comfortable temperatures are found mid May to mid September. The country's climate is influenced by the Mediterranean and Black Seas, making for generally mild conditions throughout the country. Summer days rarely get too hot. In the mountains and in the evenings, temperatures are about 10 degrees F/5 C cooler than in the rest of the country, on average. The winter can be bitterly cold, snowy and damp, but health spas are open, skiing is good, and the concert season is in full swing. Be sure to take a sweater, even in the summer, for cool evenings. As of 1 April 2011 Bulgaria will apply reduced VAT rate of 9 per cent for eligible tourist services.

Czech Republic

1. General Overview of Economy

The Czech Republic is one of the most stable and prosperous of the post-Communist states of Central Europe. Growth is supported by exports to the EU, primarily to Germany, and a strong recovery of foreign and domestic investment. Domestic demand is playing an ever more important role in underpinning growth as interest rates remain low. Accession to the EU gives further impetus and direction to structural reform. Intensified restructuring among large enterprises, improvements in the financial sector, and effective use of available EU funds should strengthen output growth.

Political system

The Czech Republic is a parliamentary democracy with a bicameral Parliament.

The Chamber of Deputies has 200 seats and is elected by popular vote under a direct representation system with a 5% entry threshold. Aside from legislative powers, the Chamber of Deputies gives and rejects confidence to the cabinet and approves the state budget.

The Senate has 81 seats and is elected by a majority system for six-year terms with one-third of the Senators being replaced every two years. It approves laws proposed by the Chamber of Deputies.

The formal head of state is the President, who is largely a ceremonial figure, but has the power to appoint the Governor of the National Bank and members of the Constitutional Court. The President is elected by both chambers of the Parliament. The head of the executive is the Prime Minister, appointed by the President. The PM appoints Ministers with approval from the President.

The Constitutional Court can rule on the unconstitutionality of laws or other legislation.

2. Tax Structure

Principal Taxes

- Personal Income Tax
- Corporate Income Tax
- Value Added Tax

The Czech tax system also includes excise duties which are imposed on particular goods. Real estate tax is levied on plots of land and on construction. The real estate transfer tax is levied on the sale or transfer of real estate. The road tax is payable for vehicles used for commercial purposes. There is also an inheritance and gift tax in the Czech Republic.

In addition to taxes, some local charges and compulsory social security and health insurance are applied in the Czech Republic.

Key features

Those liable to pay corporate income tax are all legal entities, including foreign companies with permanent establishment (mostly branches) in the Czech Republic.

The corporate income tax base is the trading result (i.e. profit or loss) which is adjusted in accordance with the Income Taxes Act. Partners in general partnerships and general partners in limited partnerships are taxed on their share of the partnership's taxable income. Taxable income derived from partnerships is subject to corporate or personal income tax, depending on whether the partner liable for the tax is a company or an individual.

A company is treated as a resident if it has a registered office or place of management in the Czech Republic. Resident companies are liable to tax on worldwide income. A company that has neither a registered office nor a place of management in the Czech Republic is treated as a non-resident. Non-resident companies are subject to Czech corporate income tax only if they receive income or gains from Czech sources and provided that the Czech Republic has the right to levy taxes in terms of an applicable double taxation convention.

The Czech taxable period is the calendar year or the economic year. The deadline for filing the annual tax return is the end of the third month after the end of the taxable period. This deadline may be extended to the end of the sixth month if the tax return is prepared and submitted by a registered tax advisor under a Power of Attorney. The Power of Attorney must be filed at the Financial Office by the end of the third month after the end of the taxable period. Companies that are subject to statutory audits have the filing deadline automatically extended to the end of the sixth month after the end of the taxable period.

Czech entities are entitled to deduct expenses that are incurred to generate, assure and maintain the income of the entity. Particular expenses are disallowed or may be deductible up to a limited amount.

A tax loss may be carried forward for offsetting against taxable profits, but no later than the fifth subsequent taxable period.

A withholding tax at the rate of 15% is levied on dividends paid to both domestic and foreign participants. This tax may be reduced under the terms of the relevant double taxation treaty binding for the Czech Republic. A withholding tax at the rate of 0% is related to dividends paid out by a subsidiary company, which has its place of business in the Czech Republic,

to the parent company in any EU Member State, Switzerland, Norway or Iceland. Dividend distributions between two Czech companies are exempt from the tax under similar conditions. Further, the rate of 0% is related to the dividend income of the parent company, which has its place of business in the Czech Republic, derivable from a subsidiary company in any EU Member State. For all these exemptions, certain conditions have to be met (e.g. shareholding of at least 10% for the period of 12 months). From 2008, dividends arising to a Czech tax resident company and to a company that is a tax resident in another EU Member State, Norway or Iceland are also exempt if paid by a subsidiary that: is a tax resident in a non-EU country with which the Czech Republic has concluded an effective double taxation treaty; has a specific legal form; satisfies the conditions for the dividend exemption under the EC Parent-Subsidiary directive; and is subject to a home country tax comparable to Czech corporate income tax at a rate of at least 12%.

The Interest/Royalty Directive is fully applicable to interest payments to any EU Member State, Switzerland, Norway or Iceland. There is a transitional period for royalties allowing the Czech Republic to apply a withholding tax up to 10% (depending on the relevant double taxation treaty) until 31 December 2010. Interest and royalties paid to a tax non-resident are subject to a 15% withholding tax under the Czech Income Taxes Act. The exemption in compliance with the Interest/Royalty Directive also does not apply to interest that is treated as dividends according to the thin capitalization rules except interest paid to a tax resident of the European Economic Area.

Capital gains on sale of securities and participations are exempted from the tax if conditions similar to those required to qualify for the dividend exemption under the EC Parent-Subsidiary are satisfied.

All transactions with related parties must be conducted at arm's length. If the Tax Authorities find that a company does not deal with related parties at arm's length principles, the Tax Administrator will adjust the company's tax base accordingly.

Thin capitalisation rules are applied in the Czech Republic and restrict the deductibility of interest and other financial costs (inclusive of guarantee fees, credit facility fees etc.) on "loans and credits" as defined in the Czech Income Taxes Act. The limitation of the debt/equity ratio is 4:1 (6:1 for banks and insurance companies). The ratio applies on debt provided or "secured" (e.g. by a guarantee) by a related party.

Under the Czech Income Taxes Act, the remuneration paid to an employee by a company should be regarded as income from a "dependent activity".

A company (employer) is generally regarded as the Czech taxpayer of personal income tax from dependent activities and is obliged to settle the tax liability on behalf of its employees. A company withholds advance tax payments from the employee's income on his/her behalf each month of his/her activity in the company. An employer prepares an annual reconciliation of advance payments, provided that the employee asks for the reconciliation of advance payments, and provided that the employee asks for the reconciliation in writing no later than by the 15th of February following the calendar year for which the reconciliation is prepared. If the employee does not ask a company for the annual reconciliation, the tax liability of the employee is treated as fulfilled by the withheld advance payments. If the employee receives, except for the employment income, other income exceeding CZK 6,000 during the taxable period, he/she will be obliged to file an individual income tax return.

Advance income tax payments are always calculated based on the last known tax liability. They are not, therefore, payable in the first year. If the last tax liability was lower than CZK 30,000, tax advances are not payable.

VAT is levied on domestic taxable supplies, the importation of goods, the acquisition of goods from another EU country, and the purchase of specified services from foreign companies. The VAT base is usually the basis of consideration for goods sold or services rendered, including customs duties, clearance and transportation costs, and excise duties (if applicable).

A company must be registered for VAT if its taxable supplies exceed CZK 1,000,000 for a period of 12 successive calendar months or purchases of goods from other EU countries exceeds CZK 326,000 per calendar year. A company can register voluntarily even if its turnover fails to reach the above amounts if it renders taxable supplies in the Czech Republic.

There is a regular VAT system in the Czech Republic. The standard rate of 20% applies to the majority of industrial goods, services and real estate transfers. A reduced VAT rate of 10% is applied to selected goods (agriculture products, foodstuffs and pharmaceuticals) and selected services. These rates apply equally to branches and subsidiaries.

Excise duties are levied on hydrocarbon fuels and lubricants, spirits, beer, wine and tobacco products.

There is a uniform real estate transfer tax at the rate of 3%. This tax is applied when real estate is sold or transferred.

Czech Republic

Double taxation treaties

The Czech Republic has concluded a considerable number of double taxation treaties. In most cases, the double taxation treaties concluded by the Czech Republic follow the OECD model.

The Czech Republic, as a legal successor to Czechoslovakia, has adopted the treaties concluded by Czechoslovakia in its legislation.

Current tax rates	
Corporate income tax	19%
Personal income tax	15%
Value added tax	Standard rate: 20%
	Reduced rate: 10%
Real estate transfer tax	3%

Withholding taxes	
On dividends	15%, if not reduced by a relevant double taxation treaty
Dividends paid out by a subsidiary company to a parent company within the Czech Republic or to the EU/Switzerland/Norway/Iceland or from the EU parent or subsidiary company (based on the EU Parent Subsidiary Directive)	0%, if certain conditions are met
Dividends paid out by a subsidiary to a parent company from the non-EU country to the Czech Republic/EU/Norway/Iceland	0%, if certain conditions are met
On interest	15%, if not reduced by a relevant double taxation treaty
Interest paid out by a Czech company to an EU/Swiss/Norwegian/Icelandic related party based on the EU Interest/Royalty Directive	0%, if certain conditions are met

On royalties	15%, if not reduced by a relevant double taxation treaty
Royalties paid out by a Czech company to an EU/Swiss/Norwegian/Icelandic related party based on the EU Interest/Royalty Directive	0% applicable from 1 January 2011 (until 30 December 2010, the Czech Republic may tax royalties up to a rate of 10%)

Social Security and health insurance

The social security and health insurance system comprises pension, state employment, and general health and sickness insurance schemes.

Social security contributions are compulsorily paid by employers (legal entities or individuals who employ at least one employee), employees and self-employed persons.

Health insurance contributions are compulsory for everyone who has permanent residence in the Czech Republic or is an employee of Czech resident employer, excluding persons whose contributions are paid by the state. Both obligatory social security and obligatory health insurance contributions settled by an employer are generally considered as deductible expenses for tax purposes. The rates of contribution for social security and health insurance are as follows at present:

Employer	
Pension insurance	21.5%
Employment insurance	1.2%
Sickness insurance	2.3%
Health insurance	9.0%

Employee	
Pension insurance	6.5%
Employment insurance	0%
Sickness insurance	0%
Health insurance	4.5%

Self-employed person	
Pension insurance	28.0%
Employment insurance	1,2%
Sickness insurance (voluntary)	1,4%
Health insurance	13.5%

Person without taxable income

Health insurance	13.5%
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Person voluntarily participating in a pension insurance scheme

Pension insurance	28%
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Customs System

Since 1 May 2004, the Czech Republic has been a Member state of the European Union. This fact influences customs arrangements significantly. The Czech Republic, like other new Member States, has completely adopted customs rules applied in the EU.

At present, the Czech Republic participates in the single market of the EU. Customs controls at the internal borders of the EU and customs formalities have been abolished for the movement of goods inside the EU. Just as the free circulation of goods within the European Union is the internal aspect of the Customs Union, the Common Customs Legislation and Tariff is the external aspect.

The Czech Republic applies Common Customs Tariffs using the Combined Nomenclature of the EU, which is based on the Harmonised Commodity Description and Coding System. The rates of customs duties are quite low in the field of industrial materials and semiproducts. The simple average rate of duty for industrial products is less than 5%. Being a member of the WTO Information Technologies Agreement (ITA), the EU eliminated customs duties for ITA products. In addition, requests for duty suspensions can be submitted by any importer of raw materials, semi-finished products or components that are not available within the EU.

Customs duties can be even lower due to the extensive application of customs preferences resulting from Free Trade Agreements concluded with a broad range of countries (Norway, Iceland, Switzerland, Liechtenstein, Macedonia, Croatia, Albania, Algeria, Tunisia, Israel, Morocco, South Africa, Lebanon, Jordan, Syria, Egypt, Mexico, Chile, etc.). Customs unions have been created with Turkey, Andorra and San Marino. Furthermore, the Czech Republic grants preferential treatment to goods originating in developing and least developed countries. These customs preferences are conditioned by proving origin of the goods.

According to customs regulations, all standard customs procedures, including procedures with an economic impact, can be used: the release into free circulation, customs warehousing, inward processing (suspension system or drawback system), processing under customs control, temporary admissions, outward processing, transit and exportation.

The Single Administrative Document ("SAD") is used for releasing the imported and exported goods for the respective procedure or for terminating the procedure. The simplified procedures may be applied for all customs procedures and can save a significant amount of cost and time for importers and exporters. The new Computerised Transit System (NCTS) and Import and Export Customs System (ICS and ECS) enable paper-less communication between the operators and customs authorities.

Annex "A"

Double taxation treaties (as 15 July 2010):

Albania	Macedonia
Armenia	Malaysia
Australia	Malta
Austria	Mexico
Azerbaijan	Moldova
Belgium	Mongolia
Belarus	Morocco
Bosnia and Herzegovina	Netherlands
Brazil	New Zealand
Bulgaria	Nigeria
Canada	Norway
China	Philippines
Croatia	Poland
Cyprus	Portugal
Denmark	Romania
Egypt	Russian Federation
Estonia	Serbia and Montenegro
Ethiopia	Singapore
Finland	Slovak Republic
France	Slovenia
Germany	Spain
Georgia	South Africa (Republic of)
Greece	Sri Lanka
Hungary	Sweden
Iceland	Switzerland
India	Syria
Indonesia	Tajikistan
Ireland	Thailand
Israel	Tunisia
Italy	Turkey
Japan	Ukraine
Jordan	United Arab Emirates
Kazakhstan	United Kingdom
Korea (Republic of)	United States
Korea DPR	Uzbekistan
Kuwait	Venezuela
Latvia	Vietnam
Lebanon	Former Yugoslavia (<i>relates to Bosnia Herzegovina – until 31 December 2010</i>)
Lithuania	
Luxembourg	

Czech Republic

Income Taxes Act and VAT Act Amendments

The Czech government presented the amendments to the VAT Act and the Income Taxes Act to Chamber of Deputies on 7 October 2010. If it is approved at all levels, it will become effective on 1 January 2011.

Below we highlight selected changes.

Changes in the Income Taxes Act

Most changes are proposed to reduce the government budget deficit in line with the continuing reform of public finance.

Corporate Tax

The exemption of income in the form of interest and other yields from bank deposits arising to savings and credit unions as well as dividend income arising to a pension fund shall be cancelled.

Individuals

The exemption of certain income (service-related requisites granted to professional soldiers, benefits granted to the former President of the Czech Republic) shall be cancelled. Further, it is proposed to reduce the amount of tax relief granted to working pensioners.

To ensure the compatibility with the EU primary law, the approach to products that are used to save for retirement shall be unified. Tax reliefs in connection to pension insurance products shall be extended to pension institutions abroad (EU, Norway and Iceland).

VAT and Excised duties

Accounting Act

3. Legal Entities

Generally, there are four permissible business company forms in the Czech Republic: joint stock company (akciová společnost - a.s.); limited liability company (společnost s ručením omezeným - s.r.o.); limited partnership; and unlimited partnership. In addition, also European company (SE) may be established in the Czech Republic. Below are the requirements of an a.s. and an s.r.o., the most popular company forms.

Joint Stock company (a.s.)

Minimum amount of registered capital is CZK 2m, for the company with a public offer of shares CZK 20m. The amount of the cash contribution at the time of formation may not be less than 30% of the share capital. The share capital of the company must be secured completely by subscription. The amount of capital contributed in kind must be declared in writing in the founding document and must be evaluated by court sworn expert.

The amount of the reserve fund must be laid out in the founding documents and may not be less than a set percentage of starting capital (20% for the a.s.). If the reserve fund is not created at company's establishment it must be created in accordance with the by-laws (statutes) of the company; in the first year the company makes profit shall be contributed at least 20% of the net profit, but not more than 10% of the registered capital, to the reserve fund; the reserve fund shall be supplemented annually with 5% of the company's net profits until the stipulated level is reached.

There are no restrictions on the number of shareholders, or on their nationality or residence. Sole founder of the a.s. can be only legal entity (company).

An a.s. must have a supervisory board of at least three members (the number of members must be divisible by three without remainder), elected by the shareholders at the general meeting. If the annual average number of full-time employees exceeds 50, then the employees shall elect at least one-third (but no more than one-half) of the members of the supervisory board.

Management is conducted by the board of directors. The board must have at least three members (which does not apply to a company with one shareholder), elected by the shareholders at the general meeting to a term of up to five years. The board of directors is responsible for day-to-day management of the company, preparation of annual financial statements and corporate reports, and maintenance of the company's accounts etc.

Shares may be registered or bearer, and both types are transferable. There is no minimum value or other limitation placed on the value of individual shares. Employee shares issued free of charge must not total more than 5% of the registered share capital. Preferred shares may be distributed up to a total value of 50% of the total registered share capital of the company. Interest-bearing shares are not permitted. A simple majority of voting shares is enough for most decisions. At companies with registered share capital under CZK 100,000,000 shareholders holding at least 5% of shares of the company may request from the board of managers that certain items be added to the agenda of a general meeting or that the management of the company be investigated (status of minority shareholder). At companies with registered capital over CZK 100,000,000 the status of minority shareholder requires the shareholding of at least 3% of shares of the company. Generally a quorum is obtained at the general meetings when shareholders holding at least 30% of the company's equity are present.

Limited Liability company (s.r.o.)

Minimum amount of registered capital is CZK 200,000; minimum contribution for individual equity holders in the company is CZK 20,000. At least 30% of each partner's contribution – in total at least CZK 100,000 - must be paid on foundation of the s.r.o. In the event the company is established by one founder the registered capital must be fully paid off.

The amount of the reserve fund must be laid out in the founding documents and may not be less than a set percentage of starting capital (10% for the s.r.o.). If the reserve fund is not created at company's establishment it must be created in accordance with the by-laws (statutes) of the company; in the first year the company makes profit shall be contributed at least 10% of the net profit, but not more than 5% of the registered capital, to the reserve fund; the reserve fund shall be supplemented annually with 5% of the company's net profits until the stipulated level is reached.

The number of partners is limited to 50; there are no restrictions on nationality or residence. Pursuant to the so called Anti Chaining Rule a single partner s.r.o. cannot form or be a single partner of another s.r.o.

A supervisory board may be set up but is not required by law. Present legislation stipulates only that rules of organisation and direction be set forth in the articles or contract of incorporation, which must be officially registered.

Management may be conducted by one or several managers, elected by the company's equity holders. The manager(s) is responsible for day-to-day management of the company, preparation of annual financial statements and corporate reports, and maintenance of the company's accounts etc.

A simple majority is sufficient for most decisions; however, a two-thirds or three-quarters vote in support is necessary e.g. to change the articles of incorporation.

4. Labour and Wages

Employment market

The Czech Republic has a highly skilled workforce, particularly in technology and engineering. Educational and literacy levels are high. Companies report few difficulties in recruiting skilled and unskilled workers, particularly in industrial areas where unemployment is highest. Finding workers is difficult only in Prague and parts of western Bohemia, where the unemployment rate hovers around 4%. There is also a dearth of individuals with management and financial expertise.

Employees' rights

The employment relationship governed by Czech law is regulated by Labour Code No. 262/2006 Coll. (hereinafter the "Labour Code") that came into effect on 1 January 2007. The Czech Labour law generally grants more legal protection to the employee and endeavours to achieve a more equal position of the parties in the employment relationship. The Labour Code, therefore, considerably restricts the liberty of the contract in the employment relationships.

The new Labour Code complies in general with EU norms. It contains the basic definitions for the discrimination and anti-discriminatory rules, the sexual-harassment provision, equal treatment of EU national and Czech individual employees, and specific EU rules on trade unions. It was planned that in detail these questions will be regulated by a separate act. Due to non-acceptance of this anti-discrimination act, the Labour Code will be amended this year and these provisions will be included in the Labour Code.

The Labour Code also prohibits rules that repeatedly closed time-limited employment contracts by employers, since these are forbidden under EU law and allows temporary-employment contracts to be renewed for a period of up to two years. Once this threshold has been met, the contract would automatically become indefinite (that is, the position would be made a permanent one), with exceptions for seasonal businesses. The minimum annual holiday is four weeks.

Working hours

The official workweek has been 40 hours. The Labour Code sets strict limits on overtime work – the total overtime work may not exceed 8 hours per week in average in the period lasting no longer than 26 weeks, not including the overtime work for which compensatory time off was provided. Employees must be paid an average wage and plus at least 25% over the achieved wage for overtime work.

Wages and benefits

The minimum-wage law is set out in Government Order 567/2006 Coll, and amounts to CZK 8,000 per month or CZK 48.10 per hour since 2007. The minimum wage is set at subsistence level; actual wages paid are much higher. The minimum wage is paid to only 2–3% of employees, according to the Ministry of Labour and Social Affairs (Ministerstvo práce a sociálních věcí), but it is important for calculating minimum bases for health-insurance and social-security contributions. Some unions (for example, agriculture and construction unions) negotiated higher minimum wages directly with their employers.

Czech Republic

The average monthly wage in year 2009 amounted to CZK 23,488. Monthly wages paid by foreign-owned companies averaged much more, at around CZK 30,000.

The state provides the social-security system, which includes pensions, maternity benefits, and health and social security insurance. To finance these benefits, employers must contribute the equivalent of 34% of gross wages to the state social-security and health funds. Payments are made monthly to separate social-security and health offices, organised by district. Workers pay an additional 12.5% of gross wages (deducted from the gross wage) to the funds.

Further benefits specifically covered in the Labour Code include the following:

Vacation: Employees who have worked at least 60 continuous working days with a given company are entitled to paid annual vacation (on a pro-rata basis related to the number of days worked in the calendar year). The minimum annual vacation is four weeks. Where a work contract lasts for less than one year, one-twelfth of the annual holiday is accrued for each 21 days worked.

Maternity: Maternity leave lasts 28 weeks (37 weeks for women giving birth to more than one child at the same time). This may be extended as a parental leave at the request of the mother until the child reaches three years of age. During maternity leave, the mother has no right to wages but qualifies for sickness benefits. Fathers also may apply for maternity or parental leave of up to three years.

Sick pay: If an employee is absent from work because of illness, he/she is provided by wage compensation by the employer for the first 14 calendar days. This compensation is granted from the fourth working day of temporary incapacity. From the fifteenth working day, a sick payment from the social security insurance is paid to the employee. The sick payment amounts to 60% of the daily assessment base in 2010.

In case of work injury, employees are entitled to compensation on losses of wage, compensation on pain and loss of social assertion, compensation on expenses occurred with the treatment and material damage. For the death of an employee, due to work injury, the dependent spouse would receive a lump-sum payment of CZK 240,000 and each dependent child receives CZK 240,000. Parents of the deceased living with him/her in the same household receive CZK 240,000. The survivors are also entitled to other compensatory payments.

Unemployment: Benefits are provided for up to five/eight/eleven months (depending on the age of unemployed person) at 65% of the previous net average wage for the first two months of unemployment, 50% for the next two months and 45% for the remaining period, up to the limit of 58% of the average wage in the Czech Republic for the first till the third quarter of the previous year.

5. Education

The Czech Republic combines an outstanding level of general education with strong science and engineering disciplines. For generations the Czech education system has generated high class, technical problem-solving skills in environments where standard solutions were impossible.

School education is compulsory from ages 6 to 15 (elementary and lower secondary school). After 9 years students may continue at three basic types of upper secondary school: vocational training centres, secondary schools and grammar schools (gymnazia). Undergraduate and graduate studies are offered by colleges (offering 3 to 4-year bachelor programmes).

The Czech education system has a very strong position in upper secondary education, which serves as the foundation for advanced learning and training opportunities, as well as preparation for direct entry into the labour market. In 2003 the percentage of adult population that had completed at least secondary education in the Czech Republic was among the highest in all OECD countries. 86% of the Czech population aged 24-64 had completed at least upper secondary education in 2003, compared to an OECD average of 66%. (Source: Education at a Glance 2005, OECD).

Vocational education and training are thoroughly integrated into both secondary and higher education institutions, and enrolment in vocational education is exceptionally high by OECD standards.

The Czech Republic also has a very good position in tertiary education. There has been an increase in university-level skills in the adult population, as measured by educational attainment.

While public universities offer programmes ranging from economics, statistics and public administration to finance, accounting, international relations and marketing, a number of private institutions specialize in business administration courses. Several institutions and universities offer high-quality MBA programmes and are affiliated with foreign universities and colleges.

The Czech Republic provides free and flexible choice in continuing education. Private training providers and non-profit organisations co-exist and complement secondary schools and universities. According to recent research, the most frequently taught courses include use of PCs, accounting, management, finance, marketing and foreign languages.

6. Infrastructure

Road network

The Czech Republic already has the best road network in the region. The central government has administrative authority for developing and maintaining motorways totalling 691 km and 360 km of speedways (rychlostní silnice), as well as 5,850 km of national highways. Regional governments are responsible for secondary and local roads, which amount to 15,000 km and 34,000 km, respectively.

The State Transport Infrastructure Fund spent CZK 50 bn on new motorway and national highway sections in 2009 (including EU money), up from just CZK 46 bn in 2008. Electronic tolls for vehicles over 3.5 tons is already effective, provided by company Kapsch (microwave technology), covering some 1,300 km of roads. The expansion of the toll system is planned but will most likely work as a hybrid of microwave and satellite technology.

Railway network

The Czech transport and communications system is good by east European standards but below the quality commonly found in western Europe. The railways are an important means of transport, with a network of 9,478 km.

Shipping and air transport

River transport, along the 303 km of rivers that are navigable, is comparatively unimportant; its main use is for the internal movement of goods on the Vltava and Labe river, north of Prague. The national air carrier, Czech Airlines (5,465,000 passengers in 2009), has similarly small domestic significance, given the country's compact size. Company is to merge in to holding with Ruzyně Airport (11,643,000 passengers in 2009) to form stronger entity. Both companies were planned for privatization in 2008 – 2009.

Telecommunications

Number of fixed telephone lines peaked in 2001 – 2002 and is steadily decreasing, counting 2,264,000 participants in 2008. Mobile phone penetration is more than 1 active sim card per citizen = 13,571,000 in 2008. There were 17% of people with broadband internet access in 2008, 60% had a computer in 2009.



7. The Most Active Industries/Sectors

Automotive Industry

The automotive industry has been the most important production sector of the Czech Republic. It already accounts for 22% of manufacturing output and employs 146,000 people (2008 CSU data).

Key Players in the automotive industry

Some of the key players in the Czech automotive industry are major OEM's that are significantly boosting all automotive output in the Czech Republic. Skoda – a Czech brand owned by the German VW group – has a major production facility in Mlada Boleslav. Significant portion of its output goes to the local and Central European markets. Other car producers are the TPCA (Toyota-Peugeot-Citroen Automobile) and Hyundai Motors with combined production of 983,992 motor vehicles in 2009 (3.6% increase compared with 2008) and combined revenues CZK 265 bln in 2009. The most important players among the automotive suppliers are subsidiaries of multinational companies, such as Bosch, Continental, Magna, SAS Autosystemtechnik and many others.

Engineering

Electrical engineering with its robust growth is becoming the Czech Republic's biggest industry - overtaking the country's traditional industrial sectors of steel production and engineering.

Czech Republic

Electrical and electronic industry

The growth of the electrical and electronic industry since the second half of the 1990s in the Czech Republic was based on the growth of both domestic consumption and export. In 2000, revenues from the sale of their own products and services in all branches reached CZK 185bn. In 2004, the revenues totaled CZK 436bn which, in current prices, amounts to more than a redoubling of the volume of production. In that period, the workforce in the electrical industry increased by 35,000 (i.e. 22%). Domestic consumption of electrical industry production reached, in accordance with new methodology, CZK 328bn in 2000 and, in 2004, grew up to CZK 428bn, i.e. more than a 30% growth. Traditionally, the largest share of consumption was accounted for by heavy-current technology and by electronic components. The largest accumulation of consumption was observed in electronic components.

The electrical industry is primarily marked by:

- the complementary character of its production in creating prerequisites for the competitiveness of other branches of the manufacturing industry and power industry;
- a high proportion of imported materials, components and parts for production and assembly;
- a wide range of technological processes;
- a high proportion of supranational capital in new investment projects, especially in connection with the introduction of advanced technologies;
- the use of logistic networks of supranational companies;
- a high proportion of science and research used in the production of computational and digital communications technology and the need for highly-qualified employees in research and in production.

Financial Services

The core of the commercial banking sector comprises four large banks that had their roots in the communist era, with three of the four hived off from the Czechoslovak State Bank's enterprise lending operations in 1990. Together, the four - Komerční banka (KB), Investiční a spořicí banka (IPB), Česká spořitelna (CS) and the former foreign-trade bank, Československá obchodní banka (CSOB) - accounted for 80% of all banking sector assets in 1994. These banks inherited a large volume of non-performing loans from the communist period (including foreign-trade credits to developing and Soviet-bloc countries, and domestic credits for private and co-operative housing construction). Successive governments led by the Civic Democratic Party (ODS) in 1992-97 resisted their full privatisation owing to fears that, once in private hands, they would cease to support domestic enterprises.

Sizeable stakes were sold during voucher privatisation, but the resulting ownership structures were not conducive to restructuring. The banks controlled investment funds, which in turn controlled large parts of the formerly state-owned enterprise sector. The result was a non-transparent web of cross-ownership and continued insider lending that helped large enterprises avoid restructuring while adding to the state-owned banks' bad-loan portfolios.

Construction

As with the rest of the economy, construction was almost entirely state-controlled under communism and has quickly been returned to private ownership. By 1996 more than 99% of all construction enterprises were in the private sector, which grew rapidly from 1990 both as a result of privatisation and through the establishment of new, often small, firms. However, the construction of larger apartment blocks fell dramatically with the end of the centrally planned system, hitting larger enterprises, and output contracted by almost 50% during the latter half of the 1990s, with the sector's share in value added falling to 6.3% in 2004, from 11.5% in 1990. The decline nonetheless appears to have bottomed out with the onset of an increase in demand for construction of greenfield production facilities, benefiting larger firms. Overall construction output rose by 8.9% in 2003, as construction activities to repair damage caused by the August 2002 floods continued, and annual growth accelerated to 9.7% - a post-independence high - in 2004, before easing to 4.2% in 2005.

Retail

Following privatisation, Czech-owned companies consolidated a large number of small outlets into retail chains. However, as Czech investors lacked marketing and management skills, and their shops were often not in prime locations, they soon succumbed to foreign competition. Several European retail chains have invested heavily in the Czech retail market. Foreign companies have also spearheaded the move from small outlets to larger department stores and out-of-town hypermarkets. The retail market was worth US\$23.1bn and accounted for 13.3% of total employment in 2003. Higher wages, restrained unemployment, and improved access to consumer credit (consumer loans are growing rapidly) have led consumers to spend actively.

Most consumer goods are manufactured locally. The local industries making consumer goods, especially the sectors producing white goods and personal computers (PCs), have received huge foreign investments in the past decade. Retail sales grew by 25.6% in volume terms between 1998 and 2002, and by a further 5% year on year in 2003, before slowing to 2.5% - the slowest rate since 1998 - in 2004.

8. Industrial Parks

Due to a considerable inflow of FDI into the country in recent years, the availability and choice of office space has improved significantly. Most projects in the country are open-field constructions, with the exception of some reconstructions of objects in cities.

The Czech Republic boasts an excellent network of over 150 industrial zones, which are located on the outskirts of virtually every town of regional importance.

9. Investment Incentives

The Czech Republic introduced investment incentives for manufacturing sector that are available to domestic and foreign investors. The Act on Investment Incentives came into force in May 2000. A new amendment is valid as of 2 July 2007. The investment incentives provided before amendment entered into force remain unchanged.

Manufacturing Industry

The Czech Republic has introduced a program designed to support the manufacturing industry's investment in advanced technology.

Conditions of Eligibility

- The investment must be made in the launch of new production (Greenfield investment) or in the expansion of existing production (Brownfield investment).
- A minimum investment of CZK 100 million (approximately USD 5 million) within 3 years; in regions with an unemployment rate 25% higher than national average rate, CZK 60 million (approximately USD 3 million); in regions in which unemployment rate exceeds the average national unemployment rate by 50%, the minimum investment must be at least CZK 50 million (approximately USD 2.5 million).
- At least 60% of the of the total value of the investment (tangible and intangible fixed assets) must be made in machinery equipment that will be acquired at a market price, intended for production purposes and produced not more than 2 years before the acquisition.
- The investment must be financed through own equity of the investor in the value of at least CZK 50 million and in a region with a high unemployment rate in the value of at least CZK 30 million and CZK 25 million, respectively (profit from the investment may not be used to fulfill this condition).
- The investment must be retained for at least five years.
- The investment must be environmentally friendly.

Available Incentives

- Five-year full corporate income tax relief for Greenfield investments, five-year partial tax relief for Brownfield investments.
- Provision of industrial (infrastructure) property at a discount.
- Financial support for the creation of new jobs.
- Financial support for the re-qualification of employees.

The total amount of investment incentives is determined separately for each investment project in accordance with valid EU rules. For the Czech Republic, the maximum level of public support commitment is 40% of the total amount of investment in tangible and certain intangible assets.

10. Foreign Direct Investment (FDI)

The stock of inward foreign direct investment (FDI) in the Czech Republic was US\$121.9bn at the end of 2009. The stock of inward FDI as a share of GDP stood at around 64%, and the stock per head, at US\$11,939, was the third-highest in the region, behind Estonia and Hungary. The country now has only a few state enterprises left to sell, the most important being the energy company, CEZ, but the government has not set a target date for its sale. Although privatization opportunities will soon dry up, steady inflows of FDI should come from reinvested earnings of foreign-owned firms and some new greenfield investment.

The Netherlands is the largest foreign investor, with 31.6% of the inward FDI stock at the end of 2008 (the latest available data). Germany's commercial and industrial links with the Czech Republic have long made it the second-largest inward investor, with 14.4% of the inward FDI stock at the end of 2008. A significant portion of FDI inflows into the Czech Republic has been concentrated in services (about 53.7% of total FDI at the end of 2008), and disproportionately in the capital, Prague, and other large cities. Manufacturing has been the second-largest beneficiary (with 34.6% of the total), especially in industries that have driven the rises in industrial output and exports of recent years: transport equipment (particularly automobiles and related components), chemicals, metal products, food products, and electrical and optical equipment. More investment is being directed towards more high-tech sectors and to research and development. (Source: Economist)

Czech Republic

11. Expatriate Life

Although in most respects life in the Czech Republic has rapidly approached Western standards of living, the cost of living remains substantially lower than in Western Europe. According to the Union Bank of Switzerland average prices of goods and services in Prague are only 43.8% of those in Zurich. Domestic purchasing power in Prague is 33.3% of Zurich's level, which is the highest purchasing power in CE.

With respect to accommodation Prague and all larger cities boast a wide range of rented furnished and unfurnished accommodations for expatriates and their families, ranging from centrally-located apartments to spacious villas in leafy suburbs. Many real estate agencies offer relocation services for a charge of one to two months' rent.

Prague and many cities in the Czech Republic are famous for their architectural heritage, museums, theatres, cinemas, galleries, historic gardens and cafes.

12. Weather and Climate

The Czech climate is mixed. Continental influences are marked by large fluctuations in both temperature and precipitation, while moderating oceanic influences diminish from west to east. In general, temperatures decrease with increasing altitude but are relatively uniform across the country at lower elevations. The mean annual temperature at Cheb in the extreme west is 45° F (7° C) and rises to only 48° F (9° C) at Brno in southern Moravia. High temperatures can reach 91° F (33° C) in Prague during July, and low temperatures may drop to 1° F (-17° C) in Cheb during February. The growing season is about 200 days in the south but less than half that in the mountains.

Annual precipitation ranges from 18 inches (450 millimetres) in the central Bohemian basins to more than 60 inches on windward slopes of the Krkonose Mountains of the north. Maximum precipitation falls during July, while the minimum occurs in February. There are no recognizable climatic zones but rather a succession of small and varied districts; climate thus follows the topography in contributing to the diversity of the natural environment.

Hungary

1. General Overview of Economy

Hungary has made the transition from a centrally planned to a market economy, with a per capita income one-half that of the Big Four European nations. Hungary continued to demonstrate strong economic growth and acceded to the European Union in May 2004. The private sector accounts for over 80% of GDP. Foreign ownership of and investment in Hungarian firms are widespread, with cumulative foreign direct investment totaling more than EUR 48bn since 1989. Hungarian sovereign debt was upgraded in 2000 and together with the Czech Republic holds the highest rating among the Central European transition economies; however, ratings agencies have expressed concerns over Hungary's unsustainable budget and current account deficits. Hungary was severely hit by the financial crisis, with the budget deficit becoming extremely difficult to finance, and the Hungarian forint quickly losing value. The country received an EUR 20billion credit facility from the IMF which helped stabilize the situation at the end of 2008. As stipulated in the agreement with the IMF, the government introduced severe austerity measures in 2009 to reduce the budget deficit to the required levels, and the budget situation has been stable since then. Presently (in 2010) the public sector deficit accounts for about 3.9% of GDP, and the currently central bank rate is 5.25%. In October 2010 the inflation is 4.2%. Unemployment has persisted around the 10.9% level, but Hungary's labor force participation rate of 57% is one of the lowest in the OECD. Germany is by far Hungary's largest economic partner. Policy challenges include increasing the current slow rate of GDP growth, and orchestrating structural reforms in the public sector.

Political system

Hungary is a parliamentary democracy with a unicameral Parliament, called the National Assembly (Országgyűlés).

The National Assembly has 386 seats and it is elected by popular vote for a four-year term by a direct proportional system with a 5% threshold. It is the highest organ of state authority and initiates and approves legislation sponsored by the Prime Minister.

The President of the Republic, elected by the National Assembly for a 5-year term, has a largely ceremonial role, but powers also include appointing the Prime Minister and choosing the dates of the parliamentary elections.

The Prime Minister selects cabinet ministers and has the exclusive right to dismiss them. Each cabinet nominee appears before one or more parliamentary committees in consultative open hearings and must be formally approved by the President.

An 11-member Constitutional Court has power to challenge legislation on grounds of unconstitutionality.

2. Tax Structure

Corporate Tax

Hungary's corporate tax rate is 10% up to HUF 500 million profit and 19% on the exceeding amount. Since the 10% rate applies only as of 1 July 2010, the 10% rate can only be applied to the proportional part of the first HUF 500 million tax base in 2010. Although the corporate income tax is much lower than in many other European countries, it is balanced at least in part by relatively high personal income taxes and social charges, which increase employment costs. Act LXXXI of 1996 on Corporate Tax and Dividend Tax (the Corporate Tax Act or CIT Act) is the primary legislation governing corporate taxation. It has been modified each year since it came into force in 1997, most recently in November 2010. The Corporate Tax Act must be interpreted in harmony with the Accounting Act (Act C of 2000).

As of July 1, 2007 a minimum tax base is introduced. Companies, the pre-tax profit or tax base of which does not exceed 2% of their total revenue less the cost of goods and services sold and revenue attributable to a foreign PE, should either pay corporate tax considering this minimum tax base or may choose not to apply the above provision if it makes the declaration defined in the Act on Tax Procedure. The taxpayer has to file this declaration along with the tax return.

Entities falling under the scope of the Accounting Act are required to keep double-entry book-keeping, upon which taxation is based. Companies must generally use double-entry book-keeping.

Branch offices have no specific tax advantages over subsidiaries other than allocation of overhead expenses without invoicing. A sustained effort has been made to ensure that the tax laws applied to branches are the same as those applied to domestically registered subsidiary companies.

Shareholder financing

Financing can be provided to a Hungarian company in various ways: contribution to registered capital, contribution to capital reserve, loans and supplementary payments.

If the registered capital of the company is changed in any way (increased or decreased), an official company court registration procedure is required. The registered capital change takes effect on the date when it is registered by the court. Funds can be provided by the shareholder to the registered capital of the company either as a contribution in cash, or as a contribution in kind. The amount provided as contribution in cash corresponding to the increase of the registered capital needs to be paid in the Hungarian bank account of the company. The shareholder is responsible towards the company that

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the indicated value of the contribution in kind does not exceed its real value as of the date when it is provided. Apart from registered capital, funds can also be contributed by the shareholder to the capital reserve of the company. The capital reserve is not part of the registered capital of the company, but it is part of its equity. Pursuant to the Accounting Act, capital reserve may only be provided simultaneously with a registered capital increase (the capital reserve itself is not registered in the company registry, though). The capital reserve increase corresponds to the difference between the face value of the registered capital and the amount of funds actually provided by the shareholder (similarly to a share premium). The increase of the capital reserve does not have direct tax consequences in Hungary.

The shareholder can also provide funds to the company as loans. However, in this case the Hungarian thin-capitalisation rules must be observed.

Taxable income defined

The basis of the computation of the taxable income ("tax base") for corporate income tax purposes is the accounting profit or loss, which is then adjusted by several increasing and decreasing items in accordance with the relevant provisions of the CIT Act. Foreign-sourced income is included in the taxable base.

In determining the taxable base, allowable deductions from the profit-and-loss statement include the following: provisions built up for expected liabilities and recaptured costs accounted for as revenue in the tax year; write-back of unplanned depreciation that increased the corporate tax base in previous tax years; dividends received accounted for as revenue (except for dividends from a controlled foreign company); the income realised by the shareholder/member (that is, a participating company, not an individual shareholder) that exceeds the acquisition value or book value of the investment received upon termination of the investment without legal successor, reduction of the registered capital or qualified transformation (a domestic transformation based on the definition of the Merger Directive) of the investment.

However, a certain part of this amount might increase the tax base if investments acquired through a transformation are sold or contributed.

The positive difference between the income and expenditure accounted for in relation to the redemption of own shares may be deducted from the tax base. Uncollectible receivables, if they meet the requirements defined in the Accounting Act, and the income accounted for in relation to uncollectible receivables, which increased the corporate tax base in previous years, is also

deductible. 100% of the allocated direct cost of research and development (R&D) decreased by the value of R&D subcontractors' fees and R&D funds received, are deductible (double dip scheme).

An employer having less than 20 employees may deduct the salary paid to a person but maximum the annual minimum wage, Ft882,000 in 2010, if this employee has a disability of 50% or more as determined by the competent medical board (applicable if the person is exempt from paying rehabilitation contributions, pursuant to Act IV of 1991 on Furthering Employment and Provision for the Unemployed). Under certain circumstances, unrealized foreign exchange gain is temporarily deductible from the corporate tax base.

To ease financing of small and medium-sized enterprises, a tax credit is granted. It is equal to 40% of annual interest payable on investment loans with a limit of Ft6m per tax year. The benefit can be used for the duration of the loan, until its expiration and until the asset that was financed by the loan is in the books of the taxpayer.

Business entertainment expenses do not increase the tax base.

The Accounting Act provides for a strict definition of irrecoverable receivables (bad debts) under the Corporate Tax Act, which maintains that irrecoverable receivables except for receivables expired or receivables that cannot be forced in a legal procedure, are deductible for corporate tax purposes. 20% of the face value of receivables overdue for more than a year are also deductible. Under the CIT Act, provisions made for future liabilities and expenses (accounted for as expenses in the tax year) increase the tax base. However, these amounts may be deducted from the tax base in the following year (when accounted for as revenue). Under the thin-capitalization rule, according to the Act on CIT, interest paid or accounted for on that part of the liabilities that is in excess of the borrower's equity as multiplied by three is not deductible for corporate tax purposes (the debt to equity ratio is 3:1). For the purpose of this rule, equity is calculated as an average daily balance of registered capital, capital reserve, retained earnings and tied-up reserves (or own sources corresponding to these). Liability means the average daily balance of outstanding loan (except for bank loans), outstanding closed securities signifying a creditor relationship and bills payable (with the exception of bills payable to suppliers). Any liabilities in connection of which interest is paid are generally included in the definition of liabilities for thin capitalization purposes. The thin-capitalisation rule also applies between unrelated parties.

Due to the above rules, thinly capitalised companies have fewer options to acquire financing from bridging loans. The number of available financing forms is further reduced since the definition of liabilities also includes privately issued bonds and bills of exchange.

The pre-tax profit must be adjusted when the interest is recorded in the books as expenditure or as part of the historical cost of a purchased asset, in accordance with the accounting rules. The reference to historical costs means that the thin-capitalisation rule applies to loans that were used by the company to purchase or manufacture a capital asset, and the interest on such loans is part of the historical cost until the asset is capitalised.

50% of royalty income is deductible from the corporate tax base, but the total deduction may not be more than 50% of the pre-tax profit.

The CIT Act includes the concept of “costs not in the interests of the enterprise”, largely to cover items that are of potential abuse for tax-evasion purposes. Travel expenses may not be deducted if the trip was not exclusively for business purposes. The consideration for a service in excess of net Ft200,000 if the use of such services contradicts the requirement of reasonable management is also not deductible. Non-deductible costs also include expenses due to subsidies, assumed liabilities and assets given free of charge to non-Hungarian companies, as well as receivables waived against related parties.

Certain income, such as dividends, received from controlled foreign companies that would normally be exempt is taxable; while certain expenses incurred, such as impairment, which are deductible under general rules, are non-deductible if incurred in relation to a controlled foreign company. In addition, undistributed profit of the controlled foreign company is also taxable at the hands of the Hungarian resident shareholder.

A controlled foreign company is a foreign company in which a Hungarian individual directly or indirectly holds at least 10% of shares or most of the foreign company's income derives from Hungary, and the foreign company is effectively taxed at less than 12.66% (10% as of 2011). A company incorporated in an EU or OECD member state or a country that has concluded a tax treaty with Hungary is not a controlled foreign company if it has real economic presence in that foreign country.

Tax losses may be carried forward indefinitely. No upfront approval is required for the carry forward of tax losses provided that these losses are generated in accordance with the principle of exercising the laws within their meaning and intent.

The tax procedures applicable to foreign companies differ depending on whether the company has a permanent establishment in Hungary. Both Hungarian-registered subsidiaries and permanent establishments of foreign-registered companies must apply Hungarian accounting rules. Hungarian-registered companies are taxable under ordinary domestic rules on their worldwide income. Hungarian permanent establishments of foreign-registered companies are taxed only on their Hungarian source income, but the same tax rules apply to them under domestic legislation. Depreciation may be included in the costs of the permanent establishment's activities.

Branches of foreign companies in Hungary are subject to taxation at conditions similar to those of domestically registered companies.

Depreciation

Accounting depreciation of assets is generally calculated by the straight-line method, under which the same percentage of the original value of the asset is deducted each year.

Tax depreciation is more stringently regulated, with the law setting the mandatory rates for most asset types. This can be more than accounting depreciation, resulting in a net deduction. The general rate of tax depreciation for machinery and equipment is seven years (14.5% per year). A three-year tax depreciation period (33.33% per year) applies to computers, office equipment, advanced industrial equipment, and many types of environmental protection, medical and laboratory equipment. Motor vehicles are depreciated over five years (20% per year). An owner of assets leased to another party may use accelerated depreciation up to 30% (33.33% on some types of asset) of the acquisition cost of the leased assets (5% of acquisition cost for buildings).

Tax depreciation can be accelerated by applying a 50% rate instead of a 33% or 14.5% rate to computers, computer accessories and new tangible assets purchased or produced in 2003 or later. Equipment used for film and video production may be amortized at a 50% rate.

For buildings, tax depreciation is set at 50 years (2% per year) for structures of long duration, 3% for those of medium duration and 6% for those of short duration. Buildings that are leased out are depreciable at 5% per year, and the equipment in the buildings at 30% per year. Industrial and agricultural structures are depreciable at annual rates of 2% and 3%, respectively. Other structures depreciate at annual rates ranging from 2% to 20%.

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Other fixed assets not specifically included in the depreciation table are tax-depreciated at 14.5% per year. Non-depreciable assets include registered land (except some land that has been used for waste disposal) and works of art. Write-off periods tend to correspond to international standards.

Companies may set aside a tax-deductible reserve for the purpose of general development up to 50% of the taxpayer's entire pre-tax profits, or up to HUF 500 million in a tax year and make an immediate deduction by this development reserve from their tax base. However, no tax depreciation can be applied to the equipment or other assets acquired through the development reserve—this regime in fact results in accelerated depreciation.

Although the Accounting Act recognizes the “lower of cost or market” principle, the law contains special rules for asset revaluation that may be followed, among other purposes, to measure the effect of inflation. Enterprises may revalue certain assets at the balance sheet date. These include liquid assets, intellectual property, tangible assets, except investments and financial investments, except for securities loans.

In revaluing assets, where market value is less than book value, the difference must be accounted for as an added depreciation expense above the amount planned. Where the market value is greater than book value, the difference can be accounted for in a valuation reserve under the equity account and as a valuation adjustment under the relevant asset account. Generally, the revaluation increases the valuation reserve if the adjustment value of the current year exceeds that of the previous year (up to the value of the reserve adjustment); it decreases the valuation reserve if the adjustment value of the current year is less than that of the previous year. The value adjustment must be performed separately for all assets, and revaluations are not included as income in the taxable base.

Profit repatriation

There is no withholding tax on dividends paid to any foreign companies based on domestic legislation. It is irrespective of the fact, when the profit from which the dividend is paid was incurred.

Capital gains taxation

Gains arising from the sale of assets are treated as ordinary business income. There is no difference in the tax treatment of earnings from long- and short-term holdings. In the course of a transformation (change of business form, merger or demerger) the taxpayers are entitled to revalue their assets and liabilities. Any gain or loss resulting from the revaluation is taxable or deductible respectively generally at the legal predecessor. However, in the case of a qualified transformation the legal predecessor may opt not to tax or deduct the gain or loss. In

that case the legal successor has to determine its tax base as if the transformation has not happened.

At the time of disinvestments, capital gains decrease the tax base for capital reduction, qualified transformation or liquidation. This tax relief is only temporary for transformation, since when withdrawing capital from the transformed company, the tax base must be increased by the amount accounted for as expense but only up to the amount of the capital gain that has formerly decreased the tax base.

Based on the “participation exemption” regime, the capital gain realized upon the sale of participations is tax exempt from corporate income tax if the following requirements are met:

- the participation is at least 30%;
- the taxpayer has reported the acquisition of the participation to the Hungarian Tax Authority within 30 days;
- the taxpayer has held the participation for at least 1 year.

The above rule can be applied by Hungarian companies to their participations in both Hungarian and foreign entities. However, any capital loss or loss in value accounted for such participations are non-deductible.

The regime, combined with the tax exemption of dividend and the lack of withholding taxes, makes Hungary a very attractive location for holding companies.

The shareholder of a company whose Hungarian real property exceeds 75% of the aggregate market value of assets shown in its financial statements (“a company owning real estate”) is subject to Hungarian taxation when transferring the shares in the company, assuming a member (shareholder) of the company is a foreign resident in a country with which Hungary has not concluded a double tax treaty, or the treaty allows the taxation of the capital gains in Hungary. The tax is payable by non-resident shareholder who gains income from the alienation of a share in the company that owns real estate. Tax liability is incurred as of the day of alienating the share or the decrease of registered capital by means of divestment. The tax base is the positive amount of the consideration at the time of alienation or decrease of the company's registered capital, less the purchase price of the share and justified expenses associated with the acquisition or holding of the share, while the tax rate is 19%.

Foreign income and tax treaties

Foreign-source income is taxable in Hungary, with a credit granted under domestic law for foreign tax paid, even if there is no tax treaty with the country of source. Hungary's tax treaties provide for either credit for the foreign tax paid or an exemption of the foreign income.

Hungary has bilateral tax treaties or similar agreements with 65 countries. Hungary does not impose withholding tax on dividends, interest or royalties paid to companies in treaty countries. 30% of withholding tax is levied on interest, royalty and service fee payment to non-treaty countries in 2010, but this provision is abolished as of 2011.

Transfer pricing

Hungarian transfer pricing rules specify that transactions between associated entities should be concluded at the same price as an equivalent transaction between unrelated partners. If an individual or an organisation, directly or indirectly, has more than 50% ownership or voting rights in another entity, or direct or indirect management control of another entity, then the entities are associated. For private individuals, the law also includes family members. (So if, for example, a husband owns 40% in an entity and his wife owns another 20% in the same entity, the family and the entity in question are associated under this law.) If the price applied between associated enterprises differs from the market price, either the taxpayer or the tax authority can adjust the tax base to reflect the market price.

Hungary's transfer pricing rules are generally based on OECD guidelines. The following transfer-pricing methods may be used: comparable uncontrolled price method, the resale-minus method and the cost-plus method, and, as of 2011, the transactional net margin method and the profit split method as well. If none of these methods leads to a proper result, the taxpayer may apply any other defensible method. If the price applied between associated enterprises differs from the market price, the taxpayer or the tax authorities may adjust the tax base to reflect the market price. If the tax authorities make an adjustment, however, they may impose a fine of up to 50% of the additional tax liability and the taxpayer may also have to pay late payment interest. A Ministry of Finance decree, regulates the details of the required content of transfer-pricing documentation.

Branch offices are subject to the same arm's-length pricing requirements as all enterprises in Hungary, whether for prices between branch and parent or between multiple branches in Hungary. The tax authorities have increased their scrutiny of transfer pricing in the past years.

VAT

The primary legislation governing turnover and sales taxes is Act CXXVII of 2007 on value-added tax (VAT). Due to the EU Accession, the Hungarian VAT regulation was aligned to the EU regulation.

Supply of goods and services performed in Hungary as well as importations are subject to value added tax (VAT). The general

rate of VAT is 25%. Certain products and services are subject to reduced rates of 18% and 5%. For example, human medicines and books have been subject to 5% VAT. Dairy and bakery products are subject to 18% VAT.

In general, input VAT of business related costs are deductible, but there are certain goods and services, the input VAT of which cannot be deducted, e. g.:

- goods/services, which have been utilized for purposes other than business activities or have been utilized for VAT exempt activities;
- fuel utilized directly for the operation of motor vehicles;
- passenger cars and related services;
- food and beverages.

Each company acts as a collector, deducting the VAT it has paid from the amount received and surrendering this to the government. Domestic sales and imported products and services are subject to VAT; exported products are tax exempt. Services deemed to have been provided outside Hungary do not fall under the scope of the act.

Repayment of reclaimed VAT of Ft500,000 or more is due within 45 days.

Branch offices of foreign companies in Hungary are subject to VAT. One disadvantage to branch offices is that each branch of a single foreign company in Hungary is treated as a separate entity and must file separate VAT returns (unlike domestic companies, which may treat their nationwide operations as a single unit). All related firms and their branches in Hungary are eligible for group taxation and are collectively regarded as a single taxpayer. Services and products provided within the VAT group are not subject to VAT.

Gifts or goods furnished free of charge are considered a provision of goods or services under the VAT Act and are charged VAT based on their full market value. Rights and intangibles are also liable for VAT. VAT must be paid on an arm's-length basis (that is, at market prices) if the buyer is part of the same corporate group or has a certain relationship with the seller.

In general, the rent of real estate is a tax exempt activity, however, taxpayers may opt to be taxed under the general VAT rules. The renting of residential real estate remains exempt from VAT without having the option for taxation under the general rules.

The value of intellectual property rights (IPR) in addition to the value of storage media is included in the VAT base of imported software.

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Taxpayers have to file annual VAT returns if their total amount of tax to be accounted for does not exceed Ft250,000 and they do not have an EU VAT registration number. If the total amount of tax to be accounted for exceeds Ft1m, the VAT return must be submitted monthly. Otherwise, the VAT return and payment are due quarterly.

As a result of the foreign-exchange liberalisation in 2001, the forint has become fully convertible; thus Hungarian entities can agree on paying in any currency other than forint. Although invoices may be denominated in, and payments may be made in, foreign currencies, taxes should be reported and paid in forint. Exchange rates quoted by the National Bank of Hungary (the central bank) or by other commercial bank may also be used when converting the VAT base and also the VAT liability into forint.

The Act on Excise Tax (Act CXXVII of 2003) applies to alcoholic beverages, petroleum and tobacco products.

After Hungary's EU accession (May 1st 2004), the consumption tax on cars was abolished and a new type of tax called registration tax was introduced. The purpose of the registration tax is the same as that of the consumption tax, but the tax liability will be defined as fixed amounts instead of percentages.

Other taxes

Corporate taxpayers also face a variety of social security taxes. Employers of more than 20 persons must also pay a rehabilitation contribution of HUF 964,500 (in 2010) multiplied by the number of handicapped employees that should be employed less the number actually employed per year. Hungarian law dictates that employers fill at least 5% of staff positions with handicapped persons.

Solidarity tax

The 4% solidarity tax, which had been introduced in 2006 was abolished as of 1 January 2010.

Special tax on financial institutions, energy, retail and telecommunication companies

In order to raise sufficient revenues to finance a reduction in corporate and personal income tax rates, while maintaining the budget deficit at the required levels, the government introduced special taxes on the financial, energy, retail and telecommunication sectors as of 2010.

Credit institutions are subject to a 0.15/0.5% tax on their adjusted balance sheet total in 2010 (as of 2011, the 0.5% rate will be increased to 0.53%). As of 2011, a new special tax on credit institutions will be introduced, which is 30% of their

pre-tax profit, but capped at the amount of the special tax paid on their adjusted balance sheet total. The amount of the new income based special tax can be deducted from the other special tax, resulting in no additional tax payment.

Insurance companies must pay 6.2% special tax on their income from insurance fees in 2010, while as of 2011 progressive rates will be introduced (1.5/3/6.4%). Investment companies, stock exchanges, commodity traders, venture capital fund management companies, and investment fund management companies are also obliged to pay special tax.

As of 2010 the government imposed a special tax (so called "crisis tax") on the energy, retail and telecommunication companies as well. The tax is based on the net sales revenues of these taxpayers. The tax rate in case of energy companies is 1.05%, in case of retail companies progressive rates of 0/0.1/0.4/2.5% apply, and for telecommunication companies progressive rates of 0/2.5/4.5/6.5% have been established.

The above special taxes can be deducted from the base of the regular corporate income tax as expense.

Contribution on interest subsidies

As of January 1, 2007 credit institutions are required to pay a 5% contribution on the interest income received with respect to the loan portfolio directly or indirectly affected by subsidies.

Tax compliance and administration

Corporate income tax is assessed on an annual basis; payment is submitted with annual tax returns. Most returns are due by May 31st following the income year. Advance tax payments based on the previous year's profits are due monthly for companies whose tax liability exceeded Ft 5m in the preceding year. All other companies must make quarterly advance payments, with payment of 90% of the expected tax required by December 20th.

The tax year may be different from the calendar year for a consolidated Hungarian branch or subsidiary of a foreign company if the parent uses a different tax year.

Personal Tax

Taxable income and rates

The Hungarian personal tax system, governed by the law on Personal Income Taxation, is progressive, but as of 2011 a flat tax system with a 16% rate will be introduced. In addition to the above, there are certain type of income that are taxed separately.

Residents are subject to tax on their worldwide income and nonresident individuals are subject to personal income tax only on their Hungarian-source income (including income from employment, business activities or real-property transactions in Hungary).

In 2010 the Hungary's personal income tax system consists of two brackets of 17% and 32%, with the higher rate applying to the part of the tax base exceeding HUF 5 million. The tax base is the gross income of the individual further grossed up by 127%.

Benefits-in-kind that are not tax-exempt are taxed separately at a rate of 54% and there is a group of benefit in kinds that are subject to the 25% preferential personal income taxation. Dividends received by individuals are subject to a 25% rate. If the individual received dividends on shares listed on an EEA stock exchange are subject to a 10% rate.

Hungary has abolished most social security exemptions for expatriates and their employers. If a Hungarian company employs a foreign individual, social security charges on both the employee and the employer are due in Hungary. Any exemptions from Hungarian social charges are based on the conditions of the assignment structure, EU social regulations or bilateral social security agreements.

A 14% health tax applies on income withdrawn from a business, dividends (taxable at 25% rate), income from securities lending, capital gains and income exceeding HUF 1 million from renting out real property.

As of 2011, Hungary introduces a flat tax system with a rate of 16%, with the rate applying to 127% of the total tax base, resulting in an effective flat tax rate of 20.3%. The system of the taxation of other types of remunerations (in-kind benefits, dividend, interest, etc) will also be substantially overhauled.

The benefits in kind falling under the 54% personal income tax rate in 2010 will be subject to the 16% personal income tax rate as well in 2011, but 27% health care contribution will be also payable. The basis of the personal income tax and health care contribution will be the value of the benefit in kind multiplied by 1,19 (i.e.: the effective rates of personal income tax and health care contribution will be 19,04% and 32,13%, respectively). Most benefits in kind which are subject to favorable tax rates in 2010 will be subject to personal income tax at an effective rate of 19.04% (16% on a base that comprises the value of the benefit multiplied by 1,19), but social security or health care contribution will be not payable in this case.

Dividend and interest incomes will be subject to the 16% flat tax rate as well as of 2011.

Determination of taxable income

For Hungarian residents, the law defines income for tax purposes as worldwide income from any source (income from employment, the carrying on of a business, capital gains, income from investments, among others). For nonresidents, only Hungarian-source income is taxable. Hungarian-source income is defined as income received domestically or offshore for activities performed in Hungary, or income earned from Hungarian assets.

Gross income is considered the taxable base, which must be aggregated with income from other sources (excluding income taxed separately such as dividend income, capital gains, among others).

Categories of tax-exempt income include employment income at minimum wage levels (because of a tax credit for low-income earners), benefits paid under the state social welfare provisions or by social insurance, allocations for childcare and state pension income, student scholarships for full-time study and tax refunds. Total tax credits may not exceed HUF 100,000 and generally are not available for individuals with an annual income of more than HUF 3.4 million or HUF 6.5 million (except for family and housing tax credits).

A standard tax credit of 17% of salary applies, up to HUF 15,100 per month, but this is reduced at higher income levels. The income ceiling on this credit is HUF 3.188 million per year (tax credit).

Professional training, business travel and accommodation qualify as business expenses if properly supported by invoices. Housing provided by a Hungarian firm is taxable as part of employment income if evidenced by an employment contract. For foreign employees seconded to Hungary without an employment contract with a Hungarian firm, housing could be considered as non-taxable benefit.

As of 2011, a new child care tax credit will be introduced. Families with one or two children are entitled to a tax base decrease of HUF 62,500 per child monthly and HUF 206,250 per child for families with three or more children.

Residency

Residents are liable to Hungarian personal income tax on their worldwide income (unlimited tax liability). Meanwhile, non-resident individuals pay Hungarian personal income tax only on their Hungarian-source income (eg income received for activities performed in Hungary) (limited tax liability) regardless of where that remuneration is paid from and the location of the bank account into which it is deposited.

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Furthermore, non-resident individuals may also be liable to Hungarian income tax on any income that is taxable in Hungary based on double-tax treaties.

For the determination of Hungarian tax residency, various criteria should be examined. Individuals with Hungarian citizenship (excluding dual citizens with no permanent residence in Hungary) and foreigners with a Hungarian settlement permit are tax residents. A foreigner without a Hungarian settlement permit is also considered tax resident if that person has a permanent home exclusively in Hungary. If the individual has a permanent home in another country in addition to one in Hungary or has no permanent home in Hungary, the individual is regarded as a Hungarian tax resident if that person's centre of vital interests is in Hungary. If the individual's centre of vital interests cannot be determined, the individual is regarded as a Hungarian tax resident if the individual has a habitual abode in Hungary (for instance, if he/she stays in the country for more than 183 days in a calendar year). An EEA national also would be deemed tax resident if his/her stay in Hungary exceeds 183 days in the calendar year. Double tax treaties, which override local legislation, may affect the residence status.

Special expatriate tax regime

There is no special expatriate tax regime. However, from 2009 it is generally also possible for any entities (not only for employers) to send individuals on business trips with an assignment letter. In case of such an assignment letter the costs of travel and certain meal expenses might be considered tax free.

3. Legal Entity

Principal forms of doing business

Under the Act on the Investments of Foreigners in Hungary, with few exceptions specified in the Act, foreigners are entitled to carry out business activity in Hungary only if they register a branch or establish a Hungarian company. Under the terms of the Companies Act, a company in Hungary may be established under a variety of legal forms. The most common for foreign investors are the company limited by shares (*reszvenytársaság* - Rt) and the limited-liability company (*korlatolt felelossegu tarsasag* - Kft). These organisational forms correspond closely to the German AG (*Aktiengesellschaft*) and GmbH (*Gesellschaft mit beschränkter Haftung*). Foreign investment may take two other legal forms: the limited partnership (*beteti tarsasag* - Bt) and the general partnership (*kozkereseti tarsasag* - Kkt). These latter forms of organisation require unlimited legal liability. All members of a Kkt are jointly and severally liable; at least one member of a Bt must have unlimited liability.

Owing to less stringent registration and operating procedures and to lower minimum capital requirements, most new private-sector firms incorporating in Hungary now choose the Kft form. For an outline of Rt and Kft requirements, see below.

A Kft may be formed by one owner. It is not permitted to solicit others publicly to become owners. Initial capital may not be increased until all quotas are fully paid. A Kft may not be filed for registration until at least half of each cash contribution has been paid. If upon the establishment the amount of in-kind contributions reaches half of the initial capital, all of the in-kind contribution has to be transferred. All outstanding cash contributions must be fully paid no later than one year from registration. All outstanding in-kind contribution has to be transferred within three years.

Company limited by shares (Rt)

Minimum capital is Ft20m in case of public Rt (*nyRt.*) and Ft5m in case of private Rt (*zRt.*). The share capital of the company must be secured completely by subscription. With certain exceptions, the amount of capital contributed in kind must be declared in writing and must be audited by certified auditors.

There are no restrictions on the number of shareholders or founders, or on their nationality or residence.

An Rt must have a supervisory board of at least three members, elected by the shareholders.

The person elected must inform in writing those companies of which he or she is already an executive officer within 15 days of acceptance of a new position. There are strict regulations on conflicts of interest. Except when acquiring shares in a public Rt, an executive officer may not acquire interest in another company pursuing identical activities. Furthermore, no person may be an executive officer in another company pursuing an identical activity unless specified in the company's articles of association approved by the supreme body of the company. A company's supreme body may confer the right of general representation upon an employee appointed by it, as a so called company secretary.

Management is conducted by the board of directors (*igazgatosag*), consisting of 3–11 members elected by the shareholders at the general meeting. The board is responsible for preparing financial statements and balance sheets of the company and for producing an annual report. No restrictions apply regarding nationality or residence of directors (except for banks, where at least two members of the board must be Hungarian residents for foreign-exchange purposes).

There is a registration fee of HUF 600,000 in the case of public companies limited by shares and HUF 100,000 in the case of private companies limited by shares and limited liability companies. Upon the increase of the initial capital 40% of the above fees is payable.

Bearer shares are freely transferable. The transfer of registered shares issued by a private Rt may be limited in the deed of foundation. Foreigners may acquire both types of shares. Preference shares may be distributed up to a value of 50% of the total share capital of the company.

Simple majority is enough for most decisions; however, a majority of at least 75% is necessary for major decisions, such as amending the articles of association, deciding on transformation or termination without legal successor of the company or modifying the rights attached to the shares, or transforming classes of shares. Shareholders representing at least 10% of shares with voting rights may ask the board of directors to add certain items to the agenda of a general meeting or to have the management of the company be investigated.

Limited-liability company (Kft)

Minimum capital is Ft 500,000.

There are no restrictions on the number of shareholders or founders, or on their nationality or residence.

A supervisory board of at least three members must be established if the annual average number of employees exceeds 200. In that case one-third of the members of the supervisory board must be elected by the employees.

Management can be conducted by one or several managing directors elected by the members for a definite term; alternatively, the articles of association may provide that all equity holders are entitled to manage the Kft as managing directors.

Companies must appoint at least one auditor if the turnover is more than HUF 100 million in the preceding two years and the average number of employees of the preceding two financial years exceeds 50 persons. Public Rts have extensive publishing and disclosure obligations. Quotas have a minimum par value of Ft 100,000. The amount of capital contribution must be divisible by Ft 10,000. Every quota holder has one quota, though several persons together may constitute a single quota holder.

A simple majority is usually sufficient for most decisions; however, a majority of at least 75% of the quota holders is necessary, for instance, to change the articles of association or to remove a managing director.

Establishing a branch

Since January 1st 2000 all foreign companies functioning in Hungary must have established either a locally registered company or a branch office (fioktelep) under Act CXXXII of 1997 on Branch Establishments.

Foreign firms have been able to establish a branch office in any sector since January 1st 1998, under Act CXXXII. A branch office in Hungary qualifies as an entity without legal personality; therefore the foreign firm bears responsibility under Hungarian law. (Kfts and Bts are also without legal personality under Hungarian law.)

The financial-sector modifications to Act CXII of 1996 on Credit Institutions and to Act CXI of 1996 on Securities permit branches. Under the amendments, capital requirements for branches in the financial sector are identical to those for domestically registered companies: Ft 2bn for a bank, Ft 1bn for an investment company and Ft 100m for a securities-trading company. A branch may engage only in activities that comply with the laws of both Hungary and the country of the parent company.

Legislation in all areas (for instance, tax law) has been drafted with the expressed intent to create a level playing field for branch offices - that is, neither giving them advantages over domestically registered companies nor subjecting them to disadvantages.

The procedure for registering a branch office is very similar to that of a Kft, with some differences. A branch office may be founded only if an agreement has been concluded between Hungary and the country where the seat of the foreign firm is located. Reporting to the Court of Registration is the responsibility of the person(s) authorised to sign on behalf of the branch office.

4. Labour and Wages

The employment market

Unemployment in Hungary is still below the European Union average; the national average rate of unemployment were steadily around 6%, however in 2010 it rose to 10.9% according to the Hungarian Central Statistical Office (it has arisen because of the financial crisis like in other European countries). The government and the National Bank of Hungary (the central bank) have expressed confidence that the economy still has reserves of idle labour, particularly in underdeveloped regions like the country's north-east and south-west. Activity rates are still low, but as the demand for labour grows, persons who are now economically inactive can be expected to enter the labour force.

Unemployment varies widely by region: the highest rates are in north-eastern Hungary; the lowest are in the border region with Austria.

Hungary

Unemployment and lower levels of economic development are generally more pronounced in the eastern half of the country. In contrast, there is now a shortage of labour in some of the more-developed regions. A persistent problem has been long-term unemployment, and nearly half of the unemployed falls in this category.

Although the Hungarian workforce is generally skilled and well educated, many of the unemployed are unskilled or older workers who might be difficult to retrain and place elsewhere. A severe housing shortage in most parts of the country limits labour mobility, with Budapest the most-affected area. Professional relocation is still uncommon in Hungary.

Certain white-collar skills can be in short supply, though this situation continues to improve. Western firms may have trouble finding and retaining local employees with skills in finance or accounting, human resources, purchasing and electronic data processing. Employees with both business skills and proficiency in Western languages can be difficult to recruit, and they command premiums over average Hungarian salary levels, but this is also improving. Many Hungarian firms encourage middle and senior management to take foreign-language courses (particularly English). Although Hungarian firms often provide younger white-collar employees with access to subsidised traditional college or university courses, foreign firms generally offer in-house, directed training. Another trend among foreign firms is to support employees in obtaining local MBA or similar professional education.

Turnover and absenteeism among shop-floor staff are sometimes still problematic, largely because of workers holding second jobs, the high ratio of female employees with families (who must attend to family responsibilities) and frequent sick days. Staff members in joint ventures or foreign-owned firms are considered less vulnerable to high turnover and absenteeism because of better overall pay and working conditions. As specified in Act LXXXI of 1997 on Social Security Pensions, the official retirement age is set in a transition to 65 years for all persons. Early retirements are still common, however, where firms seek to reduce staff levels with as few lay-offs as possible.

Labour Code

Act XXII of 1992 (the Labour Code) is the basic legislation governing labour law in Hungary. The present Labour Code is modelled on EU practice and has been amended several times to align legislation with EU regulations. Some foreign investors have commented that domestic labour and social security legislation provides too many benefits to workers at too great a cost to management, considering Hungary's present stage of development and productivity. Although social charges have been reduced in recent years, they remain high in percentage terms.

Working hours

The statutory number of weekly working hours is 40; this may not exceed 48 hours, including overtime. Employees are entitled to two non-working days per week, one of which must be Sunday. Sunday workers must receive 150% of their regular daily wage and be provided with another day off the same week. Exemptions to this rule may apply to special working schedules, but employers must provide adequate rest time for workers. Workers must be paid minimum premiums of 15% for night work and 50% for overtime work. The maximum overtime can be 200 hours annually, i.e. 300 hours if provided so by the collective agreement.

Each employee is entitled to a regular vacation every calendar year. The duration of the vacation is 20 days. However, the number of vacation days is increasing with the age of the employee so that when the employee is 45 years old the duration of regular vacation is 30 days. Supplementary vacation days are given if the employee has children.

Following the legislation, the social security contributions are mandatory for Hungarian employees. The reformed pension system has currently four pillars, thus the system comprises of a mandatory public scheme, a private scheme, a voluntary scheme and a pension insurance scheme. The rules of the systems are as follows: Individuals must contribute to the public and to the private scheme, furthermore they may contribute to the voluntary schemes, with exception of compulsory contribution to the private one for employees who enter the labour market.

From employers it is requested to pay a 24% pension, 2% health care and 1% unemployment contribution, which is calculated on the basis of the wages and salaries of the employees. Employees are obliged to pay 9.5% pension, 6% health care and 1.5% unemployment contribution.

From 1 January 2011 the employers will be obliged to pay to the public scheme of the pension system instead of the private scheme as a restrictive measure from the government. Other serious amendments are expected in the future regarding the pension system, however the details have not yet been confirmed at the time of the present update.

Wages and benefits

The Labour Code sets a basic minimum wage in hourly and monthly terms for all types of work and the monthly minimum salary requirement must be adhered to. The prevailing minimum wage is HUF 73,500 per month and HUF 423 per hour in 2010. Following Hungarian sources, the average monthly gross salary in 2010 was HUF 201,200. The Labour Code allows a range of other specific minimum-wage levels and guidelines for certain types of work (for example, by skill level, degree of responsibility and industry).

Salary levels vary widely. Wages in the state sector or at wholly Hungarian-owned enterprises are generally lower than at joint ventures. Skilled white-collar labour commands a premium, particularly for qualified information-technology specialists. There are also wide disparities among different regions of the country: salary levels in Budapest and the western counties are higher than in the depressed eastern regions.

Hungarian Labour Code adopted the principle of equal wage for equal work, meant to address discrepancies between wages for male and female employees. The implementing legislation is Act XVI of 2001. It also forbids discrimination based on gender, age, or nationality. Hungary is signatory to and adheres to ILO conventions protecting worker rights.

5. Education

Educational attainments are comparable to those of western Europe. A high standard of general education has been important in attracting foreign employers to Hungary, especially in new-technology sectors. However, some foreign investors in the manufacturing sector have complained that the systems in place for training skilled industrial labour are weak. Governments have often focused on higher education at the expense of primary and secondary schooling, with state spending continuing to hover at around 5% of GDP - broadly average for the EU25.

Schooling is compulsory for children between the ages of six and 16, and in broad terms the structure of the educational system remains little changed from the pre-transition period. General elementary or primary school is usually followed either by "vocational school" (for the training of skilled workers), "vocational secondary school" (which offers a mixture of vocational and academic study), or the purely academic "gymnasium". The gymnasium remains the primary feeder of students to universities, although various types of universities often accept students from vocational secondary schools. In 1990/91, 44% of secondary school students were in vocational schools; but by 2003/04 this had fallen to 23%. The percentage of secondary students in vocational secondary schools increased from 33% in 1990/1991 to 43% in 2003/04, and the percentage continuing to gymnasium rose from 24% to 34%.

Higher education expands rapidly

University and college education expanded rapidly in the 1990s. Enrolment rates are fairly high for the region: in 2001, according to Eurostat (the EU's statistical office), there were 25% more students in tertiary education in Hungary, however the number of the students has decreased recently. According to Hungarian Central Statistical Office the number of students in tertiary education 2009/2010 reached more than 370.000.

6. Infrastructure



Road network

Hungary has 6.8 km of roads per 1,000 sq km of land area, which it wants to increase to 27 km by 2015, approaching the average among current EU members. The total length of roadway lines is 160,057 km. Currently, there are 858 km of motorways; the density of the motorway network is low by international comparison, at less than half of the EU average. The routes forming a part of European transport corridors are given preference. There are plans to construct additional motorways continuously, although there is a setback due to budgetary restrictions. The main emphasis is on the building of new high-quality roads, with a possible neglect of basic maintenance. The financial viability of such highly ambitious construction plans has been questioned, but a new funding scheme based on public-private partnerships takes much of the costs off-budget. The motorways running south-west and south-east from Budapest (toward Croatia and Serbia, respectively) were also developed in the near past, as are several bridges over the Danube and Tisza, and non-motorway inter-city roads and ring-roads. The road network is extensive, but only around half of Hungary's roads are paved.

Railway network

In Hungary, the railway network covers the whole country and it is well connected to the international railway network. Staterun domestic railway system operated by MAV is widely used for industrial cargo shipping. However, lately the road transport has replaced railways as the primary form of freight transport, reflecting both the improvements in main road provision and past lack of investment in the state-owned railway network. The total length of railway lines is 8,057 km.

Hungary

Of the measure of goods shipped domestically in 2009 about 90% went by road and 10% by rail (these data also include pipeline deliveries, which accounted for 3,6% of the total). When international traffic is included, however, the modal split is slightly more even between road and rail, at 65% and 18%, respectively, with pipeline deliveries accounting for 12% of total freight traffic.

Air transport

In recent years, the air traffic has grown rapidly, particularly the passengers transport. This increase occurred after the introduction of the discount airlines, which the Hungarian airport authorities were forced to allow – due to non-discriminatory terms upon EU accession. In 2010, the air travel accounted for roughly 80% of total international long-distance passenger traffic. Hungary has several domestic and international airports built throughout the country. The largest one is in Budapest named Ferihegy Airport. Budapest, is striving to build the second biggest airport among the countries in the region in terms of the number of the passengers. Larger Hungarian cities maintain airports for private aircraft and for domestic flights as well.

Telecommunications

Thanks to investments in telecoms infrastructure, most of it from foreign investors, Hungary now has one of the best telecoms systems in the region. At the start of the 1990s Hungary had one of Europe's least-developed telecoms networks, with an installed base of less than 1m main lines, a penetration rate of only nine lines per 100 inhabitants, and a call completion rate of less than 40%. In 2009 there were 11.8m mobile subscriptions. The country's incumbent telecoms provider, Magyar Telekom, now controlled by Deutsche Telekom (Germany), still dominates the scene, and is the largest carrier not only in fixed-line services, but also in mobile telephony and the Internet.

7. The Most Active Industries/ Sectors

Automotive industry

Starting almost from scratch at the beginning of the 1990s, the vehicle manufacturing sector has become a vital source of foreign investment, accounting for 15% of industrial output in 2004, with total production valued at US\$9.3bn. Two major greenfield investments account for Hungary's output of passenger cars and automotive components: Audi Hungaria (owned by Germany's Volkswagen) and Magyar Suzuki (Japan). Audi Hungaria, the country's largest exporter, has been the main engine supplier to the Volkswagen group since 1994, and made nearly 1.5m engines, as well as over 23,000 vehicles, by 2004. In 2010 Audi initiated the extension of its production facilities which will amount to EUR 900m of investment. Upon the completion of these plans Audi is aiming to produce -entirely in Győr- 125.000 passenger cars every year. Magyar Suzuki the second biggest manufacturer produced over 140,000 vehicles at its Esztergom plant in the years before the crisis of 2008. Opel Hungary (owned

by the US's General Motors) previously produced passenger vehicles, but now concentrates on transmissions and components and is investing EUR 500m in 2011 to double its capacities thus becoming number one GM manufacturing site in Europe. With the advent of vehicle manufacturing in Hungary, a thriving network of suppliers and components manufacturers has also developed, including many from the EU, the US and Japan. Heavy vehicles also have a strong production base in Hungary, although firms in this segment have experienced difficulties, including a dramatic weakening of the US dollar during the credit crisis and the following recession. Raba, a domestically owned firm based in Győr, an important supplier of heavy-duty axles worldwide, is constantly increasing its market share in the Former Soviet Republics. Nabi, a bus manufacturer, once hailed as a success story, is struggling to make a comeback from financial difficulties.

Manufacturing

Hungarian manufacturing has transformed radically in the transition period. Formerly characterized by large, heavy industrial plants, dependent on cheap energy imports and sheltered from competition, Hungarian industry today is largely modern and efficient, thanks in large part to the early entry of foreign investors. Industry suffered a major decline in output during the 1990s. Manufacturing output declined a severe 54% in 1989-92, and entered strong and sustained recovery only in 1997, after economic stabilization measures introduced in 1995 showed positive effects.

Hungary electronics manufacturing ranks first in the central-east-European region and is well placed globally, having thus the biggest growth potential among industries in Hungary. This is led in part by segments brought to Hungary by foreign investors as greenfield investments - such as mobile telecommunications and other high-technology equipment, for which Hungary has become something of a centre. The electronics manufacturing industry has the biggest growth potential among Hungary's industries and contributes at least 15% of Hungary's GDP, including spillover effects on other GDP generating sectors. Transport equipment is the second most significant manufacturing sector, led by the automotive industry. Other manufacturing sectors with high export levels have a longer tradition in Hungary, such as the chemicals and food industries, although these two have gone through major restructuring and modernization.

Information and communication technology

The availability of comparatively cheap, technically skilled labour and nearby EU markets has attracted a number of leading electronics and software firms to Hungary. The country has become a major European manufacturing centre for mobile telephone handsets, led by output at the Komárom factory of Nokia

(Finland) and at contract manufacturers Elcoteq (Finland) and Flextronics (Singapore). Nokia has also chosen Budapest for its largest software development centre outside Finland, encouraging similar moves by other mobile and electronics producers. Among indigenous firms, specialists such as Graphisoft, which has become a major world supplier of architectural software, are generally perceived to have a more stable future than those competing directly with major multinationals. Over 95% of information technology (IT) production is exported.

Despite undoubted successes, rising labour costs and a volatile forint have raised competitiveness concerns, as illustrated by the 2002 decisions of Flextronics to relocate production of the Microsoft Xbox to China, and of IBM to close its hard disk factory in Szekesfehervar. Although these incidents were seen as calling investor confidence into question, the restructuring of global production capacities more often works in Hungary's favour. There are signs that an increasing number of Asian companies, including Chinese firms, are relocating some electronics production to Hungary in order to serve EU markets.

Chemicals and pharmaceuticals

Hungary inherited an important pharmaceutical industry from the communist period. The country's pharmaceutical companies have their own research and development (R&D) activities, but are generally too small to run research programs on a scale that can reliably generate new proprietary drugs. However, Hungary has become an important low-cost production base for patented compounds manufactured under license, as well as for high-quality branded generic substitutes for out-of-patent drugs. The largest pharmaceutical company and the only major manufacturer not controlled by a foreign investor, Richter Gedeon, is a leading producer of generics and active ingredients, and is one of the most important foreign drug suppliers on the Russian market. Its active ingredient production has led to extensive exports to the US and Japan. Richter Gedeon recently acquired PregLem a Swiss, and Grünenthal a German pharmaceutical company. Although Hungary's pharmaceutical market is of sufficient size to have attracted leading international producers, political interference in pricing has been a regular occurrence under both left- and right-of-centre governments, significantly adding to business risk.

The chemicals sector was already a major industry before Hungary's transition, and the two largest companies - BorsodChem and TVK - have complementary buyer-seller roles. TVK, now controlled by the oil and gas company MOL, is more closely linked to the oil and petrochemical value chain, as a major supplier of polyethylene, polypropylene and other products. BorsodChem, which makes PVC resin and higher value-added

isocyanides, seems to be coming out of the crises stronger with the new management in 2010. BorsodChem and TVK have both become important European players on the markets that they serve, and co-ordinated, large-scale investment programs have been completed at both companies. Chemicals account for over 7% of total industrial production and 2% of Hungary's exports.

Agriculture

Agriculture and viticulture have traditionally played an important role in the economy, as Hungary has a favourable climate and fertile soil. Hungary has nearly 5.9 million ha of agricultural land, or 63% of the country's total surface area. Including forests, total productive land area rises to 7.7 million ha; about 75% of productive land is now privately owned. It is self-sufficient in most agricultural product groups, and exports show a consistent and substantial surplus over imports. Major crops include wheat, maize and barley; sunflower seeds; sugarbeet; and a variety of vegetables and fruits. Animal husbandry and dairy production are also important. Numerous small family operations are expected to join a new wave of co-operatives, or exit commercial farming for practical purposes. Ironically, even as the viability of small, inefficient farms is called into question with EU membership, the implementation of the CAP has resulted in an increase in the number of registered farmers to approximately 300,000 from 218,000 earlier. This is a result of the CAP's more generous fixed subsidies, which are provided per hectare of arable land, even on small plots.

Financial Services

After an early recapitalization program followed by comprehensive privatization that brought in foreign strategic partners, Hungary has one of the region's most advanced banking sectors. Privatization of the major banks began in the mid-1990s, and most had been sold to foreign investors by the end of 1996. The largest Hungarian Bank OTP, the National Savings Bank is more than 90%-owned by foreign investors. The trend of declining state shareholdings has been accompanied by a corresponding increase in foreign ownership, from 14.9% in 1994 to above 85% in direct and indirect foreign ownership by 2010. The financial crisis hit Hungary hard since half of its household and public debt has been denominated in foreign currencies resulting the country being highly leveraged and susceptible to volatilities in the global economy.

Hungary

8. Industrial Parks

Hungary offers the widest selection of industrial parks in the region: investors can choose from more than 209 (according to the data from 2009) operating industrial parks on the basis of their business, professional, or cultural demands. Establishing a business is facilitated by highly favourable conditions, including management that is familiar with local circumstances, support from municipalities, and various tax benefits. Another very important point is that investments are usually implemented in a fairly short period of time (a few months).

Industrial parks in Hungary:

- Several large multinational companies have some part of their operations in industrial parks in Hungary.
- Up to the present, HUF 2,574bn capital has made its way to these parks.
- The parks produce 51% of industrial exports, which accounts for HUF 4,100 bn.
- The productivity of activities performed in industrial parks is over 70% higher than the industrial average, and just 15% less than the average productivity in the European Union.
- Nearly half of industrial parks are situated by motorways, and investors can expect professional logistics services almost everywhere.

9. Investment Incentives

Hungary welcomes foreign direct investment (FDI) and implements policies to encourage it. Tax incentives above a certain amount (EUR 100 million), which are in accordance with EU regulations on government subsidies, are available on a per case basis through a permit issued by the Ministry of Finance. The corporate income tax may be reduced by up to 80% under the title of investment tax benefit. The incentive is available within ten years. The most important terms of the tax incentives:

- Investments over HUF 3bn (approx. EUR 12m), investment over HUF 1bn (approx. EUR 4m), the investment has been installed and operated in preferred regions (northern Hungary, the northern and southern Great Plains, the central and southern Trans-Danubian planning/strategic region as well as the small regions of Celldömölk, Letenye, Óriszentpéter, Tét, Vasvár and Zalaszentgrót within the western Trans-Danubian planning/strategic regions)
 - or settlements belonging to a small region; or
 - investment up to a limit of HUF 100m (EUR 400,000) if used for environment protection (self-contained investment), broadband Internet service, provision of food-hygienic conditions, film and video making, as well as basic research, applied research, or experimental development.

In such cases, investments must be implemented and operated in an area managed by an academic institution or a research institution (research site) founded by the Hungarian Academy of Sciences.

- Investments of small- and medium-sized enterprises over HUF 500m (EUR 1.9m) if the enterprise within the next four years increases the number of employees with 20 in case of small-sized enterprise and with 50 in case of middle-sized enterprise, or increases the wage costs by at least 50 times in case of small-sized enterprise and by at least 100 times the annual minimum wage.

Processing and distributing agricultural products may be also subject to certain investment incentive based on the provision of the government decree.

For a period of five years following the first incentive year the company must also meet additional terms. The recipient of the tax holiday has two options: to increase the number of employees by at least 150 (or 75 in underdeveloped regions), or to increase the wage costs by at least 600 times (or 300 times in underdeveloped regions) the annual minimum wage.

Tax allowance for small- and medium-sized enterprises

Small- and medium-sized corporate tax payers are supported by special tax allowances.

Taxable income may be reduced by the value of investments in assets. Deduction is limited to the amount of profit before tax and also to HUF 30m (EUR 120,000).

40% of the interest on an investment loan (including financial leasing), is deductible from the corporation tax payable (limited to HUF 6m/EUR 24,000 per year).

Maximum intensity ratios

Rate of the tax benefit is the maximum intensity ratio defined in EU regulation minus all direct subsidies. Maximum intensity ratios defined by regions:

- 25% in Budapest (10% as of 2011)
- 30% in Pest County and in Western Transdanubia
- 40% in Central Transdanubia
- 50% in all other regions of Hungary

Defined by size of investment:

- Up to EUR 50m worth of investment – no further restriction in addition to regional preferences is applicable
- Between EUR 50-100m worth of investment – 50% of the regionally allowed intensity ratio is applicable
- Over EUR 100m worth of investment – 34% of the regionally allowed intensity ratio is applicable

Example: Maximum intensity ratio for an EUR 135m investment in Budapest (25%):

$50 \text{ million} * 25\% + (100 - 50 \text{ million}) * 25\% * 50\% + (135 - 100 \text{ million}) * 25\% * 34\%$

Defined by sectors: Sensitive sectors are described in accordance with EU regulations, for which further decreased state subsidies or no subsidies at all are granted.

10. Foreign Direct Investment (FDI)

Hungary welcomes foreign direct investment (FDI) and implements policies to encourage it. The country started to see a decline in FDI during 2003, attributable to several factors: competition for investment from other emerging markets increased; local labour costs were rising; and there were fewer potential acquisition targets, since the bulk of privatisations were already completed. To make matters worse, accession to the European Union forced Hungary to modify its corporate tax-holiday scheme, completely scrapping some measures. But FDI inflow picked up in 2004, reversing the decline. Cumulative FDI stood at €64,2 bn in 2010, furthermore 75% of this amount flows from the European Union. The largest foreign investors in terms of FDI in 2010 were Germany (22.2%), Austria (14.5%), the Netherlands (13.4%), Luxemburg (10.7%); France (6.1%) and the United States (4.1%) according to the Ministry for National Economy.

According to data from 2010 60% of FDI had gone into service sector (e.g. 9% into real estate, 11% into the automotive industry, 8.8% into financial services and 9.4% into telecommunications).

11. Expatriate Life

The quality of life that Hungary offers foreign investors and employees in Budapest and throughout the country is an important factor when businesses consider locating here. Expatriates working in Hungary for extended periods have so far not been disappointed: they have found living in Hungary pleasant and Budapest exciting and less expensive than other major European capitals. Moreover, the country boasts a rich and internationally recognised culture, distinctive cuisine, superb wines, a centuries-old spa tradition, excellent schools, and numerous leisure activities and facilities. With its millennium-old culture and awe-inspiring technological legacy, it is not surprising that many world businesses make Hungary their central European home.

12. Weather and Climate

The climate in the southeast of Hungary is very different to the climate of North- and West-Hungary and is similar to the climate of the Mediterranean. The summers are long, hot and nearly without rain. The temperature is rising up to 38 degrees. Autumn stays like the Indian summer warm and without much rain. October is still a good month for canoeing. Start of the canoeing season is the middle of April. Higher rainfall is at the beginning of June but without rain periods over several days.

Poland

1. General Overview of Economy

After joining the EU in May 2004, Poland became the 10th EU economy in terms of nominal GDP. Since then, growing at the average rate of 4.8 percent it progressed to the eight biggest EU economy producing 327 billion euro of goods and services in 2010. At the year of global recession in 2009, Poland was the only EU economy registering positive GDP dynamics (1.7 percent) fueled by domestic consumption and public investments. The former was attributed to continued wage growth in line with labor productivity, while the latter came as a result of EU structural funds, which Poland is the biggest beneficiary among the new EU members. The global crisis underlined microeconomic dichotomy in Poland, where the efficient and private enterprise strong growth of profits, employment, and investments, while state-owned underperform in terms of productivity, overpaid labor, and financial losses. Restructuring and privatization of state "sensitive sectors" (e.g., banks, insurance, coal, steel, and energy), while vigorously initiated still pays the price of years of negligence. Weakening of global FDIs and financial investors' confidence was substituted by expansion of IPOs and privatization via the Warsaw Stock Exchange, which became one of the best performing market in the EU. Also, financial sector in Poland did not face a single bankruptcy or deleveraging problems widespread in other EU economies, not to mention cases of Greece or Ireland. Even so, much remains to be done.

Poland's agricultural sector remains handicapped by surplus labor and inefficient small farms. Legal and bureaucratic obstacles are hampering development of small- and medium-sized companies and Poland is still being ranked no better than 70th in the Doing Business reports. Last but not least, there are increasing tensions in public finance both on the revenue and expenditure sides. Complicated, costly, and inefficient tax system from the one hand and amplifying expenditures on health care, education, social transfers, and bureaucracy may reflect lack of both concept of economic reforms and political willingness to deal with the forthcoming challenges. However, in 2007-2013 Poland again will be the biggest beneficiary of EU funds that will strengthen domestic entrepreneurs to reap the rewards of membership via booming exports to the EU.

Political system

Poland is a parliamentary democracy with a bicameral Parliament, consisting of the Sejm (the lower house) and the Senate. The 460-member Sejm is elected under a proportional representation electoral system for a four-year term. When sitting in joint session, members of the Sejm and Senate form the National Assembly. The National Assembly is formed on rare occasions, such as taking the oath of office by a new president.

The Senate has 100 members elected for a four year term in 40 multi-seat constituencies under a rare plurality bloc voting method, where several candidates with the highest support are elected from each electorate.

The President is elected directly by popular vote for a five-year term, and his powers include calling a referendum, choosing the date of elections or using his veto to stop legislation.

Most of the executive power is in the hands of the Prime Minister, who is free to select his co-workers - members of the Council of Ministers. The cabinet he selects must be approved by the Sejm by granting him the vote of confidence. The Constitutional Court can rule on the unconstitutionality of laws or other legislation.

2. Tax Structure

The taxation system is uniform across the Republic of Poland, and only small differences may appear in local taxes. In general, foreign companies and individuals pay the same taxes as Polish legal entities or private individuals (with some exceptions applicable to non-resident individuals). The exceptions to this rule may result from international treaties signed by Poland (Agreements on the Avoidance of Double Taxation).

The main taxes in Poland are:

- corporate income tax (CIT);
- personal income tax (PIT);
- tax on goods and services (VAT);
- excise duty;
- tax on civil law transactions;
- stamp duty;
- real estate tax

All companies intending to conduct business activities are given a tax identification number (NIP) after registration with the appropriate local Tax Office.

The Tax System and Regulations

All taxes in Poland are imposed by the tax law acts which set the rules for imposing taxes, their rates and duties, as well as the responsibilities of taxpayers. The Minister of Finance may be authorized by an Act to decree regulations. All legislation is published in official publications [Journal of Laws (Dziennik Ustaw – Dz. U.) and the Official Journal of the Republic of Poland (Monitor Polski – M.P.)].

The Tax Ordinance (Tax Code – Ordynacja podatkowa) is the most general tax regulation which defines:

- the tax administration structure;
- Advance Pricing Agreements;
- tax rulings;
- general taxation regulations, e.g. payment deadlines and tax arrears (tax underpayments);
- tax liabilities of third parties;
- tax information;
- tax proceedings;
- fiscal confidentiality;
- exchange of tax information with other countries;
- tax certificates.

Other relevant legislation includes the Corporate Income Act, Personal Income Act, Value Added Tax Act, Civil Law Activities Tax Act (for capital duties and transfer tax), Local Taxes Act (including e.g. real estate taxes).

Parliament passes tax legislation with a simple majority of votes.

Taxes in Poland are generally administered by:

- Tax Offices – units supervising the collection of taxes in their territories. They also issue individual administrative decisions in taxation cases. Fiscal Audit Offices perform taxation and procedural audits of fiscal accounting.
- Tax Chambers – supervise the tax offices and are empowered to review the administrative decisions of tax offices and fiscal audit offices.
- The Minister of Finance – is responsible for Polish budgetary policy and supervises the entire taxation system.
- Some taxes are administered by the local authorities, e.g. real estate tax.

Taxpayers may appeal to the Tax Chamber against the decisions of the local Tax Office or Fiscal Audit Office. An appeal against a decision of the Tax Chamber may be directed to the Regional Administrative Court. Taxpayers are also entitled to resort to the Supreme Administrative Court to review judgments of the Regional Administrative Courts.

The taxpayers may also apply for tax rulings to the Minister of Finance or the local tax authorities (with respect to the local taxes). Obtaining the ruling can help to avoid certain negative consequences in the event of the tax authorities taking a different view on a matter, i.e. fiscal penal responsibility, penalty interest.

Moreover, if the tax consequences of the case covered by the ruling occur after obtaining the ruling, the taxpayer will not be obliged to pay the tax.

Corporate Income Tax (CIT)

Legal entities and organizational units (with the exception of partnerships) are subject to corporate income tax. Taxpayers that have their registered office or the place of management in Poland are liable for CIT on their global income (unless Double Tax Treaty modifies this rule). If a corporate taxpayer does not have its registered office or the place of management, in Poland, tax is only levied on income derived in Poland, unless double tax treaties state otherwise. Having satisfied several conditions, companies may establish a “fiscal union” a group of companies treated as a single CIT taxpayer (the concept of a “fiscal union” is discussed in more detail in point 2.2.3.5 of this Guide).

Taxable Income and Tax Rates

Taxable income is the aggregate of all revenues earned in a tax year – both financial and operational (with some exceptions), net of tax deductible costs. Income decreased by additional specific expenses (e.g. tax losses carried forward, deductible donations) constitutes the basis for the calculation of taxation. Generally, tax-deductible costs are expenditure borne in the course of generating taxable revenue. Some expenditure, however, is not tax-deductible (e.g. representation costs, some kinds of administrative or contractual penalties, etc.).

Fixed assets and intangibles are subject to depreciation / amortisation write-offs. Where their value does not exceed PLN 3,500, they can be recognised as tax-deductible in total in the month in which they are brought into use or in the following month. Certain assets, such as land and works of art, cannot be depreciated.

Income (tax base) that is calculated in accordance with the tax provisions is subject to CIT at a rate of 19%, which ranks among the lowest in Europe.

Revenues / deductible costs generated by a partnership are added to each partner’s revenues / deductible costs in proportion to their interest in the partnership; thus, the income is effectively taxed at the level of each partner.

At the beginning of 2006, a new relief for the purchase of new technologies was introduced. Thanks to this, taxpayers can decrease their tax base by the expenditure incurred for that purpose (in the amount not exceeding 50% of this expenditure) whereas they may still depreciate the value of purchased technologies in full. Additionally, the minimum period for the depreciation of costs of completed research works has been decreased to 12 months.

Poland

The calendar year is generally the tax year. Taxpayers may however, select a different tax year covering 12 consecutive calendar months.

Taxation of Dividends

Dividends paid by the Polish companies to other Polish companies

Income arising from participation in the profits of a legal entity with its registered office or the place of management in Poland, including the income from dividends, is taxed with the withholding tax at the rate of 19%. According to the transitional provisions of the Polish CIT Act, if the dividend was received before 1 January 2008, this tax can be credited by the recipient of the dividend against its tax on other incomes.

Moreover, exemption from the withholding tax is available in case the dividend recipient has at least 10% of shares of the company paying the dividend for an uninterrupted period of at least 2 years. The two-year period condition can be fulfilled after the dividend is paid.

The above exemption is also available if the dividend is received by the foreign permanent establishment of the dividend recipient.

Dividends paid by the Polish companies to the foreign companies

In the case of dividend payment to the EU resident companies, EEA (European Economic Area) resident companies and Swiss companies the exemption from withholding tax will apply upon the condition of at least 10% (25% for Swiss companies) shareholding for an uninterrupted period of at least 2 years. The two-year period condition can be fulfilled after the dividend is paid.

The above exemption is also available if the dividend is received by the foreign permanent establishment of the dividend recipient. The residence of the dividend recipient should be confirmed with the certificate of the tax residence issued by recipient's tax administration.

If no aforementioned exemption applies, dividends paid to non-residents are subject to withholding tax. The rate of withholding tax depends on whether there is a tax treaty between Poland and the shareholder's country of residence:

- if no tax treaty exists between Poland and the shareholder's country of residence, the withholding tax rate is 19%; or
- if a tax treaty exists between Poland and the shareholder's country of residence, the withholding tax rate depends on the tax treaty. The rate ranges from 0% to 15%. Utilizing the decreased rate may depend on other conditions, usually the level of shareholding.

The decreased rate of withholding tax specified in the tax treaty is available provided that the dividend payer has a certificate of residence of the dividend recipient.

Dividend received by the Polish companies from foreign companies

As a rule, dividends received by Polish tax residents from foreign companies are aggregated with other taxable revenues subject to CIT under the general rules. However, the withholding tax payable abroad may be credited against CIT liability in Poland (although the credit may not exceed CIT attributable to the dividend-type income).

In case of dividend payment received from EU resident companies, EEA resident companies and Swiss companies, the exemption from withholding tax will apply upon the condition of at least 15% (25% for Swiss companies) shareholding for an uninterrupted period of at least 2 years (as from 1 January 2009 the required shareholding level for EU and EEA residents will be decreased to 10%). The two-year period condition can be fulfilled after the dividend is paid.

This exemption is also available for EU and EEA companies if they conduct their business activity through a permanent establishment located in Poland and the received dividend is connected with the permanent establishment.

The exemption is not applicable if the dividend income is received as liquidation proceeds.

Furthermore, the Polish tax regulations also provide underlying tax credit related to dividends received by a Polish company from an entity which:

- is not a resident of EU, EEA state or Switzerland; however
- Poland has concluded a double tax treaty with the country of its tax residence.

This underlying tax credit is available upon the condition of at least 75% shareholding for an uninterrupted period of at least 2 years. The two-year period condition can be fulfilled after the dividend is paid.

Taxation of Interest, Royalties and Intangible Services

Generally, interest paid to foreign tax resident is subject to a withholding tax at a rate of 20%, unless a relevant double tax treaty provides for a reduced tax rate.

Similarly, the 20% withholding tax applies to royalties and certain intangible services (such as consulting, accounting, market research, legal services, advertising, management and control, data processing, human resources, guarantees and other services

of a similar nature), unless a relevant double tax treaty provides otherwise. In general, payments for intangible services are classified under double tax treaties as business profits that are not subject to withholding tax in the source country.

Additionally, the amendment to the CIT Act of 18 November 2004 implementing the Interest and Royalty Directive provides that the withholding tax rates applicable to the interest and royalties in some cases will be subject to a gradual reduction according to the following timetable:

- from 1 July 2005 until 30 June 2009 – the applicable rate was 10%;
- from 1 July 2009 until 30 June 2013 – the applicable rate currently amounts to 5%;
- as of 1 July 2013 – the exemption applies.

In principle, in order to benefit from the above reduction in tax rates, the following conditions should be met:

- the said payments are made by a taxpayer having its place of the registered office or place of management in Poland or (under certain conditions) by a Polish permanent establishment of a company being a taxpayer in another EU country on its world-wide income;
- the said payments are made for the benefit of a company which is a taxpayer in another EU country on its world-wide income, or (under certain conditions) such a company's permanent establishment located in another EU country;
- the final recipient of the said interest payments is a company which is a taxpayer in another EU country on its world-wide income;
- there is at least a 25% direct shareholding relation between the recipient and the payer (i.e. the recipient has at least 25% of shares in the payer or the payer has at least 25% of shares in the recipient), and the shares are held or will be held uninterrupted for at least a 2-year period;
- this benefit is also available when the recipient of the interest (royalties) is a sister company of a Polish company paying the interest (royalties), provided that the parent company directly holds at least 25% of shares in both sister companies uninterrupted for at least 2 years.

If the requirement to hold the shares for 2 years is not satisfied at the time of payment of the interest (royalties), benefit can still be gained from the reduction (the exemption). However, if the shares are disposed of before the 2-year period lapses, the exemption expires and the company paying the interest (royalties) is required to pay the withholding tax according to a relevant double tax treaty and, as the case may be, it may be also obliged to pay penalty interest.

The above mentioned regulations apply to companies incorporated in EU member states, and to the companies from the Swiss Confederation. The list of eligible companies is provided in an enclosure to the CIT Act.

Generally the entity paying interest, royalties or remuneration for purchase of intangible services withholds and remits the tax at the movement of payment. According to the definition included in the Polish CIT Act "payment" means fulfillment of the obligation to repay the debt in every form, including set-off or capitalization of the interest. A certificate of residency is needed in order to apply a reduced tax rate, or to refrain from withholding the tax in accordance with a double tax treaty, or to apply benefits resulting from the implementation of the Interest and Royalties Directive.

It should be stressed that according to CIT Act interest, royalties or remuneration for purchase of intangible services received in connection with activity realised by permanent establishment of foreign entity in Poland is basically treated as a taxable income of such a permanent establishment and subject to taxation under general rules. In such a case entity performing payment should not remit the tax, still, relevant certificate of residence as well as written statement that the analysed payments are connected with activity of permanent establishment should be provided by the foreign entity.

Carrying Losses Forward

The CIT regulations allow taxpayers to carry losses forward to future years. It is not possible to carry losses back and offset them against income in prior years. Losses may be offset against the income generated in the following five tax years. The maximum amount of a given year's loss offset in any single tax year may not exceed 50% of this annual loss.

The right to carry losses forward is always linked to the entity that incurred the losses, rather than to the entity's specific assets. This means that the tax losses are not transferable with assets or the business (e.g. if the whole of a given taxpayer's operations are transferred to another entity). Furthermore, only in the case of mergers can the tax losses of the surviving companies still be utilised, whereas the tax losses of the acquired companies are forfeited. If the merger results in the establishment of a new company, the tax losses of the merging companies cannot be utilised.

Group Company Regulations

The CIT Act allows for the creation of a "fiscal union" (or tax consolidated group), under which companies in a capital group are treated as a single taxpayer of CIT.

Poland

The basic requirements for obtaining the status of a tax consolidated group are the following:

- the capital group may be established only by limited liability companies or joint stock companies with registered offices in Poland;
- the average share capital of each member company should amount to at least PLN 1,000,000;
- the holding company should hold at least 95% of the shares in the remaining group companies;
- subsidiary companies cannot be shareholders in the holding company or other subsidiary companies in the group;
- none of the members of the group can have tax arrears in taxes which are state income (this condition is deemed to be satisfied if a member of the group pays the tax arrears together with penalty interest within 14 days of correction of the tax return / receipt of the tax decision);
- the holding company and the subsidiaries have agreed to establish the capital group for a period of at least three years by means of a notarial deed; the agreement must also be filed with the tax office which issues an administrative decision and registers the capital group if all the conditions are met.

After the creation of the tax consolidated group, the companies forming this group should additionally satisfy the following requirements:

- none of the companies included in the group can singularly benefit from income tax exemption not resulting from CIT act;
- the annual level of tax profitability of the group cannot be less than 3%;
- companies from the group cannot maintain relations with companies from outside the group resulting in a violation of the transfer pricing restrictions.

The fiscal union formed and registered with the relevant tax authorities is treated as a separate entity for CIT purposes, which results in particular in the following advantages:

- the losses of some of the members of the tax consolidated group can be offset against the taxable income of its other members;
- the regulations on transfer pricing do not apply to transactions between companies within the group;
- donations between companies within the group are deemed to be a tax-deductible expense for the donor;
- the simplification of tax formalities, as only one company in the group prepares a tax return.

Thin Capitalisation

The Polish CIT Act contains provisions on thin capitalization, restricting the debt / share capital ratio to 3:1. Interest paid on loans in excess of this ratio is not tax-deductible. When calculating the debt-to-equity ratio, some additional debts to direct and indirect shareholders are taken into account. These regulations apply when loans are granted to a company by:

- a shareholder owning directly at least 25% of the voting shares;
- shareholders jointly owning directly at least 25% of the voting shares;
- another company, if the same shareholder owns directly at least 25% of the voting shares in each of the companies.

The term "loans" for the purposes of thin capitalization regulations is broad and includes debt securities, deposits and irregular deposits. The thin capitalization restrictions cover loans granted by foreign as well as Polish tax residents for CIT purposes.

Transfer Pricing

General

In principle, the Polish transfer pricing rules are based on the OECD Transfer Pricing Guidelines. As such, they introduce the concept of the "arm's length" level of transfer prices. If related parties conclude transactions on terms that differ from market practice and, as a result, the Polish entity discloses taxable income lower than it would disclose otherwise have disclosed, the taxable income of this entity will be adjusted in accordance with this principle.

Transfer pricing requirements apply also to Polish permanent establishments of foreign entities and foreign permanent establishments of Polish entities.

Statutory transfer pricing documentation

In order to facilitate transfer pricing audits, the regulations put on taxpayers the requirement to prepare special documentation concerning the terms of transactions concluded with related parties (statutory transfer pricing documentation). The requirement comprises each transaction with related entity (both cross-border and domestic), where the total amount arising from the contract or the amount actually paid in the tax year exceeds:

- EUR 100,000 – if the value of the transaction does not exceed 20% of the share capital defined in accordance with the regulations on thin capitalization; or
- EUR 30,000 – if the transaction concerns services, sales or use of intangibles; or
- EUR 50,000 – in all other cases.

The duty to prepare statutory documentation also relates to transactions where the payment directly or indirectly goes to a company having its registered office in a tax haven. The threshold is EUR 20,000 in these cases.

The statutory transfer pricing documentation must be prepared in Polish. Taxpayers must present it within 7 days of the request of the tax authorities. If the authorities find out that the taxpayer's profit is higher (or the loss is lower) than declared in connection with related party transactions, and the taxpayer does not provide them with the statutory documentation, the difference between the profit declared by the taxpayer and the profit determined by the authorities is subject to 50% taxation.

Advance Pricing Agreements (APA)

The provisions related to the APA procedure came into force on 1 January 2006. They allow taxpayers to verify the correctness of the pricing methodology applied in the domestic / cross-border related party transactions and ascertain its up-front acceptance of the transfer pricing methodology by the tax authorities. There are three kinds of APAs:

- unilateral;
- bilateral; and
- multilateral agreements.

Before submitting the APA application, the taxpayer may request that the Ministry of Finance clears doubts regarding the individual case, in particular if it is useful to seek an APA, what information is necessary, what is the procedure and when the decision can be expected.

The APA application can be submitted by the Polish entity only. The fee should be paid within 7 days afterwards. In the case of any doubts regarding the pricing method chosen by taxpayer or documents enclosed to the application, the Ministry of Finance may request additional explanations. In the end, the taxpayer receives a decision with a validity of no more than 5 years. Upon request it can be extended for further 5-year periods.

The proceedings should be finalized as follows (i) unilateral APA – no later than in 6 months, (ii) bilateral APA – no later than one year, and (iii) multilateral APA – no later than in 18 months. The fee is 1 percent of the transaction value, up to the limit of EUR 1,250 – 50,000 (depending on the type of APA).

Taxpayers requesting APAs in Poland must choose one of the OECD methods, describe how it will be applied, indicate the circumstances which may influence the correctness of the pricing methodology, prepare documentation used as a basis for setting the level of transactional prices, inter alia agreements

and other documents indicating the intentions of both parties and propose tax years to be covered by the APA.

Tax information

Taxpayers conducting transactions with foreign related parties are subject to certain notification requirements. In particular:

- where a taxpayer and a related foreign entity engage in transactions exceeding EUR 300,000 in the tax year, the tax authorities must be informed of the transaction within three months from the year end;
- where the foreign entity has a representative office or permanent establishment in Poland, the tax authorities must be informed if the value of transactions exceeds EUR 5,000.

Branches of Foreign Companies

Foreign companies have been able to establish branches in Poland since 1 January 2000. The range of activities of these branches is limited to the scope of activities of the foreign entity. Establishing a branch requires registration in the National Court Register. Branches are subject to similar tax rules as those imposed on limited liability and joint stock companies.

Foreign companies may also operate in Poland in a form of representative offices. The range of activities of representative offices is limited to representation and advertising.

VAT Rates and Regulations

Generally, the Polish VAT regulations are based on EU VAT Directives. However, the VAT regulations are subject to significant changes in 2011. Due to economic downturn the VAT rates with respect to majority of goods and services are increased starting from 1 January 2011. In addition certain VAT regulations had to be adjusted in order to better comply with EU directives (scope of VAT exemptions, rules of free of charge delivery of goods, etc.). The general principles of the new system are presented below.

VAT is a broad-based tax levied on the supply of goods and services in Poland. A Polish entity is required to register for VAT once its annual turnover on transactions subject to VAT exceeds PLN 150.000 (if the entity starts business activity during the year, the limit is calculated as proportion of number of days of running business activity in the year and the limit for whole year). Foreign entrepreneurs have to register for VAT in Poland before they start any VAT-able activity in Poland (except for limited clearly enumerated cases). Generally, VAT is imposed on every supply of goods and services at the base or reduced VAT rate, unless the transaction is exempt from Polish VAT.

The base rate of VAT is 22% and is charged on most goods and services.

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A reduced VAT rate of 8% is imposed on the sale of such products or provision of services as:

- selected foodstuffs (not being subject to 23% VAT rate);
- specific medicines and goods used in health care;
- catering and restaurant services;
- veterinary services
- selected services related to TV and radio broadcasting
- selected transport services;
- municipal services (e.g. mains water supply, sewage treatment, street maintenance, plowing etc.);
- fertilisers.

A reduced VAT rate of 5% is imposed on the sale of such products as:

- selected foodstuffs (not being subject to 8% or 23% VAT rates);
- books and magazines for experts.

A reduced 0% VAT rate is levied (under specific conditions) on the intra-Community supply of goods, exports of goods, as well as some international transport services and services related to international transportation.

A reduced 0% VAT rate may be applied to some domestic supplies, e.g. equipment for selected ships and airplanes.

Selected health care, financial, insurance, educational and cultural services etc. are exempt from VAT, which accordingly prevents the taxpayer from recovering input VAT incurred in relation to such services.

The tax due to the Tax Office is calculated as the surplus of output VAT charged on sales over recoverable input VAT stated on purchase invoices.

Transactions between VAT taxpayers must be documented with a VAT invoice. Sales to individuals who do not conduct business activities must be registered by a fiscal cash register if the turnover with individuals exceeds a specific threshold. This threshold generally amounts to PLN 40,000 (approx. EUR 10,000) but sales of several kind of goods need to be registered in a fiscal cash register independent of the value of sales during the year.

Registered VAT taxpayers are obliged to submit monthly VAT returns (or quarterly VAT returns) to the appropriate tax office and keep registers of purchases and sales subject to VAT. In addition, EC Sales and Purchase Lists and Intrastat (in case the statutory thresholds are exceeded) declarations must be submitted by the taxpayer with respect to its intra-EU transactions.

VAT that is due must be paid by the 25th day of the month following the month (quarter) in which the VAT obligation arises.

Although Polish VAT law is generally compliant with the Sixth EU Directive, it contains various country-specific provisions and requirements, which are not common in other local VAT regimes. These are usually very troublesome for foreign entrepreneurs. In consequence VAT and Intrastat compliance is often a challenge and is being outsourced to firms experienced in Polish VAT settlements. Deloitte offers such assistance.

In the situation when a foreign entity (from outside the European Union) not registered for VAT purposes in Poland purchases goods/services in Poland, based on certain rules defined in the decree of the Ministry of Finance, it may apply under several conditions for a refund of input VAT incurred on purchases in Poland, on a reciprocity basis. Foreign entities within the EU may apply for a refund of input VAT by submitting electronic VAT refund applications.

Gambling tax

The economic activity in the area of games of chance and mutual betting is out of scope of VAT. Instead of this, the entrepreneurs conducting this type of activity are subject to gambling tax.

Excise Duty

Excise duty is a consumption tax levied on certain goods which could be divided into four groups such as: energy products, electricity, alcohol beverages and tobacco products. Excise duty is also imposed on cars.

The excise duty legislation is set out in a number of EU Directives, which means that each EU Member State may charge its own rates of excise duty along with differences in local country policy.

The following activities are subject to excise duty:

- the production of excise goods;
- the movement of excise goods outside a tax warehouse;
- import of excise goods;
- intra-Community acquisition of excise goods excluding intra-Community acquisition to a tax warehouse;

Excise regulations indicate some other activities which may be subject to excise duty.

There are special rules concerning taxation of electricity, it is chargeable at the moment of supply to end user.

Excise duty is calculated either as a percentage of the value of goods produced (or the customs value of the commodities) or on a volume basis (fixed rate per unit).

The production of excise goods could be performed exclusively in a tax warehouse (excluding electricity and cars).

The holding and movement of excise goods is subject to strict controls and special procedures apply. In respect of excise goods, there is possible to apply the excise duty suspension procedure. However, there are some conditions (documentation requirements, excise guarantee) which should be fulfilled in order to apply this procedure.

Currently, intra EU movement of excise goods under duty suspension procedure is based on a paper process. However, a new electronic system "EMCS" is being implemented in Poland and will be binding as of 1st January 2011.

Tax on Income Derived From Capital (Natural Persons)

As a rule, capital gains derived in Poland are subject to a 19% flat rate tax. From 1 January 2005, capital gains also realized outside Poland are subject to 19% flat rate tax (previously, they were subject to progressive taxation). Income derived from the sale of shares is subject to a 19% flat rate tax and should be declared in the separate annual tax return PIT-38 disclosing the capital gains realized during the given tax year.

The following income is also subject to a 19% flat rate tax:

- interest – 19%;
- dividends – 19%.
- proceeds from investment funds, etc.

Personal Income Tax (PIT)

Under the Polish PIT Act, individuals may be subject either to limited or unlimited tax liability in Poland. The tax status of a given individual depends solely on whether he has his place of residence in Poland. Up to 1 January 2007, the term "place of residence" was not defined under the Polish PIT Act and the common practice was to turn to its Civil Code definition, which stipulated that the "place of residence" was a place in which given individual stays with the intention to stay permanently. Starting from 1 January 2007, the amendment to PIT Act introduced the definition of residency for PIT purposes.

Given person is considered to have a place of residence in Poland if he / she:

- has closer economic or personal links with Poland (centre of vital interest), or
- stays in Poland for a period exceeding 183 days in calendar year.

Provisions on tax residency should be in Poland is currently determined with the use of the double tax treaty concluded by Poland.

Individuals not having their place of residence in Poland are viewed as Polish tax non-residents subject to limited tax liability in Poland, whereas those having their place of residence in Poland are regarded Polish tax residents in Poland subject to unlimited tax liability in Poland.

The status of a Polish tax resident implies that the total worldwide income received by a given individual is subject to taxation in Poland. Polish residents for personal income tax purposes are obliged to disclose in their Polish tax returns private income such as interest, dividends, royalties, capital gains, real estate rental income or income derived from business activity rendered personally (including participation in civil partnership and limited partnership). The above income should be reported and taxed in Poland taking into account relevant double tax treaty provisions. An individual enjoying Polish tax non-resident status is, on the other hand, taxable in Poland only on income derived for work performed on the Polish territory, or from other Polish sources and is entitled to 20% taxation on specific types of income (e.g. fees received under the civil law contracts or resolution of shareholders) as opposed to progressive taxation at 18% and 32%.

The tax year for individuals is equal to a the calendar year.

In general, cash and benefits received by an individual constitute his taxable income, unless a particular income is tax exempt in Poland according to Polish domestic law and the appropriate Double Tax Treaty (if relevant).

Examples of income exempt from taxation in Poland:

- amounts due to the individual with respect to business trips (per diems, travel and accommodation expenses), up to the limits defined in the provisions of the Polish law;
- amounts paid by the employer for raising only the professional education of its employees (e.g. the value of courses and trainings which have been undertaken in order to raise professional qualifications as agreed by employer).

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Selected possible deductions from income:

- Polish social security contributions or EU (EEA) statutorily due social security contributions paid in the given year provided that they were not deducted for tax purposes in this other country and were not due on the income exempt from taxation in Poland;
- donations granted for Polish and equivalent organizations in the EU states or EEA countries or Switzerland conducting activities in the field of public welfare, donations granted for religious purposes (except for donations to natural persons) and the volunteer blood donations up to a level of 6% of the individual's income;
- donations for church charity purposes (applicable only to church legal entities) no deduction limit provided (some additional conditions must be met to take advantage of this deduction);
- contributions paid to the Polish social security system;
- expenses incurred by an individual for using Internet in the place where the individual lives, up to the value of PLN 760 (as of 1 January 2011 the Internet deduction will be applicable not only to the expenses incurred in the place of individual's residence);
- expenses incurred for rehabilitation purposes (some additional conditions must be met to take advantage of this deduction)
- interests on loans drawn for housing purposes (under specific conditions if the loan was granted between 1 January 2002 and 31 December 2006).

Selected possible deductions from tax:

- 7.75% of the assessment basis of statutory due healthcare contributions paid by an individual in a given calendar year for either his or her national healthcare insurance in Poland or in another EU or EEA countries or Switzerland provided that they were not deducted for tax purposes in this other countries and were not due on the income exempt from taxation in Poland;
- Child tax deduction in the amount of PLN 1 112,04 per year per child. This deduction is applicable for parents bringing up children under 18 years of age or children under 25 years of age enrolled into a school or university.

Additionally please note that under Polish PIT Law regulations, it is possible to allocate 1% of the annual tax liability to a selected Polish welfare organization. It does not influence the final tax liability of the individual (funds are transferred by the tax office based on the taxpayer's suggestion indicated in the annual tax return).

PIT rates for 2011 are as follows:

Polish tax brackets valid in 2011	
up to PLN 85 528	18% of taxable base less PLN 556.02
over PLN 85 528	PLN 14 839,02 plus 32% of excess over PLN 85,528

As a rule, the PIT rates indicated in the above table are applicable to an individual's total income.

Notwithstanding the above, the Polish PIT Act provides for flat / linear taxation on certain sources of income (which applies instead of progressive taxation). The following items are subject to a flat tax rate:

- capital gains (see point 2.2.6) – 19%;
- income from the sale of real estate which was purchased from 1 January 2009, provided that it is not related to the business activity carried by a given person; if the sale of the real estate takes place after five full calendar years from the date of purchase or the sale takes place before five full calendar years but specific conditions are met, no tax is levied, otherwise – 19% tax on the proceeds from the sale of the real estate;
- Polish source income derived by non-residents from independent artistic, literary, scientific, educational and journalistic activities, copyrights and inventions, as well as from personal service contracts, specific task contracts, managerial contracts, or similar contracts and from board member fees – 20%;
- income derived from conducting business activities in Poland – 19% (provided that the entrepreneur declares his choice of 19% flat tax rate by the date as determined in PIT Act; otherwise he is subject to taxation of his business activity income under general rules).

Apart from the above, according to the provisions of the Act on lump-sum taxation of certain revenues earned by private individuals, the taxpayer may enjoy lump-sum taxation on certain sources of income if he chooses to apply this taxation system instead of applying the progressive taxation governed by the provisions of PIT Act. Lump-sum taxation is applicable to such income as:

- revenues derived from renting real estate (if such tax regime is chosen by the taxpayer by the due date) 8.5% total gross proceeds (applicable as of 1 January 2010);
- revenues derived from performance of certain types of business activity;

Tax is generally due on a monthly basis (under certain circumstances, an entrepreneur may pay taxes due on a quarterly basis). Polish employers are obliged to calculate, withhold and pay the tax advances due on their employees' remuneration to the tax office relevant for the employer's place of the registered office.

Individuals who receive income from abroad are personally responsible for the payment of monthly tax advances due on this income (there is no obligation to file monthly tax returns).

As a rule, every taxpayer is obliged to file an annual tax return disclosing his aggregate annual income at the end of the tax year. The deadline for filing the tax return and paying the annual tax liability is 30 April of the year following the tax year for which the return is filed.

Taxpayers may file the annual tax return jointly with their spouses if the following conditions are met simultaneously:

- both spouses are subject to marital co-ownership for the entire tax year (no prenuptial/postnuptial/*rozdzielność majątkowa* agreement was put in place between spouses indicating how their assets would be allocated in case of divorce),
- both spouses are married for the entire tax year,
- neither of the spouses conducts business activity taxed at linear or flat rate (including participation in partnerships).

Additionally, to qualify for joint filing:

- both spouses should be subject to unlimited tax liability in Poland (Polish tax residents) or
- one spouse should be subject to unlimited tax liability in Poland and the other spouse should be subject to unlimited tax liability of another EU or EEA country (possessing certificate of tax residency issued by this other country) and at least 75% of their world wide income should be taxable in Poland or both spouses should be subject to unlimited tax liability of another EU or EEA country, should possess certificates of tax residency issued by this other country and at least 75% of their world wide income should be taxable in Poland.

Tonnage tax

As from 1 January 2007, based on the Tonnage Tax Act, the qualified ship-owners performing certain commercial shipping activities in international traffic are entitled to subject their incomes to tonnage tax instead of income tax.

Please note that since tonnage tax is regarded as a sort of public aid (income subject to tonnage tax is out of scope of CIT / PIT

taxation) the Tonnage Tax Act should be authorized by the European Commission. The respective authorization was granted in the decision of 18 December 2009 - C 34/07 (ex N 93/2006).

The qualified ship-owners are:

- individuals and legal entities being the Polish tax residents performing commercial shipping activities in the international traffic listed in the Tonnage Tax Act,
- foreign tax residents (i.e. individuals as well as legal entities) performing the above activities in Poland,

which for the purposes of performing these activities use the vessels of the minimum capacity of 100 gross register tons (GT) each.

The main activities that can be taxed with tonnage tax are transportation of passengers and cargo as well as selected offshore operations. Please note that some other commercial activities (e.g. lease of the containers, ship management services) may also be subject to tonnage tax provided that they are related to the activities mentioned above.

Generally, the tonnage tax base is calculated as a multiplication of the daily rate (determined in the Tonnage Tax Act and depending on the capacity of a given vessel) and the period of exploitation in a given month of the all ship-owner's vessels subject to tonnage tax. The standard tonnage tax rate is 19%. Income (in the part not re-invested in the ownership, renovation, modernization or reconstruction of another vessel within 3 years) from the sale of ships is subject to taxation with the application of 15% tax rate.

Double Tax Treaties

Polish PIT and CIT regulations provide that a credit method of avoiding double taxation is used, unless the specific double tax treaty states otherwise. Poland has signed Double Tax Treaties with 84 countries. Most of the treaties signed by Poland are based on the 1977 OECD Model Convention, although some exceptions appear in several treaties.

Tax on Civil Law Transactions

The following acts are subject to tax on civil law transactions:

- contract of sale and exchange of goods and property rights;
- loan agreements;
- donation agreements – to the extent related to taking over debts, encumbrances or the liabilities of the donor;
- annuity agreements;

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- agreements on division of inheritance and agreements on the dissolution of co-ownership – to the extent related to the repayments or additional payments;
- establishment of mortgage;
- establishment of usufruct for consideration (including irregular usufruct) and servitude for consideration;
- irregular deposit agreements;
- partnerships / companies deeds (articles of association);
- amendments to the above transactions resulting in the increase of the tax base;
- court judgments and settlements having the same result as above transactions.

In principle, the tax liability arises at the time when the transaction takes place. The taxpayer is obliged to submit the tax return and to pay the tax within 14 days from the day when the tax liability arose, unless the tax is collected by a tax remitter.

The exemplary tax rates are as follows:

on contracts of sale:

- of the real estate, other tangibles and selected property rights related to the real estate – 2% of their fair market value;
- of other property rights – 1% of their fair market value;

on loan agreements – 2% (0.5% on the loan granted by the direct shareholder) in partnership of the amount of the loan;

on the establishment of mortgage:

- to secure an existing liability – 0.1% of the amount of the secured liability;
- to secure a liability of an unfixed amount – PLN 19;

on partnerships / companies deeds:

- 0.5% of the value of the contribution to the partnership or 0.5% of the company's share capital;
- 0.5% of the increase in the contribution or 0.5% of the increase in the share capital;
- 0.5% of the amount of the additional payments;
- 0.5% on the annual market value of the usufruct of objects or property rights vested in the partnership without consideration.

The taxpayers are determined taking into account the nature of a given civil law transaction, e.g.:

- contract of sale – the buyer;
- loan agreement – the borrower;
- partnerships / companies deeds – partners in case of the civil law partnership and the partnership / company in all of the remaining cases.

A notary public is a remitter of the tax when civil law transactions are executed in the form of a notarial deed.

Local Taxes and Charges

Local taxes include:

- real estate tax;
- road vehicle tax (imposed only on trucks and buses);
- agricultural tax;
- forestry tax;
- dog ownership tax.

Local communities are entitled to establish rates for certain taxes. However, these cannot exceed the maximum limits set by the Parliament or decrees of the Minister of Finance.

Inheritance and donations tax

Polish tax system includes also an inheritance and donations tax imposed on the acquisition, by the individuals, of goods located in Poland and property rights executed in Poland among others through inheritance, donation and usucaption.

Stamp Duty

Stamp duty is payable on certain submissions and administration acts, including:

- official acts;
- certificates;
- permits;
- other documents, e.g. power of attorney.

Rates vary from PLN 1 to PLN 11,000.

3. Legal Entity

Principal forms of doing business

Companies can take a variety of forms, including joint stock company (SA - Spolka Akcyjna) and very popular - limited-liability company (Sp z o.o. - spolka z ograniczona odpowiedzialnoscia). A form reserved for specific occupations like architects, lawyers or doctors is a professional partnership company.

Joint Stock company (SA)

The minimum start-up capital for a joint stock company is PLN 100,000, of which 25% must be paid up before registration. One or more founding members, who must sign an article of association, can establish a joint stock company.

Reserve capital is 8% of annual net profits, until reserve reaches one-third of share capital.

The company must be founded by at least one natural or legal person. Single – shareholder limited liability company cannot establish a joint stock company where it will be the one and only shareholder. Once the company has been established, one shareholder may buy out others. There are no residence or nationality requirements unless otherwise stipulated in the international agreement to which Poland is a party.

A supervisory board with at least three members, each appointed for a term of up to five years, is required. Both: no residence or nationality requirements, but the chairman of the board for banks registered in Poland must have a working knowledge of Polish.

The minimum value of share is PLN 0,01 (1 grosz). The most common type of shares are registered, bearer, common or preferred.

Limited-liability company (Sp z o.o.)

The minimum capital required to establish a limited-liability company is PLN 5,000. A limited-liability company may have a single shareholder (subject that single – shareholder limited liability company cannot establish a limited liability company where it will be the one and only shareholder).

If share capital exceeds PLN 500,000 and there are more than 25 shareholders, the company must have a supervisory board (or supervisory commission) with at least three persons.

The minimum share value is PLN 50. Shares do not exist in a document form and as such can only be the registered ones.

There are no residence or nationality requirements as to the members of the management board however work permit may be required in certain circumstances.

Establishing a branch or representative office

A branch may be established by foreign investors provided that there is a reciprocity rule between the Republic of Poland and the country of the investors' origin (this requirement does not apply to the entrepreneurs coming from EU and European Economic Area member countries as they can establish branches regardless of the reciprocity rule). The Law on Freedom of Economic Activity of July 2004 stipulates that a branch should be registered in the National Court Register under the name of the investor plus translated into Polish a legal form of a foreign investor with addition "branch in Poland". A branch may conduct only those activities that are related to the business of the foreign investor. A branch is entitled to generate income.

Foreign investors may also establish a representative office which should be registered with a separate register at the Ministry of Economy. A representative office is permitted to conduct only the following activities: advertising and promotion of the parent company.

4. Labour and Wages

The employment market

The unemployment rate in Poland - according to the Central Statistical Office (Główny Urząd Statystyczny) - stood at 18% at the end of 2005. Poland boasts a skilled and educated workforce. Consequently, finding local managers is becoming less difficult. Skilled labour is generally concentrated in central and northern Poland, specifically in the regions of Warsaw, Gdansk, Silesia and Poznan. The eastern border regions suffer from high structural unemployment and low levels of investment. The recent rise in unemployment has diminished labour mobility among middle managers. English-language skills are now a basic requirement for most white-collar positions.

Employees' rights and remuneration

Poland's Labour Code – as well as a huge number of other labour law acts, regulates working hours, work safety, minimum wage, non-discrimination in employment and collective bargaining, personnel files and employment termination. Contracts may be concluded for an indefinite period of time, for a definite period (including also contract for substitution of an employee during her/his absence at work) or for the time of completion of a specific task. Any such contract may be preceded by a contract concluded for a trial period.

Employers must provide at least the minimum terms and benefits indicated in the Labour Code, modifying them only to provide more favourable terms for employees. Collective-bargaining agreements may not deal with issues already covered in the Labour Code or those having to do with termination, workplace order and discipline, and maternity leave. Industry-wide

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agreements must be registered with the Ministry of Labour and Social Policy (www.mpips.gov.pl), and company agreements with a regional labour inspector.

The Trade Union Law protects the country's trade unions. Unions enjoy considerable influence on termination and other labour issues. Wage bargaining is almost always conducted at the enterprise level. Workers who are not members of a recognised union are still entitled to have their rights protected by a union. Unions must give employers relevant information about members in the workplace; failure to comply with the request releases the employer from the agreement with the union.

Discrimination based on sex, nationality, race or union membership is illegal.

Poland's labour law is more stringent than is typical in Europe. Enforcement can be rigorous and inspections by state authorities frequent. Labour courts tend to side with employees.

Working hours

The standard average working time cannot be longer than 8 hours per day and 40 hours a week. If it happens that these limits are exceeded, the employee shall be entitled to extra remuneration for overtime. Overtime may not exceed four hours a day and 150 hours per calendar year per worker. The legal rate for overtime work is a 50% premium for each extra hour and a 100% premium for each hour of work provided on Sundays, statutory holidays or in the night.

Wages and benefits

The Council of Ministers set the gross minimum monthly wage at PLN 1317.00. There is only one minimum wage across all sectors, regions and occupations. Wages in the private sector are far higher than those in the public sector. Currently, more and more Poles in managerial positions earn salaries comparable to expatriate personnel.

5. Education

As the Polish education system was geared to the needs of a centrally planned economy (and, in particular, to heavy industry) it was unable to provide much training in areas such as finance and information technology (IT) that are important to an emerging market economy. As with other public services, the education sector suffered from a sharp fall in pay and status relative to other parts of the economy in the 1990s, although teachers' pay have been improved more recently.

Since 1989, the Polish system of higher education has done much to catch up and broaden its curriculum. The state sector's activities have been complemented by a thriving private sector, as both

sectors expanded to meet a rapid increase in demand. The participation rate in higher education has also increased sharply. Number of students increased from 403 th. in the academic year 1990/91 to 1.930 th. in academic year 2007/08, a figure that compares well with western Europe. As academic salaries fell behind in the 1990s, many teachers with tenured posts in the state system also worked in the private university-level schools, of which there were 326 in 2007/2008. Of the 1.93 million of students in 2007/08, 659 th. were at private institutions, many of which are business schools (23% of all students). Universities (both public and private) have also started to cater to the needs of mature students by providing part-time, evening and weekend studies.

There are currently 18 fully accredited traditional universities in Poland, 20 technical universities, nine medical universities and five universities for the study of economics. In addition to these institutions there are then nine agricultural academies, three pedagogical universities, a theological academy and three maritime service universities. Amongst these are the seven higher state academies of music. All of these public academic institutions are supplemented by a number of private educational institutions. Altogether there are almost 500 higher education entities, which is one of top rates in Europe. The OECD's International Student Assessment Programme, ranks Poland's educational system as the 23rd best in the world, which is around OECD average

6. Infrastructure



Infrastructure Road network The poor state of the road network is one of the weakest aspects of Poland's infrastructure and a major handicap to business and economic development. The sharp rise in private car ownership has also put pressure on the country's roads. There are only a few short stretches of motorway (916 km at the end of 2009), and two-lane roads connect most major cities (1200 km). Road improvement and motorway building were to have been critical components of the any newly elected Polish government. However, many practical difficulties - including land purchase and other planning problems - restrained governments from implementing new motorways development programs. In recent years - due to EU Funds for infrastructure investments - road construction spending saw increase. Three major motorways connecting the entire country are being built. Many road intersections are in a planning phase - either with contracts signed or construction in progress. Most of them are planned to be executed by mid 2012 to be ready for Euro 2012. By the end of 2012, eight of ten largest Polish cities will be connected by a motorway network, being a part of Paneuropean transport network.

Road network

Motorways and express roads are part of national roads network. As of December 2008 Poland had 383,313 km of public roads, of which 122,080 km were unpaved. The quality of the Polish road transport system has been stalling the country's economic development by slowing down the movement of goods and people. In 2007 only 3% of Polish roads met EU standards. Although the total length of roads is relatively high, Poland is missing the minimum required density of motorways and expressways. 4,808 km (2,990 mi) of the routes were classified as part of TINA European transport corridors. According to GDDKiA national roads condition report of 2008, 25% of national roads conformed handling of 11.5 tons per axle loads

Railway network

The express passenger services of Polish State Railways (PKP) are of a high quality, with good intercity links to neighbouring European cities such as Prague, Berlin and Vienna, and to Polish cities en route.. No high-speed lines exist in Poland though some 500 km of track allow traveling at 160 km/h, especially on the Central Trunk Line (CMK) that links Warsaw with Katowice and Kraków. In 2008, the Polish government announced the construction of a dedicated high speed line based on the French TGV model and possibly using TGV style trainsets by 2020. The Y-shaped line would link Warsaw to Łódź, Poznań and Wrocław. This line would allow speeds of up to 320 km/h (200 mph). This project includes also an upgrade of Central Trunk Line to 250 km/h (160 mph) (or more) as this line features an LGV-like profile. As of 2008, EuroCity and EuroNight direct sleeping

trains have started operating between Moscow and Amsterdam, Basel and Munich via Warsaw and Poznan These trains consist of sleeping coaches from various rail operators being added to the train as it passes through their operation area.

Polish State Railways have recently started investing in track, signaling systems and stations. The Company is being restructured, with infrastructure being separated from inter-city and local train operations. The European Commission will put pressure on the government to liberalise transport services, but the government is likely to want to retain a strong influence on strategic sectors such as the national rail network. The lack of competition in this field is one of the reasons for this bad condition of Polish State Railways.

Air Transport

The national airline, LOT Polish Airlines, was partially privatised in 1999, when the SAirGroup (based around Swissair) bought an initial 37.6% stake. The collapse of SAirGroup in 2001 returned LOT to state ownership, and in 2002 LOT drew closer to Germany's Lufthansa by joining the Star Alliance network of airlines. LOT is facing growing competitive pressures, as EU membership has compelled Poland to liberalise access to its airspace. According to the latest announcements, British Airways may be interested to become a major stakeholder in the upcoming 2011 LOT privatisation. The low fare airlines have been quick to move in, with easyJet (UK), Ryanair (Ireland), Wizzair (Poland/Hungary) and SkyEurope (Slovakia) all offering flights from a variety of airports in Poland.

Poland is also battling with other countries in the region to become the regional transport hub for east-central Europe, but rapid growth in passenger numbers in recent years has exposed the lack of capacity at Polish airports. The busiest airport in Poland, Warsaw's Okecie (8,282,035 passengers and 50,143 tonnes of cargo per year), is the main international hub for LOT and currently serves as the destination for around 75% of all major international flights into Poland. Poland's second-busiest airport is in Krakow and the third in Katowice. The airport in Gdansk is also developing rapidly.

Other Polish cities, like Wrocław, Gdańsk, Kraków and Poznań all have major international airports. In preparation for the Euro 2012 football championships a number of airports around the country is being renovated and redeveloped. This includes the building of new terminals with an increased number of jetways and stands at both Copernicus Airport in Wrocław and Lech Wałęsa Airport in Gdańsk.

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Water Transport

On the Baltic Sea coast, a number of large deep water seaports exist to serve the international freight and passenger trade. They serve large ships, also the ro-ro passenger ferries of Unity Line, Polferries and Stena Line which connect Poland with Scandinavia. The ports of Szczecin-Swinoujscie and Gdynia have seized new market opportunities, catering, for example, to tankers which carry oil from the Middle East. In 2010, Poland's two largest ports, Gdansk and Szczecin-Swinoujscie, handled 24.8 m tonnes of cargo and 19.2 m tonnes of cargo, respectively.

Riverine services operate on both domestic coastal routes and on almost 3,812 km of navigable Polish rivers and canals. Most notable canals in Poland are the Danube–Oder and Elbląg canal.

Telecommunications

Although Poland's communications infrastructure has improved immensely since 1989, progress has been uneven, with use of cellular telephones rising rapidly (44,96 million mobiles being used at end of 2009, which amounts to 99,2% of market penetration), but the number of the landlines is decreasing, especially in the countryside (12.3 million at the beginning of 2006, in 2007 only 10.3 million). The former state monopolist, Telekomunikacja Polska (TPSA), has been mostly privatised, with France Telecom buying the largest share. Various other companies have entered the fixed phone market, but generally aiming for niches (e.g. Netia covering mostly business). Although prices have reduced and availability has increased considerably since the introduction of competition, the fixed-line market is still dominated by the TPSA.

Difficulty to get the fixed line resulted in mobile cellular telephone use boom.. All mobile phone operators in Poland use GSM. There are three major competitors managing comparable market shares, Era, Orange Polska (soon to be a part of T-Mobile), and Plus GSM. The fourth network, Play Mobile, owned by Netia and Novator Telecom, started offering UMTS network services in early 2007. All mobile operators have UMTS services in the major cities, with nationwide coverage to be implemented soon..

7. The Most Active Industries/Sectors

Manufacturing

Manufacturing led the economy's recovery after the system-change recession in 1989-91. It briefly weakened in 2000-01 in Poland's first conventional cyclical downturn, but then began to grow increasingly strong from mid-2002, on the back of rising export. Within manufacturing, heavy industry (and especially steel) has generally found it difficult to adapt to new market conditions, but some sectors have seen notable success. These include the motor industry and the furniture sector. The production of construction materials is also a success story, even if

domestic construction is only now emerging from a prolonged downturn. The food and drinks sector is the largest branch of manufacturing.

Remaining state ownership in manufacturing is concentrated in the problematic sectors of defence equipment, shipbuilding and branches of the chemicals sector. The state also retains a considerable stake in oil refining.

Automotive Industry

Poland is well on the way to becoming a major car manufacturing centre, with several components manufacturers also setting up plants in the country..

Fiat of Italy is the major Western investor in the industry, and has had a presence in Poland for many years as a producer of small cars from its base in Bielsko-Biala in the south-west of Poland. Skoda (owned by German Volkswagen) and Renault of France, although they have no production in Poland, are also prominent on the domestic market. Opel/General Motors of the US, which built a greenfield assembly plant in the Gliwice special economic zone (SEZ) in Silesia, is another leading producer and its success has contributed to the unexpected resilience of the Katowice region. The VW Group has a significant presence in western Poland and is also a notable car producer.

In 2009 Opel started production of Astra IV in Gliwice and Fiat in Tychy increased production to 500 th cars.

Total investment in Polish automotive sector amounted to 28 bn USD. Automotive industry consists of nearly 900 companies, of which over 300 are foreign shared. There are 400 suppliers, including Delphi, Eaton, Bridgestone, Hutchinson, TRW, Isuzu, Lear or Pilkington . Poland is the 3rd largest bus manufacturer in Europe with plants of Solaris, Scania, Man or Autosan. It is expected that in the upcoming months Poland will experience a growing interest from producers and parts suppliers of electric cars.

Agricultural Production

The size of the agricultural sector in employment terms made it one of the most troublesome issues in Poland's EU accession negotiations. Although agriculture generated a small percentage of GDP (3,8%), it still accounts for around 16% of employment. The high level of agricultural employment (even if much of it is, in effect, hidden unemployment) relative to agriculture's share in GDP shows that substantial scope for restructuring exists. It also demonstrates the immense problems facing the rural economy and rural society in general in Poland. There are around 2 million farms, all privately owned, and most of them very small (the average farm size is only 8 ha), poorly equipped, and

often run by elderly farmers. Farms exceeding 15 ha account for almost 10% of all farms and cover almost half of total agricultural area. Around half of all farms are run on a subsistence basis, yielding little or no produce for the market. Poland is the leading producer in Europe of potatoes and rye and is one of the world's largest producers of sugar beets and triticale, rapeseed, grains, hogs, and cattle. Poland is a net exporter of processed fruit and vegetables, meat, and dairy products.

Construction

In the second half of the 1990s, commercial construction activity was concentrated in a handful of major cities - notably Warsaw, Poznan, Gdansk and Krakow - as they and their surrounding regions attracted the majority of inward investment, as well as a substantial share of new hotels, offices and housing developments. Construction activity was weaker elsewhere, because other regions missed out on inward investment and also because of the lack of progress in motorway construction. Construction slowed sharply from 1999, as high interest rates discouraged corporate investment. Despite the strong growth of the economy as a whole in 2004, the construction sector has been slow to recover, with signs of sustained growth only emerging in the first half of 2005. In years 2006-2007 construction sector was developing fast owing to both Euro 2012 and EU funded investments in infrastructure and growing housing market. This was significantly limited by 2008 financial crisis, though production of construction materials is now growing stronger, suggesting that the real level of construction activity, taking into account the grey economy, may be more robust than the official figures suggest. The cement industry was privatized in the first half of the 1990s and is dominated by a German-Belgian group, Heidelberg/CBR, the Lafarge group of France, the Dyckerhoff and Miebach companies (both of Germany), and Rugby and Readymix of the UK.

Financial Services

The financial services sector in general is well regulated. The banking sector is mostly in private hands and survived the economic downturn in 2008-2009, although currency depreciation and inter-bank money market standstill brought sector breakdown. In 2009 most toxic derivatives have been either settled or expired, and the system enjoyed higher liquidity. Overall, the financial services sector has so far escaped the crises that have hit severely some other post-communist economies.

2009 was difficult for the entire financial services industry in Poland. Banks operating in Poland recorded total revenues of 50 bn PLN and profits of almost 9 bn PLN (compared to 13 bn PLN in 2007). Network expansion stopped and performance audits led to staff restructuring and shut down of less profitable branches. Some banks (AIG, GMAC) made changes in ownership,

while other (Noble, Getin, Fortis) implemented consolidation to cut the costs. In 2010 Irish AIB sold its Polish subsidiary, profitable BZ WBK to Santander Bank.

Banking groups from Germany, France, Italy, the Netherlands and the US have a strong presence in Poland. For many Western institutions, the route into Polish banking was through buying stakes in the state-owned regional banking network. Subsequent consolidation in the west European banking market has led to a wave of mergers of their Polish subsidiaries. One of biggest M&A transactions was merger of Pekao and BPH in 2007, which produced a new market leader Bank Pekao (UniCredit) controlling at the start some 27% market share. In the recent years there were also new banking projects developed; Polbank, Allianz Bank, Alior Bank and Meritum. Currently there are almost 70 banks operating in Poland.

Traditional Industries

Steel Production

Output of crude steel fell sharply, from 20 million tonnes in the late 1980s to just 9,7 million tonnes in 2008 (7,2 in 2009). Some restructuring took place in the 1990s, with a few smaller plants closed on environmental grounds, and one major steelworks, Huta Warszawa, sold to an Italian concern, Lucchini (Huta Warszawa was acquired by Luxembourg's Arcelor in mid-2005). Steel production is concentrated in the south of the country, with 60% of output coming from two plants: Huta Katowice and Huta Sedzimir, which have been consolidated into a single company, Polskie Huty Stali (PHS). PHS was finally privatized in late 2003, sold to the UK-based LNM (now Arcelor Mittal Steel). Arcelor Mittal Steel, with operations in Romania and the Czech Republic as well as in Poland, has become the major force in central European steel production. Polish steel market foregoes further consolidation. Centrozłom was acquired by KGHM Ecoren and Zlomrex remains within Arcelor's interest. Arcelor itself is expected to acquire Cognor, in order to enlarge distribution market share. 2011 is expected to be profitable for the industry with at least 10% growth. Distributors expect higher demand for steel products due to infrastructure and Euro 2012 investments

Mining and Semi-processing

Although Poland remains one of the world's significant coal producers, mining and quarrying output has been falling relatively to total industrial production. Poland's deep-coal mining industry has been under pressure throughout the transition period as demand has fallen. At the same time, the strength of the trade unions in the sector has kept labour costs high, despite the sector's parlous financial state. A restructuring plan backed by the World Bank has led to a sharp fall in employment in the industry. The industry gained some temporary respite in 2004 as world coal and coke prices rose sharply, but a return to more

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normal market conditions re-emphasized the need for further restructuring. Today Polish coal mines are important players in the world coal industry. Kompania Węglowa is the second European coal producer (2009 revenue: 11,627 bn PLN) and other big producers enjoyed sound results. Jastrzębska Spółka Węglowa closed 2009 with 4.07 bn PLN revenues and Katowicki Holding Węglowy with revenues amounting to 4.15 bn PLN). The most efficient Polish coal mine Bogdanka was recently an object of an unsuccessful takeover by Zdenek Bakala and his NWR. Following that, industry experts expect that Polish coal mine sector may merge to form a national coal holding able to compete on global markets. Ministry of Economy announced also their privatization plans according to which Jastrzębska Spółka Węglowa could be the first Polish state-owned mine to be considered for IPO in 2011. Mining market is expected to reach a value of 4.37 bn US\$1 by 2014, as compared with 12.32bn US\$ in 2009. In the long run Poland is expected to reduce its dependency on coal in order to fit the EU CO2 emission limit by cutting current level by 20%.

Apart from coal, Poland also produces significant quantities of copper and silver, which are mined by one enterprise, KGHM Polska Miedz. In 2010 KGHM launched its new strategy which considers involvement in new technologies and mining companies' acquisitions. KGHM now undertakes numerous acquisition projects in Europe and Canada regarding among others a producer of silver and two producers of copper. The company announced recently net profit of PLN 1017.59 mn in Q3/2010 vs. PLN 382.20 mn profit a year earlier.

Retail sector

Western retailers are already very active in Poland. Privatisation has moved the fastest and furthest in retailing. Western retailers and other services providers have also entered the Polish market, making use of relaxed property rules to set up large out-of-town stores. There were almost 500 hypermarkets in Poland at end of 2009. French groups such as Auchan, Géant and Carrefour, and the Swedish furniture supplier IKEA are active in the Polish market. The retailer Tesco has also entered the market, expanding rapidly through the takeover of the German HIT group. Other present brands include Biedronka (Jerónimo Martins), Castorama (DIY), Electroworld (consumer electronics), E.Leclerc, Intermarché, JYSK (furniture, décor, etc.), Kaufland, Leroy Merlin (home improvement and gardening articles), Lidl, Makro Cash & Carry, Media Markt (consumer electronics), Praktiker (DIY), Real, Selgros and Cash & Carry.

Hypermarket sales reached over PLN 30 bn in 2009, up 17% on previous year. The owners of small shops have been campaigning vigorously against the influx of foreign competition, and the government has come under intermittent political pressure

to introduce measures, perhaps through the planning system, to limit the growth of the large foreign chains. According to the findings by market research company Nielsen during the last five years the number of small shops has fallen from 74,000 in 2005 to 54,000 in 2010.

8. Technology and Industrial Parks

The new initiatives, such as creation of industrial parks, technology parks, entrepreneurship and technology incubators simplify start-up of new enterprises, development of existing ones, especially in the SME sector, technology transfer as well as commercialization of the research results.

The general idea of these activities is to set up a proper infrastructure and a wide range of administrative, book-keeping, legal, advisory and other services for entities running their start-up activities within the area of a park or incubator. According to PAIIIZ in Poland, there are at least 60 industrial and technology parks operating. Major cities like Warsaw, Poznan, Wrocław, Katowice, Kraków or Gdansk host either technology or industrial parks. Such initiatives are gaining momentum in many other Polish cities.

The new projects regarding the establishment, development or modernization of industrial, science and technology parks in Poland are supported by European Funds. The management institutions of the park may apply for co-financing from various Operational Programs for 2007-2013.

Parks may obtain a refund even up to 85% of the eligible costs related to:

- preparation and realization of the park's strategy;
- investment in expansion of the technical infrastructure;
- promotion of the park's activity.

With regard to the expansion of activities, parks may receive co-financing for actions aimed towards:

- searching for new, innovative enterprises;
- potential and innovative ideas evaluation;
- capital investment in a newly created enterprise.

Additionally, under each aid scheme the park may simultaneously apply for training grants related to the projects.

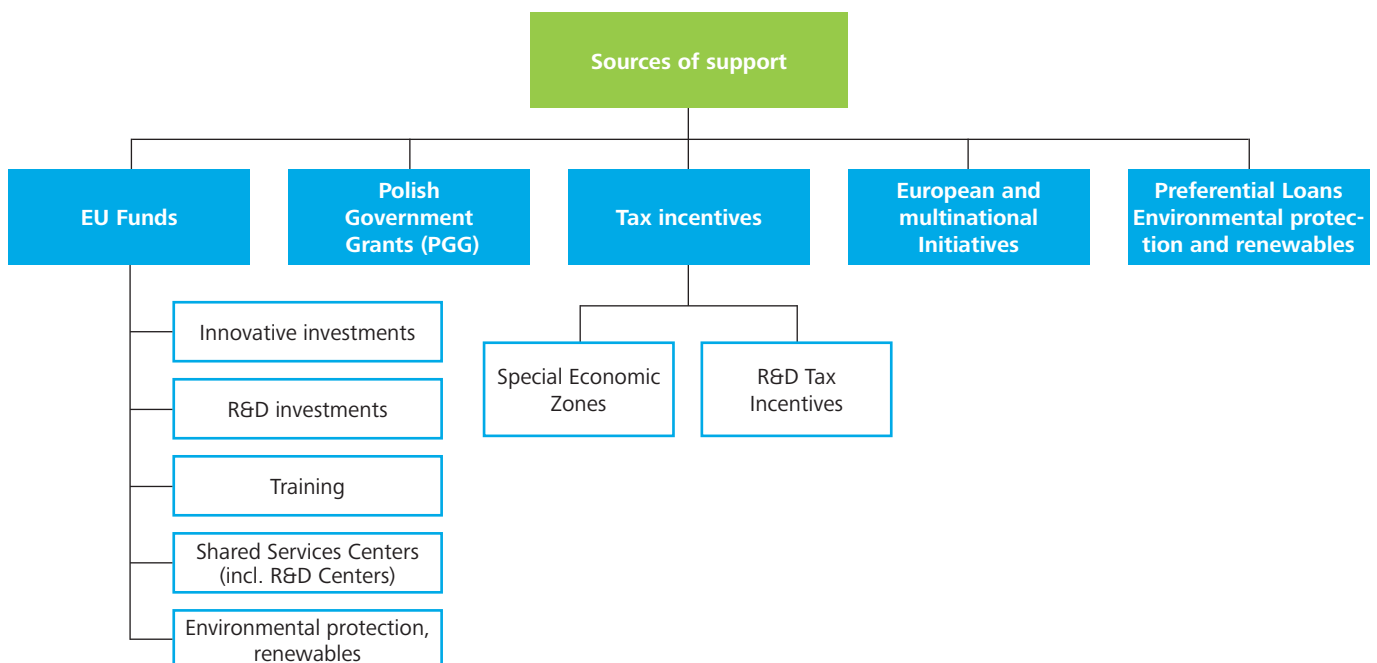
9. Investment Incentives

Enterprises that invest or expand their activity in Poland may apply for various types of tax and non-tax investment incentives such as investment grants, R&D grants, training grants, tax incentives (incl. tax exemptions) and many others. Companies which already operate in Poland and do not plan any expansion may still enjoy training grants for their employees in Poland and R&D tax incentives for current R&D activity.

Support comes from both domestic and European Union sources. However, levels of aid are set up separately for each aid scheme and do not depend on the investor's origin. Investment grants are in most cases recognized as regional aid. Total aid granted for a specific project cannot exceed the maximum aid intensity for a given region in Poland (see Regional state aid map of Poland). Investment incentives constitute aid that is non-refundable (in most cases) and free of additional costs. Grants are credited to the investors' account in a form of reimbursement of incurred costs (periodical payments) or in a form of prepayment, which allows for effective financial liquidity management of the project.

European Union Funds

In the current programming period 2007-2013, Poland is the major beneficiary of EU funds. The total budget set for support to investments made by enterprises was several times higher than the budgets for previous years (2004 – 2006), and it amounted to almost EUR 80 billion. In accordance with the strategic directions of EU economic development for the years 2014-2020, it is expected that the pool of funds for Poland under the Structural Funds will also be significant. Funding will be allocated in particular for *highly innovative projects, research and development projects, projects in the field of eco-efficiency projects and social inclusion.*



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Currently, most of the EU funds provided for the period 2007-2013 have been exhausted, but still calls for proposals under the following areas are expected to be announced:

1. Innovative investments	Investments of an innovative nature aimed at establishing an enterprise, its development, production diversification, or implementation of a fundamental change in the overall production process together with the use of innovative technological solutions.
2. Training	Employees trainings, including e-learning and post-graduate studies (also MBA), and related advisory, internship and traineeship.
3. Research & Development	Industrial research and development activities conducted by entrepreneurs to develop new \ significantly improved products and/or processes and/or services.
4. Service centers	Investments in the modern services sector (shared service centers, IT centers, R&D centers).

Regional Aid Map

The total value of aid that an investor obtains cannot exceed the maximum aid intensity level for a given region of Poland and it depends on:

- location of the investment (aid intensity level);
- investment value (eligible expenses);
- enterprise size.

Different types of regional aid such as investment grants and CIT exemptions in SEZ can be accumulated by investors up to the maximum aid intensity level.

The Regional Aid Map in Poland for 2007-2013 was set at the level of 16 administrative units of Poland known as “voivodships”.

In case of medium-sized and small enterprises, these intensities are increased by 10% and 20% respectively.

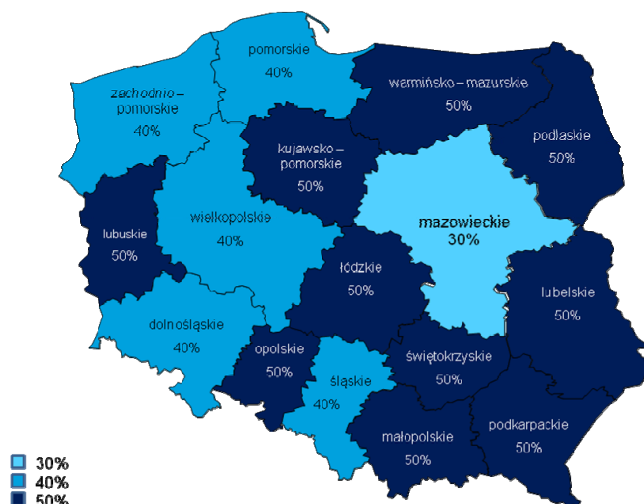
R&D tax incentives

Polish R&D tax incentive system (implemented on 1 January 2006) is currently much less effective than those implemented by other EU member states. Recently the debate on creation of new R&D tax incentive system is conducted in Poland, however, no specific declarations has been made yet by the government. Companies involved in R&D activities may deduct from their CIT base up to 50% of expenditure incurred for the acquisition of new technologies in the form of intangible assets (e.g. proprietary rights, licenses, rights under patents or utility models, know-how etc.). In the case of loss the tax benefit may be used during the subsequent 3 tax years. On a monthly basis, entities with the CBR status can make appropriations to the innovation fund corresponding to 20% of their revenue, which reduces the tax base.

The tax benefit is addressed to all entities operating in Poland and acquiring new technologies, except for taxable persons using the flat rate method and enterprises which carry out business activity in special economic zones.

Eligible costs include expenses incurred for the acquisition of innovative technologies that are not used worldwide for a period exceeding 5 years, which needs to be proved by an opinion issued by an independent scientific unit. The list of eligible expenditures includes only costs of acquired technological solutions in the form of intangible assets. Therefore, the costs of internal R&D works as well as costs refunded from other public aid sources do not qualify for tax benefit.

Regional Aid Map of Poland (2007-2013)



Special Economic Zones (SEZ)

Tax incentives in the form of corporate income tax exemption are available for investors in Special Economic Zones in Poland. Special Economic Zones (SEZs) are designated areas in the territory of Poland, in which business activities (manufacturing and services) can be conducted on preferential terms.

There are fourteen Special Economic Zones in Poland. Each SEZ consists of a number of sub zones which means that areas of SEZs in Poland are presently scattered across the country. Infrastructure within areas of SEZs in Poland is well developed and makes them very attractive for investors.

The number of investors in SEZs is growing fast, especially since the accession of Poland to the European Union. SEZs have already attracted more than 1250 investments (status as at the end of 2009), including multinational companies like Bridgestone, Dell, Delphi, Electrolux, Fiat, General Motors, Gillette, Guardian, Isuzu, LG, Michelin, Motorola, Philips, Shell, Toyota, Volkswagen, Whirlpool and others. The total value of tax exemptions within SEZ exceeded PLN 6 billion at the end of 2008.

In order to benefit from tax incentives in SEZs, a special permit has to be obtained from the SEZ Management.

Eligible activities include both manufacturing and services (also modern services, such as: R&D, IT, BPO, call centers). Manufacturing investments in SEZs include numerous sectors, such as automotive, electronics, household appliances, plastic products, wooden products, metallic and non-metallic products. Tax incentives in SEZs (the amounts of unpaid CIT) are recognized as regional aid and they cannot exceed the maximum aid intensity for a given region of Poland (see Regional state aid map of Poland). Eligible expenditures are comprised of investment expenses for tangible and intangible assets. Alternatively, eligible expenditure can be calculated based on two-year labour costs of newly employed staff.

Apart from the above incentives, companies investing in the SEZ are often granted exemptions from real estate tax by local authorities.

Polish government grants (PGG)

The objective of the governmental support programme is to provide additional funding to investments which are strategically important to the Polish economy and which generate many new workplaces. A detailed scope of the support is negotiated individually with the competent Polish public authorities.

Programme can be applied for entrepreneurs planning

investments in the following "priority" sectors: automotive, aviation, electronics, R&D, biotechnology and modern services sector (BPO, IT, SSC) or in case of "major" scale production investment in other sectors. Till the end of 2009 more than 50 programmes were constituted for large project of multinational companies including Cadbury, Dell, Fiat, Ford, Gillette, LG, Samsung, Sharp, Shell, Toshiba, Toyota, Volkswagen.

Preferential loans/grants – Environmental Protection and Water Management Fund

Support for ecological project of national level significance and scope as well as regional actions important due to environmental requirements. Types of projects eligible for a loan/grant include inter alia: **renewable energy sources** (wind energy, biomass and biogas, geothermal energy), **green investment scheme** (biogas plants, CHP biomass plants and biomass heating plants), **waste management** (recycling of waste, waste disposal, utilization of waste) and **environmental management** (ISO certificates). Co-financing is available in form of preferential loans up to 75% of eligible costs or grant - depending of supporting scheme.

Selected European and multinational R&D Initiatives

7 Framework Programme - The program aims to support multinational cooperation in science and research in selected ten thematic areas, including eg. "Information and communication technologies" and "Nanosciences, nanotechnologies, materials and new production technologies".

Competitiveness and Innovation Framework Programme

(CIP) - supports innovation activities (including eco-innovation) and provides better access to finance in the regions. The CIP is divided into three operational programmes:

- The Entrepreneurship and Innovation Programme (EIP)
- The Information Communication Technologies Policy Support Programme (ICT-PSP)
- The Intelligent Energy Europe Programme (IEE)

Multinational Initiatives run by National Centre for Research and Development

– NCBIR is a national project coordinator designated for several European and Multinational initiatives such as eg: NCBIR - MATIMOP.

(Polish-Israeli competition for research and development projects, focusing on developing innovative products and technology with real prospects for commercial applications) and EUREKA's Eurostars Programme (the first European support programme specifically dedicated to SMEs and focuses on international collaborative research and innovation projects.

Poland

10. Foreign Direct Investment (FDI)

Poland was very successful in attracting foreign direct investment (FDI) in the 1990s. Its market size, membership in the OECD (1996) and NATO (1999), as well as its recent membership in the European Union (May 2004), have made it attractive to foreign investors. Cumulative FDI inflows reached 128.834 mln EUR as of 2009, according to the Polish Agency for Information and Foreign Investment (Panstwowa Agencja Informacji i Inwestycji Zagranicznych - PAIiIZ). In 2009, FDI amounted to 8.942 mln EUR, which is just a bit less than the previous year (10.206 mln EUR). FDI peaked in 2007 at 17.242 mln EUR, mainly on the back of large privatisations. During I-X 2010. According to initial assessments some 5.300 mln EUR was invested in Poland from abroad. Most of 8.942 mln EUR FDI located in Poland in 2009 were invested in entities dealing with:

- Food processing (1.711 mln EUR),
- Business process outsourcing (1.644 mln EUR),
- Financial intermediation (1.617 mln EUR),
- Trade and repairs (948 mln EUR),
- Production and distribution of energy, gas and water (856 mln EUR),
- Transport manufacturing (524 mln EUR).

Most investments came from Germany (2.137 mln EUR), France (1.375 mln EUR), Luxembourg (1.250 mln EUR), Sweden (940 mln EUR), USA (895 mln EUR), Austria (586 mln EUR), Netherlands (478 mln EUR), Italy (459 mln EUR) and Spain (393 mln EUR).

11. Expatriate Life

Poland is one of the major destinations for travellers. Its beauty can be admired in both its old cities and in the wild scenery of its national parks and nature reserves. Polish cities are cultural treasures in their own rights, showcasing unique examples of gothic, baroque, renaissance, and neoclassical architecture. Warsaw is a cosmopolitan center with museums, shops, and fine restaurants. Krakow is a smaller city with well-preserved historical buildings, a charming central square, and a vibrant market that wins visitors over instantly. The Tatras mountain range are a summer and winter sports playground of dramatic beauty. The Mazurian Lakelands are also natural gems in Poland's topography. In addition to these wonderful natural and historic sites, Poland has retained its strong tradition and history while embracing modern and democratic institutions.

12. Weather and Climate

Poland has a temperate climate characterized by relatively cold winters and warm summers. Winters become increasingly severe inland from the Baltic coast, with January temperatures averaging -1° C (30 F) in the north and going as low as - 5° C (23 F) in the southeast. July temperatures range from 16.5° C (62 F) near the coast to 19° C (66 F) in the south. Rainfall varies with altitude, ranging from less than 51 cm (20 inches) a year to as much as 127 cm (50 inches) in the southern mountains

Romania

1. General Overview of Economy

Romania entered the 1990s a relatively poor country, even by Balkan standards, largely a result of the failed Ceausescu economic policies of the 1970s. However the collapse of the Ceaușescu regime in 1989 and its accession to the European Union have led to an improved economic outlook.

In 2007, when Romania joined the European Union (EU), it became the second-largest market in Central Europe and the seventh-largest in the EU. With a population of over 21 million, it is an emerging economy with one of the highest growth potentials in the region. Romania's adoption of a controversial flat-rate income tax of 16 per cent in 2005 has been vital in driving both economic growth and foreign investment. In 2001-2007, economic growth averaged an annual 7 per cent, placing the country among the fastest-growing economies in Europe.

Romania was one of the last EU economies to enter recession, with q/q growth turning negative only in the third quarter of 2008. It will also be one of the last EU economies to exit recession and make a sustained recovery.

Real GDP shrank by 7.1% y/y in 2009 and is estimated to have contracted by a further 2% in 2010, reflecting the negative impact on private consumption of the government's planned cuts in wages and employment, and the increase in VAT. Although exports grew, this was offset by the growth of imports in absolute terms. The FOB-CIF commercial deficit reached around EUR 4.1 billion in Q2 2010. It is doubtful that q/q growth will be sustained in the second half of this year as the full impact of the government's ambitious austerity package is felt. Under the present scenario, economic growth is forecast to stay below the potential in the years ahead and Romania will reach its pre-crisis GDP level no sooner than 2014.

The IMF estimates that the current-account deficit, which fell to 4.5% in 2009 after reaching 13.5% of GDP in 2007, will widen to 5.1% this year and to 5.4% of GDP in 2011, compared with a regional level of 4%. Should it be largely covered by net inflows of foreign direct investment (FDI), a higher current-account deficit can be considered beneficial, as it would allow Romania to maintain a higher level of investment without a large increase in external debt.

The surplus of the net current transfers (both public and private sector) fell 39% y/y in January-August 2010 to EUR 1.8bn. According to the latest official information, Italy has a share of 43% in remittances from abroad, Spain 31% and Greece 7%. Besides lower remittances of the Romanian workers, net current transfers were affected by lower inflows of European funds.

FDIs will finance less than 40% of the C/A deficit this year. They will be directed mainly towards areas with significant growth potential at the end of the present recession (energy, IT&C, agriculture).

In August 2010, headline inflation (CPI) continued to surpass the upper bound of the inflation target. Consumer prices grew by 7.8% yoy, bringing cumulative inflation (in January-September 2010) to 6.3% ytd. This increase was mainly explained by the VAT rate hike (from 19% to 24%), introduced on July 1st 2010. Meanwhile, the tight budget coupled with potential fiscal consolidation will be key factors putting downward pressure on prices in the following months. As a result, according to a forecast by the National Bank of Romania, the CPI will fall back within the target band in 2011.

Disinflation is set to continue in 2011-15, but the inflation is not expected to fall to Western European levels within the forecast period. Depreciation of the leu will generate further inflationary pressures later in 2010 by driving up the price of imported energy and raw materials. Wear-end inflation is estimated to reach 8.1% in 2010 (averaging 6.1% for the year on the national measure). Provided that fiscal and incomes policies are tightened and that wage growth is curtailed, inflation should fall to around 3.5% by the end of 2011, inside the central bank's target band and to 2.4% by December 2015, as Romania strives to meet the conditions for entry into the EU's exchange-rate mechanism (ERM2). However, this will still be higher than the rates prevailing in most old and new members of the EU.

The government secured a 24-month stand-by agreement with the IMF in March 2009, which is supported by the EU, the European Investment Bank (EIB), and the European Bank for Reconstruction and Development (EBRD). It is worth Eur 19.5bn (about US\$27bn) in total and is the main factor shaping economic policy. The IMF agreement requires the government to narrow the budget deficit; to make cuts in public-sector wage costs, pensions and social security benefits; to reduce staffing levels in the public sector and reform public-sector wages; and to reform the pension system. Romanian authorities are determined to continue the relation with the IMF after 2011 and a precautionary stand-by arrangement is the most likely scenario at present. This will enable the government to draw further funding only in the event of a downturn in domestic or global economic conditions (or both). A continuation of the agreement with the IMF in the next years is good news for the capital markets and opens the door for a successful issuance of euro mid-term notes on the global markets.

Romania

In September 2010 registered unemployment rate (domestic methodology) remained constant for the fourth month in a row at 7.4%. While this could be seen as a sign of a stabilization of the private segment of the labor market, the unemployment outlook remains rather pessimistic due to the rightsizing process in the government sector. As the government could begin to cut payrolls and the favorable summer seasonal effect in agriculture and construction will vanish, unemployment could climb to around 8.5% at the end of 2010. Economic growth will not be strong enough to reduce significantly the unemployment rate and our forecast shows that it will remain above pre-crisis levels in the next years. Real wages will be negative both in 2010 and 2011.

Political system

Romania's political system is a Parliamentary Democracy. The Romanian Parliament exercises the legislative powers while the main executive powers are attributed to the government. The president of the Republic, who is elected for a mandate of five years (while the Parliament is elected for a mandate of four years), guards the observance of the Constitution and acts as a mediator between different powers in the state (legislative, executive and judiciary) as well as between the State and society.

The Parliament includes the Chamber of Deputies and the Senate, elected through direct suffrage. The election law establishes the number of deputies and senators. The Parliament passes constitutional laws (which concern the revision of the Constitution), organic laws (endorsed by the majority suffrage of each chamber) and ordinary laws. According to the article 74 of the Constitution, the Education Act is an organic law. The Government (executive body) is invested by the Parliament on the basis of its governmental programme.

The national legislature is made up of a bicameral parliament composed of the Senate (137 seats) and the Chamber of Deputies (332 seats). Both chambers are directly elected from 41 multimember constituencies, comprising 40 counties and the municipality of Bucharest.

The last national elections were on November 30th 2008 (legislative) and on November 26th and December 6th 2009 (presidential). The next parliamentary election is scheduled for late 2012 and the next presidential election is scheduled for late 2014.

The national government consists of a Cabinet, headed by the prime minister, nominated by the president. The government is a coalition of the Democratic Liberal Party (DLP) and the Hungarian Union of Democrats in Romania (HUSR), supported by independent and ethnic minority representatives. The opposition parties are: Christian Democrat-New Generation Party (CD-PNG); Conservative Party (CP); Greater Romania Party (GRP); National Liberal Party (NLP); National Union for the Progress of Romania (UNPR); Social Democratic Party (SDP). Currently the President of Romania is Traian Basescu, the Prime Minister – Emil Boc (DLP) and the Deputy Prime Minister – Marko Bela (HUSR).

2. Tax Structure

Resident/Non-resident

Resident is considered to be any Romanian legal entity, any foreign legal entity having its place of effective management in Romania, any legal entity with its registered office in Romania, set up according to European legislation and any resident individual. For associations between Romanian legal entities and foreign individuals or entities, which do not give rise to a legal person, the tax is computed and paid by the Romanian legal entities on behalf of the partners.

Tax year

The tax year is the calendar year. The deadline for submitting the financial statements for the previous year is:

- within 150 days after closing of the financial year for national companies, autonomous regions, research and development institutes;
- within 120 days after closing of the financial year for all other legal entities a;

*** Please note that for the next year all dates may suffer changes.*

The persons that did not pursue an activity, except for trading companies, as well as those undergoing liquidation, according to the law, shall submit a statement for this purpose, within 60 days as of the end of the financial year, with the territorial units of the Ministry of Economy and Finance.

All companies must also produce half-year (as at 30 June of the current year) unaudited financial statements. Companies are required to file comprehensive tax returns monthly or quarterly. Corporate tax is paid quarterly (banks pay annual corporate income tax based on quarterly advanced payments).

The companies that fulfill two out of the following three criteria:

- total value of the assets of EUR 3,650,000
- net turnover of EUR 7,300,000 and
- average number of employees during the fiscal year of 50 should prepare annual financial statements that comprise:
 - Balance sheet
 - Profit and loss account
 - Statements of changes in equity
 - Cash flow statement
 - Explanatory notes for the annual financial statements.

Corporate taxation

Resident entities are subject to tax on worldwide income. Non-resident companies are taxed only on their earnings in Romania (through branches, permanent establishments or associations, which do not create a new legal person).

Corporate tax is chargeable at a flat rate of 16% on accounting profits determined according to the Romanian Accounting Standards, adjusted for certain items under tax legislation. Thus, the taxable profit of a Romanian legal entity is calculated as the difference between the income derived from any source and the expenses incurred in obtaining the taxable income throughout the fiscal year, deducting non-taxable income and adding non-deductible expenses.

The non-taxable income expressly includes:

- Dividends received by a Romanian legal entity from another Romanian legal entity;
- Revenues from reversal or cancellation of provisions / expenses that were previously non-deductible and recovery of expenses that were previously non-deductible;
- Non-taxable income expressly provided in agreements and memoranda approved by law;

Expenses are considered deductible if they are directly related to deriving income and correspond to taxable income. As regards the deductibility criteria, the Romanian Fiscal Code provides that expenses may be considered as deductible expenses, limited deductible expenses and non-deductible expenses.

Among the deductible expenses:

- Expenses made for acquisition of packaging;
- Expenses incurred for marketing and advertising with a view to promote the company;
- Research and development expenses that do not meet the requirements to be recognized as intangible assets for accounting purposes;

- Transport and accommodation expenses for business trips in Romania or abroad incurred by employees and directors and secondees whose costs are covered by the Romanian company;
- Expenses incurred for professional training and development of employees;
- Write-off of receivables in certain conditions.

Among non-deductible expenses:

- Business entertainment and protocol expenses, which exceed the limit of 2% applied to the difference between revenues and deductible expenses other than profit tax expenses and protocol expenses;
- Fines or penalties due to Romanian authorities or foreign authorities;
- Expenses with luncheon vouchers over the limit established by the Government (RON 8,72 for 2010);
- Contributions to non-mandatory pension funds over certain legal limits (EUR 400 per year, per employee) are non-deductible expenses;
- Contributions to private health insurance over certain legal limits (EUR 250 per year, per employee) are non-deductible expenses;
- Social expense, which exceed the limit of 2% of the salary fund realized;
- Other expenses related to salaries which are not taxable to individuals;
- For the period 1st May 2009 – 31st December 2010, fuel expenses are non-deductible for corporate income tax purposes. As an exception, fuel expenses are granted deductibility if these are incurred in relation to vehicles that are used for certain activities (e.g. sales activities, paid transportation services, rental activities, security services, repairs, courier activities etc.)
- Sponsorship expenses are not deductible, but they can be taken as a credit from the profit tax liability provided that the following conditions are met:
 - They are within the limit of 3 % of the turnover, and
 - Do not exceed 20% of the profit tax due.

Any tax differential arising from corporate profit tax incentives is treated as taxpayer's reserves that cannot be used for share capital increases, offsetting losses incurred or distribution to shareholders.

Tax losses incurred may be carried forward for five years and are not updated for inflation. The carry back of losses is not allowed. For losses incurred after January 1, 2009, the carry forward period is extended to 7 years.

Romania

Advance tax ruling availability

The National Agency for Fiscal Administration may issue advanced tax rulings (ATR), at the request of taxpayers. The ATR is an administrative fiscal document referring to a future fiscal situation of a taxpayer and is binding for the tax authorities, provided that its terms and conditions have been complied with by the taxpayer.

The advanced tax ruling is valid only as long as the relevant legal provisions are not amended.

The deadline for issuing an APA is:

- 12 months in case of a unilateral agreement;
- 18 months in case of a bilateral/multilateral agreement.

The agreement is issued for a period of up to 5 years (in exceptional cases it is possible to be issued for a longer period).

The agreement produces effects only for the future (there are some exceptions).

Capital gains tax

There is no separate capital gains tax payable in Romania by companies. Companies record capital gains in the profit and loss account, on which normal profits tax is payable. Foreign companies that sell their interest in Romanian companies may be taxable on any capital gain made. Capital gains obtained by non-residents from the sale of real estate located in Romania or from the sale of shares held in Romanian legal entities are subject to corporate income tax (i.e., 16%).

Income from real estate properties also include, inter alia:

- Income from sale/transfer of participation titles held in a legal entity, if minimum 50% of its fixed assets are either directly or through several legal entities real estate properties located in Romania;
- Income obtained from exploitation of natural resources located in Romania, including the gain obtained from the sale/transfer of any right related to these resources, etc.

Revaluation of assets

In order to determine the fiscal value of land, respectively the un-depreciated fiscal value of fixed assets, the accounting revaluations performed after 1 January 2007, as well as the un-depreciated part of accounting revaluations performed between 1 January 2004 and 31 December 2006 existing as at 31 December 2006 were to be considered. Also, accounting revaluations performed until 31 December 2003, as provided by law, are considered for fiscal purposes.

As of 1st May 2009, revaluation reserves for fixed assets, including land, performed after 1 January 2004, which are deductible for corporate income tax purposes by way of depreciation or expenses with alienation/write-off of the assets, will be taxed simultaneously with the deduction of the tax depreciation or at the moment of the disposal or write-off of the related fixed assets.

Withholding tax (subject to tax treaties)

Payments to:	Interest	Dividends	Royalties
<i>Resident Companies</i>	-	16%/0%	-
<i>Non-resident Companies</i>	16% / 10%	16% / 0%	16% / 10%

Dividends distributed to local companies are subject to a withholding tax of 16% starting 1 July 2010, also dividends distributed to foreign companies and/or non-resident individuals are subject to 16% withholding tax, unless a reduction under a double tax treaty or the Parent-Subsidiary Directive is available. In case the holding percentage is at least 10% and is maintained for a period of at least 2 years, no dividend tax is applied.

In general, income obtained by non-residents from Romania is subject to withholding tax. The applicable withholding tax rate is 16%. Such income may comprise:

- Dividends paid by a Romanian legal entity;
- Interest paid by a Romanian resident;
- Royalties paid by a Romanian resident;
- Commissions paid by a Romanian resident;
- Income for services performed in Romania;
- Income from liquidation of a Romanian legal entity.

Derogations

From the above mentioned withholding tax rate, there are certain derogations, such as:

- Dividends paid by a Romanian legal person to a legal person resident in another EU member state or in a state member of the EFTA or to a permanent establishment of a company from an EU member state or from one of the EFTA member states, shall be taxed at a rate of 10%. In case the parent company has a holding of at least 10% in the capital of the subsidiary and such holding is maintained for a period of at least two years the dividends would be exempt;

- Interest and royalties paid between related legal entities, subject to the conditions provided by the Interest and Royalty Directive are subject to a withholding tax of 10% until January 1, 2011. Starting this date such income would be exempt provided that the beneficial owner of the interest and/or royalties holds at least 25% in the capital of the subsidiary and such holding is maintained for a period of at least two years.
- Income obtained from gambling is subject to a withholding tax of 25%.

Tax treaties

Romania has signed over 82 Double Tax Treaties. Different rates of withholding tax can apply to interest, dividends and royalties, depending on the terms of the treaty with the particular country. The tax treaty provisions are applicable if a certificate of fiscal residence is made available by the income beneficiary by the income payment date.

Thin capitalization

Romanian companies can generally deduct interest expense, subject to thin capitalisation rules. The level of deductibility for loans obtained from companies, other than banks, their branches, credit co-operatives, leasing, mortgage companies and other non-banking financial institutions is limited to:

- The National Bank of Romania's (NBR) reference interest rate – for loans denominated in Romanian currency (i.e. RON).
6% annual interest rate – for foreign currency denominated loans. The government can update this level periodically.
Any interest expenses which exceed this cap are permanently non-deductible for corporate income tax purposes.

In addition to the above capping rule, the deductibility of interest expenses is subject to limitations based on the computation of the debt/equity ratio. Interest expense and foreign exchange net losses are fully deductible where the debt/equity ratio is lower or equal to three and the company is in a positive equity position. Otherwise, the interest expense and related net losses from foreign exchange differences are non-deductible. Unlike the above-mentioned threshold, the non-deductible interest expenses and foreign exchange differences can be carried forward to future periods, subject to the same thin capitalization test until their full deductibility.

These limitations are not applicable to banks, non-banking financial institutions.

Transfer pricing

Romanian Tax law provides for transfer pricing rules and principles, in line with the OECD guidelines. The law sets out that transactions between related parties should be carried out at arm's length prices.

In view of establishing the transfer prices, the taxpayer carrying out transactions with related parties is liable, upon tax authorities' request, to prepare and present, within certain timeframes, a file of the transfer prices.

In determining the price, the following methods are recommended by the Romanian profits tax regime:

- Comparable Uncontrolled Price Method (CUP)
- Cost Plus Method (CPM)
- Resale Price Method (RPM)
- Any other method accepted under OECD guidelines

Stamp duty

Stamp duty is payable on most judicial claims, issue of certificates and licenses, and documentary transactions which require authentication.

There are two types of stamp duty, which include the following:

- Judicial stamp duty
- Extra-judicial stamp duty

Judicial stamp duty is levied on claims and requests filed with courts and the Ministry of Justice, depending on the value of the claim. Quantifiable claims are taxed under the regressive tax mechanism. Non-quantifiable claims are taxed at fixed amount levels. A judicial stamp duty may also be levied at the transfer of real estate property under certain circumstances.

Extra-judicial stamp duty is charged for the issue of various certifications such as identity cards, car registrations, etc.

Sales taxes/VAT (inc. financial services)

The Romanian VAT legislation is harmonised with the EU VAT Directive.

VAT is generally applied to transactions involving goods and services for which the place is deemed to be in Romania.

The current VAT standard rate is 24%.

Exports of goods and other specific operations are VAT exempted with deduction right, based on specified documentation, while financial services are generally VAT exempted without possibility to recover the input tax incurred.

The fiscal period is usually the calendar month. For taxable persons registered for VAT purposes whose previous year-end turnover did not exceed EUR 100,000, the fiscal period is the calendar quarter. Also, if certain conditions are fulfilled, taxpayers may choose for other fiscal periods (i.e. semester, year).

Romania

Taxpayers who submit quarterly VAT returns and perform an intra-community acquisition of goods in Romania have the obligation to switch to the monthly submission of the VAT returns.

VAT compliance provides for periodical submission of VAT returns (i.e. Statement 300) with the competent tax authority by the VAT registered entities and periodical payment of VAT, due by the 25th of the month following the reporting period.

Taxpayers have also to submit:

- Intrastat statements – due by the 15th day of the month following the one for which the statement is prepared;
- EC Sales Lists (i.e. Statement 390) – due by the 15th day of the month following the one for which it is prepared;
- Invoices Lists (i.e. Statement 394) – due by the 25th day of the month following the semester for which it is prepared.

Taxable persons not registered for VAT purposes are required to pay VAT and to submit a special VAT return for services rendered by non-residents, which have as a deemed place of supply Romania. These obligations must be fulfilled by the 25th day of the month following the one when the services are supplied.

There are two reduced rates of VAT, 9% and 5%. The reduced rate of 9% is applied to certain transactions such as:

- tickets to museums, castles, historical monuments, fairs and expositions, movie-theatres (cinemas), etc.;
- supply of school books, books, newspapers and magazines, except for those intended solely for advertising purposes;
- supplies of all sort of prosthesis, except for dental plates and of orthopedic products;
- drugs for human and animal use;
- accommodation in hotels and similar structures, including the rental of land for camping.

The reduced rate of 5% applies to the supply of buildings as part of the social policy, including the land on which they are built. The building supplied as part of the social policy include, among others, the supply of buildings intended to be used as retirement homes, foster home and centers for recovery and rehabilitation of disabled children, the supply of buildings to city halls with the purpose of subsidized renting-out to certain persons or families of special economic condition, as well as the supply of buildings with a maximum utilizable space of 120 m² and a value exceeding RON 380,000 (excluding VAT).

Payroll and social security taxes

Employers in Romania are liable to pay social security contributions as a percentage of the salary paid to employees as follows:

CAS (social security contribution): generally between 20.8% and 30.8% of salary fund, depending on the labour conditions.

Health fund: 5.2% of salary fund.

Unemployment fund: 0.5.% of salary fund.

Labour Chamber commission: 0.25%-0.75% of salary fund.

Insurance fund for work related accidents and professional diseases: 0.15%-0.85% of salary fund.

Medical leave fund: 0.85% (capped) of salary fund. The computation base for the contribution is capped at the level of twelve times the national minimum salary.

Guarantee fund for salary debts: 0.25% of salary fund.

Disabled person contribution: 4%*No. of employees*MSE x 50%. The contribution is payable by companies with more than 50 employees that do not hire disabled persons. Alternatively, the contribution equivalent can be used by companies to purchase goods from institutions where disabled people work. (MSE - Minimum Salary per Economy).

3. Legal Entities

The general legal framework with respect to Romanian Companies is provided by Companies' Law no. 31/1990. Under the law there are five types of companies described below as follows:

- Partnerships;
- Limited partnerships;
- Partnership limited by shares ;
- Joint Stock Companies;
- Limited Liability Companies;

Basically any person can participate to the creation of companies provided that was not condemned for specific criminal offences stipulated in the law.

Partnerships, limited partnerships and partnerships limited by shares forms a separate corporate entity from their shareholders but all of the shareholders in case of a partnership or only some of them in case of limited partnerships and partnerships limited by shares, are liable for the company's debts.

In case of the joint stock companies and the limited liability companies, the shareholders' liability is limited to the amount they had invested, i.e. the subscribed share capital.

Due to the advantages they offer, joint stock and limited liability companies are most common types of company used in Romania.

Limited Liability Company

Shareholder structure

Companies Law provides that this type of company may be established by at least two shareholders. The maximum number of shareholders allowed by law for a limited liability company is 50.

As an exception from the said rule, the law stipulates the possibility to establish a limited liability company having only one shareholder, named sole shareholder limited liability company.

The formation of sole shareholder limited liability company is subject to some legal restrictions, such as:

- a natural or legal entity cannot be sole shareholder in more than one limited liability company.
- a sole shareholder limited liability company cannot be sole shareholder in another limited liability company.

The shareholders of a limited liability company are liable for the debts of the company but their liability is capped to the subscribed share capital.

Share capital

The minimum share capital is 200 RON and may be divided into shares having a minimum value of 10 RON.

The shares issued by a limited liability company are incorporeal assets and cannot be represented by negotiable financial instruments.

The shareholders must entirely pay the subscribed capital upon the moment of the incorporation of a limited liability company

A limited liability company is a close corporation, cannot be formed by public subscription or be registered on the stock exchange markets and cannot issue bonds.

Transfer of shares

The shares issued by a limited liability company may be transferred between the shareholders without restrictions.

The transfer of shares to third parties is subject to the approval of the shareholders holding three quarters from the share capital. The shareholders may not derogate from the above mentioned restriction by inserting a contrary provision in the articles of association or by any other agreement.

The transfer of shares must be registered in the Trade Registry and in the shareholder register of the company.

Joint Stock Companies

Shareholder structure

The minimum number of shareholders required by law to set up this kind of company is 2. In case that the company has only one shareholder for a duration exceeding 9 months, then any interested person may claim the dissolution of that respective company.

Similar with the provisions established for limited liability companies, the liability of the shareholders is capped to the subscribed share capital.

In case of a joint stock companies the law does not impose a maximum limit regarding the number of shareholders.

Share capital

In case of joint stock companies, the minimum share capital required by law is 90,000 RON. The said amount may be modified by the government so that the minimum share capital to always remain at least at the level of RON equivalent of EUR 25,000.

Joint stock companies may issue bearer shares or nominative shares. The shares issued may be preferential shares or regular ones, and they can be converted one into another. However preferential shares cannot exceed one quarter of the share capital. Generally the preferential shares do not allow the holder to vote in the general meeting. For raising capital, joint stock companies may also issue bonds.

Upon the moment of the incorporation of a joint stock company the shareholders must pay at least 30% of the subscribed capital. The difference may be paid in 12 months from the incorporation date, in case of cash contribution or 2 years in case of in kind contribution.

The shares issued by a joint stock company may be acquired by a public subscription. In this case the shareholders must pay in cash 50% of the subscribed capital and the other half in 12 months from the incorporation date of the company.

Transfer of shares

Generally the shares of a joint stock company are freely transferable between the shareholders or to a third party. However the shareholders may restrict the transfer of the shares by inserting some limitations in to the article of association.

A joint stock company cannot acquire its own shares or grant financial assistance (e.g.: loans or security), for the acquisition of its shares, excepting in some limited cases, expressly provided by the law.

The transfer of shares property takes place by executing an assignment agreement and by its registration in the shareholders' register.

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4. Labour and Wages

The collapse of the communist economic system has resulted in significant changes in the size and composition of the labour force. Although the working-age population increased between 1989 and 2000, total employment fell by more than 2.2m, to 8.6m at the end of 2000. In the second quarter of 2010 total occupied population is of 9.5m. The labour force participation rate (working-age labour force as a proportion of the population of working age) fell from 80% in the early 1990s to around 60% in the early 2000s. The largest job losses have been in industry, where employment fell from 4,169,000 in 1989 to 2,004,000 in 2000, with the greatest redundancies being seen in large enterprises. Because of revised definitions and coverage, following reweighting after the 2002 census, data from 2002 onwards are not comparable with those from previous years. According to the new data, total employment has remained at much the same level in recent years, averaging 9.2m in 2002-06. Employment in the agricultural sector has fallen, from around 40% of the total to 30%, while that in industry has remained fairly stable. Employment in the construction sector, which has been experiencing a boom in recent years, has increased by more than 1 percentage point to 5.5% of the total. Employment in hotels and restaurants, trade, real estate and other services has increased from about 30% of the overall total to 40% over the past five years.

Unemployment peaked in 1999, reaching 11.8% in December of that year, and has declined steadily since then. It continued to fall in 2005, to 523,000 or 5.9% of the labour force in December, and further still in 2006 to around 5.1% in December. Unemployment has increased lately, due to the economic crises and inherent lay-offs and closures in large, loss-making state-owned enterprises. Unemployment rate in the second quarter of 2010 was of 6.8%, lower than the previous quarter, but higher than the same quarter of the previous year.

Romania still has a low rate of unemployment compared with other transition economies, which can be attributed partly to the relatively slow rate of reform and restructuring. In addition, many displaced workers return to the countryside, where there is significant over-employment and hidden unemployment. There has also been an increase in the number of people of working age seeking employment abroad and remitting earnings to their families at home.

Clear regional patterns of unemployment have emerged. High rates of persistent long-term unemployment are recorded in counties affected by factory closures and restructuring, whereas unemployment is falling in counties with low rates of pre-existing unemployment. For example, unemployment rates in Alba, Gorj, Mehedinți, Teleorman, Vaslui have been consistently high, at 9-14%.

The most significant gains in employment in 2010 were recorded in the retail and wholesale trades, Other sectors in which employment expanded in recent periods include post and telecommunications, research and development, financial intermediation, and the public sector, including public administration and health and social assistance.

Salaries in the private business sector in Romania have increased averagely by 14% compared to the first month of the previous year and following mass layoffs. Despite job cuts and reductions of salary budgets in 2009, Romanian employers did not stick to the same policy regarding the spared personnel. On the contrary, at the start of the year the amount of the average salary was by 14% higher than a year back, even though budgets for staff remuneration was reduced by 5% and the number of employees was decreased by 18%, according to a draft report by Pay Logic on salary trends in the period January 2009 - January 2010. The tendency reflects last year's development of 25 private companies in the automobile, healthcare and financial industries, as well as in sectors of retail trade and services.

Companies prefer to hire fewer but more efficient employees and pay better. Indeed the employees worked harder and the amount of overtime work grew by 38% over the period considered' according to Pay Logic – a company specializing in professional human resources management services. Yet, why are employers reluctant to hire more people in view of the looming economic recovery, evidenced by increased overtime work? The answer is simple: employers still prefer to use 'sieved' staff that has proved its merits over a year of crisis instead of hiring new people, who would yet need to acquire sufficient competence. Still the good employees were not better paid than a year earlier as average remuneration dropped in January 2010 compared to the same period of the previous year, the report says. Yet there are worse situations like at manufacturing companies where salaries dropped by 24% over the reported period although staff reduction exceeded the average rate in the sectors monitored (-22%), while employees worked overtime (-39%). Employees in the production sector reduced their sick and paid leave (-39%) in comparison with the average level of 30%.

Those, who preserved their jobs during the crisis are not necessarily just lucky as the fact that the company kept them might not be incidental. 'In 2009 employers laid off employees, who were problematic, i.e. did not perform efficiently' Pay Logic points out. Experts noticed that those, who remained, had a different attitude to their job, put more effort and the quality of their work improved. 'To put it in a nutshell, they realized they had a job that would allow them to pay off their obligations to the banks' Pay Logic adds. Furthermore, discontinuing previous fluctuation

of staff, companies have started taking more interest in investing in their employee's qualification.

Legal framework

The Romanian employment legal framework is governed by Law no. 53/2003 – regarding the Labor Code (“the Labor Code”), Law no. 130/1996 on the collective bargaining agreement, and Law no. 168/1999 on labor conflicts and Emergency Government Ordinance no. 56/2007 regarding the employment and transfer of foreigners in Romania. Also there are collective bargaining agreement concluded at the national level and other collective bargaining agreements concluded at the level of industry, group of employers and employer which are applicable in employment relation.

Working hours

According to the legal provisions in force, the normal duration of full-time employees' work time is 8 hours per day or 40 hours per week (5 working days). The maximum legal duration of the work time cannot exceed 48 hours per week, including extra hours. As an exception, the duration of the work time, including the extra hours, may be extended to over 48 hours/week, provided that the average of the working hours, calculated for a reference period of three calendar months, does not exceed 48 hours/week. For youngsters up to the age of 18, the duration of the working time is 6 hours per day and 30 hours per week.

The work time is regularly, distributed, to 8 hours per day, 5 days per week, followed by two rest days. For certain sectors of activity, companies or professions, collective or individual negotiations, or specific laws may settle a daily duration of the work time, shorter or longer than 8 hours. A daily duration of a 12-hour working day shall be followed by a 24-hour rest period.

Specific provisions are provided with respect to individualized work schedules, to the extra time work, to the night work, as well as to the organization of the work conditions.

All employees are guaranteed their rights to a paid annual rest leave. The minimum duration of the annual paid rest leave is, according to Labor Code, 20 working days.

Specific provisions are also enforced with regard to the vocational training leaves.

Wages and benefits

Salary: Discriminations are banned in the setting and granting of a salary, on such criteria as gender, sexual behavior, genetic features, age, nationality, race, skin color, ethnicity, religion, political option, social background, disability, family situation or responsibility, trade union membership or activity. The salary consists of the base salary, indemnities, increments and other bonuses. Salaries are confidential, employers being bound to take all steps to keep confidentiality.

The Romanian Constitution refers under Article 41 to the minimum wage as a means of social protection. Starting with January 1, 2007, the national monthly minimum gross base salary guaranteed to be paid, for a full-time working schedule (an average of 170 hours per month), is set through Government Decision no. 1051/2008 at RON 600. Vacation: All employees are guaranteed their right to a paid annual rest leave. The minimum duration of the annual paid rest leave is, according to Labor Code, 20 working days. According to CLA, the annual paid rest leave is minimum 21 working days. As an exception, the Collective Labor Agreement concluded at the national level for 2007-2010 provides a paid rest leave of 24 working days, in case of employees under 18, whereas for newly-hired employees, for the first year of activity registered in the Employment Card, these are entitled to a paid rest leave of minimum 20 working days.

In case of special family events (employee's marriage, the child's marriage, the child's birth etc.), the employees are entitled to paid days off, not included in the duration of the rest leave. The law, the applicable collective labor agreement or internal regulation settles the special family events and the number of paid days off.

5. Education

The general legal framework to organise, administrate and provide education in Romania is established through the Constitution, the Education Law (Law 84/1995, republished, subsequently amended and completed) – organic law, ordinary laws and governmental ordinances. Specific procedures and regulations are established through Government Decisions and Orders of the Minister of Education, Research and Innovation.

Implementation of the legislation and general administration and management of the education and training system is ensured at the national level by the Ministry of Education, Research and Innovation. In exercising its specific attributions, the Ministry of Education, Research and Innovation cooperates at the central level with other Ministries and institutional structures subordinated to the Government.

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Universities and other higher education institutions are autonomous and are guaranteed by the law the right to establish and implement their own development policies, within the general provisions of the in-force legislation. The Ministry of Education, Research and Innovation coordinates the activity of the universities and other higher education institutions, complying with the principles of university autonomy.

Institutions belonging to State Pre-tertiary education (pre-primary, primary, secondary and post-secondary non-tertiary education) are subordinated to the Ministry of Education, Research and Innovation through County School Inspectorates. These inspectorates ensure observance of the legislation and evaluation of the education system and process, as well as the implementation at county level of education policies, established at central level.

In 2008/2009 school year, the structure of the education system was the following:

- Pre-primary education – organized for children aged 3-6/7. Pre-primary education is not compulsory;
- Primary education (compulsory) – organized for pupils aged 6-7/10 and including grades I to IV;
- Lower secondary education - organized in two successive cycles (both compulsory):
 - *Gimnaziu* – grades V to VIII for pupils aged 10-14;
 - *Liceu* - lower cycle or, alternatively, *Scoala de arte și meserii* (Arts and Trades School) – grades IX and X for pupils aged 14-16;
- Upper secondary education, organised in:
 - *Liceu* - upper cycle (non-compulsory) – grades XI to XII/XIII for pupils aged 16-18(19)
 - Preceded by a completion year - for graduates of *Școala de Arte și Meserii* (Arts and Trades School);
- Post secondary non-tertiary education, including post-high schools and foremen schools;
- Tertiary education, including university and post-university education.

Compared to 2000, when public expenditure was 3.5% of the GDP, in 2009, public expenditure on education rose to 6% of GDP in 2009, the same as in 2008. The budget for 2009 amounted to Eur 7 billion and for 2008, the budget for education reached Eur 9 billion. The school population declined by 3.9% in 2009/2010, compared to 2006/2007.

There have been sweeping changes in the structure of the education system in recent years. Most progress has been made in reform of educational and professional training; increasing

institutional capacity; modernization of curriculums; evaluation and certification; and international recognition of diplomas and certificates. The number of teaching staff in higher education has doubled during the transition, but resources have failed to keep pace with demand, so that expenditure per student has halved. This has affected the provision of equipment, including of information technology (IT). Unless concerns about underfunding and low pay are addressed, the crisis in education could deepen. There are already recruitment shortfalls in certain subjects and few graduates are entering the profession. Qualified teachers are turning to private educational institutions or leaving the profession all together in search of better pay and better working conditions.

The restructuring of the national system of education and the new legislative regulations in education have led to the reorganization of the education network units in Romania. As a result of the reform measures within the national system of education, during 2006-2009, the number of educational units decreased by 240 (2.8%, respectively).

The new configuration of the education network was correlated to the size of school population and to the conditions offered by the existing material resources in order to provide a qualitative educational process.

Due to the reduced school population, the number of graduates has decreased, except for the secondary school, where during 2008/2009 was registered a 38.6% increase compared to 2006/2007, and a 35.4% increase compared to 2007/2008. At the end of the academic year 2008/2009, the largest number of graduates was college-level institutions (over 214,000 persons), 71.2% higher compared with the 2006/2007 academic year.

Educational attainment levels in Romania are similar to those of other countries in the region. Some 14% of the population has a higher educational qualification; 21% graduated from secondary school; 11% graduated from elementary school and 1.3% did not graduate from any school.

(Source: Economist Intelligence Unit 2009 Country report)

The average rate of the school dropout in Europe is 14 percent and Romania is 'slightly' over this rate, with 16 percent, according to European Commissioner for Education, Culture, Multilingualism, Sport, Media and Youth Androulla Vassiliou.

6. Infrastructure

All transportation infrastructure in Romania is the property of the state, and is administered by the Ministry of Transport, except when operated as a concession, in which case the concessions are made by the Ministry of Administration and Interior.

Road and rail

Romania total road network is estimated to be 198.930 km long, out of which 321 km of highways, 16.177 km of national roads, 34.668 km of county roads, 27.781 km of local roads and 119.988 km of streets (inside and outside the cities), according to Romanian National Company of Motorways and National Roads.

Currently Romania has the least developed motorway among all EU member states, the total number of km estimated to be finished in 2011 is 411.

Nevertheless, the construction of an extensive motorway network is among the top priorities for the government. There are plans to build another 800 km of motorways in a first stage which by optimistic forecasts will be ready by 2012.

Currently Autostrada Transylvania is the largest motorway project in Europe with a length of 588 km from Bucharest to Oradea (near the Hungarian border). Underwritten by US\$ 2.5 bn of state loan guarantees, the 415-km road is to be built by US company Bechtel and is expected to take between seven and nine years to complete, and to generate significant employment during its construction, as well as through subsequent improved links with EU markets. Work on the motorway resumed in mid-2006, after a suspension for one year caused by legal and funding difficulties. The authorities still have difficulties in finding funds for continuing the construction of the highway and for 2011 there are no financial resources for the works. The problem for the authorities is that the cancellation of the motorway would incur penalty charges of more than EUR 1 bn.

Other motorways projects under construction include: Cernavoda–Medgidia (19 km) and Medgidia–Constanta (32 km), part of the A2 (Autostrada Soarelui) motorway.

Timisoara–Arad (32 km) and Arad's ring-road (12 km), part of the A1 motorway (Bucharest–Nadlac) are another projects estimated to be completed in 2011. In the same year, Constanta's ring-road should be ready.

The rail network, which is the main means of internal transport for passengers and freight, covers 14,217 km, the fourth-largest railway network in Europe, but only 35% of the system is electrified. Following years of falling volumes, the number of passengers seems to have stabilized at around 500,000 per day.



Annual cargo traffic volumes are about 70m tones, mainly of coal, oil products, common metals, cement, quarry products, chemicals and agricultural items.

Caile Ferate Romane (CFR) is the official state railway carrier of Romania. CFR is divided into four separate companies: *CFR Calatori*, responsible for passenger services; *CFR Marfa*, responsible for freight transport; *CFR Infrastructura*, manages the infrastructure on the Romanian railway network; and *Societatea Feroviara de Turism*, or SFT, which manages scenic and tourist railways. Currently, *CFR Marfa* is in the process of privatization by selling the shares on the stock exchange.

Railways incurred losses caused by decline in market share, overstaffing, outdated equipment, and historical non-payment by many loss-making state-owned enterprises. The railways could not finance maintenance and investment in facilities and equipment. Railways covered the losses by accumulating arrears to the state and through debt to other creditors. As a result, the Government launched a railway reform program in 1996 – supported by World Bank, EBRD, EU-PHARE.

Currently, a series of maintenance and modernization works are underway and railway infrastructure investments in Romania is expected to amount to EUR 7 bln in the next 5 years.

Shipping

The Port of Constanta is the main Romanian port and is located at the intersection of the trade routes connecting the Western European and Central European developed countries with the raw material suppliers from the Community of independent states, Central Asia and Transcaucasus. It is one of the largest European ports and the largest Black Sea port.

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Along the Romanian Black Sea shore there are other two commercial maritime ports: Mangalia and Midia.

Furthermore, all ports are directly connected with the Danube-Black Sea Canal, which ensures the connection with the Danube, the Poarta Alba-Midia Navodari Canal.

In Romania, the Danube River has a length of 1,075 km, approximately 44% of its whole navigable length. The Romanian Danube is divided into two structurally different sectors: the River Danube and the Maritime Danube. Several of the ports situated along the Maritime Danube, namely Galati, Braila, Tulcea and Sulina, allow the access of both river and maritime vessels, so they also serve international sea trade.

Ports are administered by national companies under the authority of the Ministry of Transport. There are a few exceptions, namely Sulina, Turnu Magurele and Zimnicea ports, which are administered by local authorities.

The inland waterway network presently has a length of 1,700 km and is comprised of:

- The Danube from Bazias to Sulina;
- Secondary navigable branches of the Danube;
- Navigable canals.

Air transport

Romania has a total of three international and 16 domestic airports. Four new domestic airports are planned, and the one at Cluj-Napoca is being upgraded to international standards. Bucharest's international airport at Otopeni is undergoing a major upgrade.

In November 2010, Schengen Area evaluation committee experts visited International Airport Henri Coanda in Otopeni, near capital Bucharest, to assess the country's progress regarding airspace. The Bucharest Airports National Company said in a press release that the evaluation team made up of auditors from ten Schengen member states assessed on Monday the technical measures taken to separate the passenger flow intra and extra Schengen on the Henri Coanda airport.

The Schengen experts will also visit the "Traian Vuia" Airport in Timisoara and two border crossing points at Moravita, Timis County (western Romania).

Tarom, the National Air Transport Company, has a 70% market share and in the first 7 months of 2010, the company had 1,120,037 passengers, with 9,743 flights to both internal and external destinations. Tarom has yet to set a date for privatisation.

In 2007 Romania has signed an "open sky" agreement, which allows any airline operator from the EU to set up business wherever it wants. As a result, Tarom is facing growing competition from low-cost airlines.

The low cost airlines operating in Romania are: Wizz Air, Blue Air, Germanwings, easyJet, Ryanair, Vueling, Wind Jet, Air Lingus and Baboo, Air Berlin, Flyniki.

Telecommunications

Romania is one of the fastest-growing IT markets in eastern Europe. The country has made significant progress in all of the information and communications technology (ICT) subsectors, including basic telephony, mobile telephony, Internet and IT. Telecommunications companies, such as Orange Romania (French-based) and Vodafone Romania (UK-based) are in 2010 among the most profitable in the country. The telecoms market (fixed telephony, mobile telephony, the Internet and other data-transmission services) was worth an estimated € 4 bn in 2009.

The telecoms sector has been deregulated, expanded and modernised and has grown especially rapidly over the past two years. The fixed-line telephony market was liberalised on January 1st 2003, breaking the monopoly of the national operator, Romtelecom, in which a Greek company, OTE, has a 54.01% stake.

In November 2010, the Romanian state announced plans to sell its 46% stake in Romtelecom and invited OTE representatives, the majority shareholder of the operator, to make an offer by the end of the year, the Communications Ministry announced. Romanian telecom operator Romtelecom, registered an operating loss of 13.9 million Euro in the third quarter of 2010 and its revenues dropped by 6.5%, to 181.5 million Euro, because of austerity measures and rising unemployment.

Fixed lines numbered 5.29m at the end of 2009, representing a penetration rate of 24.7 per 100 people, according to data from the National Communication Authority (ANC). This compares with 25.2 per 100 people in Poland and 17.2 per 100 people in the Czech Republic. Telephone density varies considerably from county to county, ranging from around 50% in the capital, Bucharest, to about 10% in Dimbovita county.

The new fixed networks, dubbed "alternative fixed lines" by the ANC, have been developing rapidly at the expense of the former monopoly, Romtelecom, but Romtelecom remains the dominant player. It controls most of the local access market, accounting for about 65% of the total number of fixed lines, although its portfolio has shrunk.

Strong demand has led to extremely impressive growth in mobile telephony over the past five years. Mobile penetration surpassed fixed-line penetration in 2001, and by the end of 2009 the number of mobile subscribers was estimated at 29.6m, representing a penetration rate of around 138%.

The mobile telephone market was worth an estimated US\$4.1bn in 2008, but the value of the market fell to an estimated US\$3.5bn in 2009, a decline of about 15%, owing to the deleterious effect of the economic crisis on incomes.

The combined revenue of the top operators (Orange, Vodafone, Cosmote - which acquired Telemobil/Zapp in June 2009 - and RCS&RDS - with its Digi Mobil brand) fell by about 13% compared with 2008, although the total number of mobile subscribers increased by about 900,000. This compared with an increase of 5.7m in 2007 and 4.5m in 2008 (although much of this growth was boosted by the large operators offering pre-paid cards as bonus schemes to existing customers).

In February 2008 Nokia opened its first mobile-telephone assembly plant in Romania—in the Tetarom IV Industrial Park, 20km from Cluj-Napoca in central Romania—after investing EUR 60m. By September 2008 Nokia was employing 1,600 people at the plant. Companies supplying parts to Nokia are considering building production facilities close to the plant.

The Internet

Although Internet penetration, at about 36% in 2009, is low compared with other European countries, the growth rate of the sector is significant, at an estimated average of 20% per year in 2006-09, according to data from the ANC. Much of this growth has come because of the growing number of mobile connections, which may give a flattering picture, given that the reported figures give the number of users with Internet-enabled handsets, rather than actual users of the mobile Internet access service.

The number of Internet access connections rose to 7.8m in 2009, from 6.9m in 2008, of which 2.8m were fixed broadband Internet access connections and 4.6m were active mobile connections. The Internet access and data transmission market just managed to keep growing in 2009, despite the recession, and was worth about US\$1.1bn, compared with US\$1bn in 2008.

Growth in recent years has been driven by the growth of broadband connections, as more businesses seek high-speed and quality transmissions. Broadband connections accounted for 36% of all Internet connections by the end of 2009 (including fixed and mobile Internet access).

The number of Romanian (.ro) domains has grown rapidly in recent years, rising by 25% year on year, to 430,000, at the end of 2009, compared with 68,000 at the end of 2004. Revenue from online advertising is expected to increase significantly over the next five years, owing to increasing Internet penetration and the increasing emphasis that companies place on this as a marketing tool. Companies such as Home.ro, Romania Online and others selling advertising on their hosted sites are set to reap the rewards.

According to a ranking issued by Internet World Stats, Romania ranks 8th according to internet users. The total number of Internet users in Romania was 7.43 billion at the end of 2009, while Sweden and Belgium rank 9th and respectively 10th. Germany ranks first with 55.2 billion Internet users.

The largest internet service (ISP's) providers are Astral Telecom (now part of UPC Romania), RDS (part of the RCS group) and the Internet division of the former telephone monopoly, Romtelecom. As well as these operators, the main mobile communications players—Orange (France), Vodafone (UK) and Zapp (taken over in 2009 by COSMOTE of Greece)—offer mobile Internet access, Zapp being the leader in this market segment.

There has been strong consolidation of the market in recent years, with many local ISPs—such as Canad System, DNT, FX Internet, Kappa, PCNet and TotalNet—being acquired by larger players such as Astral (which was later acquired by UPC Romania) and RCS. This trend of consolidation is set to continue. In December 2009 there were about 1,065 active Internet providers, down from 1,100 in 2008, 1,338 in 2007 and 1,412 in 2006.

Further strong growth in this segment is expected as a result of falling prices, increased computer penetration, and more competitive offers from cable television companies and mobile providers of broadband Internet.

The media

Since 1989 a free press has flourished and new media outlets have proliferated and at present Romania has one of the most dynamic media markets in southeastern Europe. For most households, the broadcast media are the main sources of information. Public television broadcasts through two mainland channels (TVR 1, a general interest channel, and TVR 2, which focuses on cultural and educational programmes) and two international satellite channels (TVR International and TVR Cultural). There are several regional public television channels, but TVR 1 is the only national channel covering almost the whole country. There are several private competitors at national level, the most important being ProTV, Antena 1 and Prima TV. The first two have more

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viewers in the cities than public television. There are many other private stations broadcasting nationally by satellite and there are more than 100 local private TV stations.

The printed media in Romania has seen fallen readership during 2009-2010 ending in April this year, shows a recent National Readership Study (SNA).

Among the few publications which managed to increase their readership reach during this period were tabloid, *Click*, with an increase of 4.2 percent, daily *Financiarul*, with 1.9 percent, *Marie Claire* glossy magazine, with 4.5 percent, *Gazeta Sporturilor*, the Sunday edition, with 4.1 percent.

Central daily newspapers have seen decreases in readership but they kept their position in the top. The first place was occupied by tabloid *Libertatea*, with 1.25 million readers each issue, but with a drop of 7 percent compared to January 2009 – January 2010 period.

It was closely followed by *Click*, with 1.26 million readers each issue. The third is another tabloid, *CanCan*, with 905,000 readers each issue.

Sports newspaper *Gazeta Sporturilor* comes forth, with 731,000 readers and a drop of 1.2 percent in its readership.

Adevarul ranks fifth, a general daily newspaper with 638,000 readers, followed by *Jurnalul National*, with 615,000 readers.

Evenimentul Zilei quality newspaper had a 449,000 readership but suffered a loss of 9.5 percent in readership. *Ziarul Financiar*, one of the main business newspapers, has 197,000 readers each issue, a drop of 9.2 percent, followed by *Gandul*, with 180,000 readers and a drop of 11.8 percent.

Business magazines were also down in readership. *Saptamana Financiara* reported a drop of 8.7 percent to 264,000 readers each issue, while *Capital* dropped 14.2 percent, to 205,000 readers per issue. *Business Magazine* had a drop of 2.2 percent, to 87,000 readers each issue.

The overall Romanian media market dropped by 37 percent in value in 2009, reaching a level below the one in 2006 and affecting all the market segments, according to the recently-released *Media Fact Book* which focused on ad spending in Romania last year.

The print market saw a 55 percent decline, followed by outdoor, with a 40 percent drop. TV advertising declined by 34 percent and radio by 28 percent.

Internet – based media was the least affected, with only 19 percent in drop, according to Initiative's Media's report. The local media market is expected to reach EUR 308 million in 2010, from EUR 339 million in 2009. The market peak was in 2008, when it reached EUR 540 million.

In 2010, TV advertising will lead, with EUR 209 million, still downwards compared to last year. The print market will only reach EUR 27 million, down on EUR 37 million compared to 2009. Radio will make a EUR 23 million market, while outdoor advertising, EUR 35 million. Internet and cinema advertising will together reach EUR 14 million, being the only market segment to display growth. Actually, the growth of online is the biggest and most important trend, both in terms of usage, content dimension and complexity, writes the report.

7. The Most Active Industries/Sectors

Agriculture

Along with Romania's accession to the EU, 2007 brought a new era in the local agricultural economy and the rural development. The accession represented for Romania the most important pressure factor for fast reform in the industry. Unfortunately, the local rural environment, dominated by Agriculture, is still poorly integrated into the market economy.

In terms of agriculture production, in Romania the largest sector was held in 2009 by the vegetal crops. It amounted to 60% out of the total production, compared to 39% represented by the animal industry and 1% represented by agricultural services. In 2009 the estimated cereal production was higher than the one in 2007, but lower than 2006 and 2008. Compared to 2008 results, in 2009 cereal production was considerably lower, however the fruit and vegetable production was higher. In terms of forestry, 2009 saw a decrease in raw wood demand, the surface of the forest land occupying 0.4% more territory than in 2008.

The contribution of agriculture, forestry and fishery industry to the GDP rose up to 6.5% in 2008, while in other EU member states this figure revolves around 1.7%.

Out of the 23.8 Mil Ha representing the country's territory, the agriculture surface amounts to 61.7%. Thus, Romania ranks 7th in Europe in regards to agriculture area (after France, Spain, Germany, Poland, UK and Italy) and 5th in regards to tillable area (after France, Spain, Germany and Poland).

Agricultural, forestry and fishery segments' employment amounted to 2.76m in 2007 and accounted for 30.5% of total employment. Local rural economy presents as a dominant feature the high level of subsistence farms, which produce mainly for self consumption, trading randomly on the market.

Romania's agriculture sector is considered to be the most important beneficiary of EU funding. Bureaucracy and little access to information can only lead to low absorption rate of the 7.5 billion Euro allocated during 2007-2013 under the Common Agricultural Policy.

Manufacturing

The strategy of heavy industrialization during the communist era left Romania with a concentration of relatively obsolete plants in the metallurgical, heavy engineering and chemical industries. Production of sophisticated consumer goods and machine tools was neglected, and engineering products failed to meet the quality standards of the world market.

In the 2006-2009 timeframe, the indicators of the industry's turnover registered a positive evolution. The most significant growths were seen in the following domains: electric equipment manufacturing, plastic and rubber masses productions, manufacturing of road transport vehicles, metal construction and other metal products (except automobiles, machinery and installations), wood processing (except furniture).

Recent developments brought a decline in the local market, much more visible than in other EU countries. Exports increased to 55% and 58% in 2008 and 2009 respectively, as the production levels lowered. After the market contracted with the economic crisis, its recovery may come from targeting less affected markets with stronger economies, while also attempting the recovery of the local steel consumption through heavy investments.

Foreign investors entering the local steel market started out in 2007-2008 with record profits and high prices, only to witness slowly but surely the decline of the demand both locally and globally. Such high rolling times are not expected to occur in the future. Nowadays foreign companies see the need to bring supplementary funds not only to cover losses but also to improve operations.

The automotive industry takes off

The automotive industry has attracted the attention of many foreign investors of the years, as one of the most profitable segments of the local industry. The industry although may be considered still in its early stages, it has seen rapid growth throughout the years, ranking fourth largest producer in the region, after the Czech Republic, Poland and Slovakia. The industry accounts for more than 5% of the total manufacturing output.

Around 120,000 people are directly employed in the automotive industry while significant others work for tier-two or tier-three suppliers. An advantage of manufacturing in Romania is that the companies benefit from low labor costs and highly skilled and specialized workforce. Another factor of importance is country's

proximity to main European markets.

The local market disposes of a wide network of suppliers and components manufacturers, consisting of traditional local suppliers and foreign-owned companies, with the foreign-owned companies producing mainly for export.

Despite a long history in the automobile production business, the local industry has only taken off along with the takeover of Automobile Dacia by Renault France in 1999. Nowadays Dacia accounts for 80% of domestic production. The company managed to become a success on foreign markets with the introduction of the Logan model, which led to 150% increase in car exports in 2005, and further 40% year-on-year increase in 2006. 2008 saw a major foreign company entering the market, when Ford US bought Automobile Craiova. According to the company's officials, the total investment in the plant will raise up to 1 billion Euros by 2011, employing at the same time up to 9,000 people. The company forecasts 300,000 units production by 2013, with around 90% going to export.

In terms of economy, further contraction is expected in 2010 following the 7.1% in 2009. As a result of the contraction and the government's fiscal austerity measures, consumer demand for non-essential goods, including automobiles, will remain at low levels in the short term.

Despite the reports from the Romanian Agency for Foreign Investments about new companies willing to invest in the local market, the automotive industry is expected to remain at a slow pace on short term. A recovery is only foreseen on medium term, provided investments are attracted through low labor costs, skilled labor force, investment-friendly government policies and geographic proximity to large automotive markets.

In 2011-14 growth is expected to average about 4.6% per year, and new passenger car sales are forecast to grow by around 16.9% per year over the same period.

Pharmaceuticals benefit from FDI

In the Business Environment Ratings for 2009, Romania has moved up two places on the rankings table to reach fourth position among the 20 Central and Eastern European (CEE) key markets surveyed as a part of the Pharmaceuticals & Healthcare Business Environment Rankings. Romania's current position reflects the robust nature of the country's pharmaceutical industry and the strong growth it has made in recent months. We envisage that sales of pharmaceutical products are set to increase over the next five years, with sales of prescription drugs and over-the-counter (OTC) medications expected to grow from US\$3bn to US\$5.46bn, thus representing a compound annual growth rate (CAGR) of 12.74%.

Romania

Romanian pharmaceutical production has benefited from inflows of FDI for modernisation of what remains a relatively backward industry by European standards. Foreign pharmaceutical firms entered the market through direct imports, licensing-in agreements, acquisitions-for example, GlaxoSmithKline (UK/US) bought a 65% stake in Europharm, and Lek (Slovenia) bought a 90% stake in PharmaTech-and privatisations (Gedeon Richter of Hungary bought a majority stake in Armedica). FDI in the sector is leading to quality improvements, and, with more factories meeting good manufacturing practice (GMP) standards, improving export prospects.

Imported drugs are growing rapidly, from 45% of the market by value in 1996 to about 80% currently. However, imports account for only about 20% of the market by volume, with domestic producers largely concentrating on the production of low-value generic drugs whose patent has expired, while imports are concentrated on more sophisticated drugs.

Romania's pharmaceuticals market is characterised by high growth and increasing levels of foreign direct investment ahead of planned EU accession. Generics represent around 30% of the market by value, although their share is likely to slip as the operating conditions in the country improve for foreign players. The over-the-counter (OTC) market is underdeveloped, accounting for a 20% share of the total, mirroring the historical reliance on public healthcare system for medicines.

Domestic manufacturers produced about 1,500 types of drugs for domestic consumption and 690 for veterinary use in 2005. Domestic producers are generally small and have struggled to raise the investment required to meet GMP standards, which have been a requirement for operation since the end of 2003. Drug market in Romania in the first quarter of 2010 increased by 21.4% to EUR 602.1 million, sustained evolution of prescription products.

On the production side, there are only a few significant domestic players left, and during the next few years these are expected to be acquired by foreign companies-attracted by Romania's relatively large market, fast growth and low cost base. The government is attempting to consolidate smaller domestic producers into the expanding majority state-owned pharmaceutical company, Antibiotice

Recent data suggests that the Romanian pharmaceutical market has shown strong resilience to the economic downturn in 2009. Data released by market research firm IMS Health shows that pharmaceutical sales grew 20% year-on-year (y-o-y) to reach RON3.5bn (US\$1.2bn) in the first five months of 2009,

reinforcing data released by the Cegedim Consultancy Group which measured Q109 growth at 22.5% y-o-y. It is believed that full-year growth rates will be less impressive, although we project that outside the Commonwealth of Independent States (CIS) countries, Romania should be the fastest-growing market in local currency terms during 2009.

In other developments, some of Romania's leading private healthcare providers have announced plans to invest EUR80mn (US\$113mn) over the next three years in an attempt to expand their networks in the country. These include healthcare providers such as the Unirea Medical Centre, Romar Medical and MedLife.

Latest figures suggest that the market for medical equipment in Romania could reach a value of more than EUR200mn (US\$282mn) by 2012, up 50% from the EUR139mn (US\$196mn) estimated for 2009.

Growth in this area will be supported by the private sector, which has gained considerable momentum in recent years, as well as by the public sector, where efforts towards de-centralisation, (expected to begin next year), will open the pathway for tenders being made for hospital equipment. Firms most likely to compete in the medical equipment market that supplies big hospitals are leading US manufacturer GE Healthcare (currently with 40% of the total market), the German conglomerate Siemens, also with 40% of market share, and leading Dutch multinational Philips, with the remaining market share of 20%.

Meanwhile, GSK Europharm announced that it will produce a drug used to treat HIV-AIDS in Brasov, north-west of Bucharest by the end of the year. The drug will be scheduled for export as of the first quarter of 2011 after the conclusion of all registration procedures. The medicine is the second product to have its production transferred from other GSK manufacturing plants to the facilities based in Romania.

Stabilisation measures delay industrial upturn

Following the initial post-1989 recession and recovery, the closure of loss-making plants in the mid-1990s contributed to a further decline in industrial output of nearly 30% between 1997 and 1999. Industrial output started to recover in 2000, expanding by 25% between the end of 1999 and the end of 2004. The growth of gross industrial output slowed to 2% in 2005 but recovered strongly in 2006, growing by just under 8%, with manufacturing output increasing by more than 8%. Labour productivity in manufacturing industry rose by more than 10%. There were also clearer signs of changes in the structure of manufacturing output in 2006, with several sectors recording double-digit rates of growth while others declined.

Industrial labor productivity continued to demonstrate impressive growth, rising by 9.9% year on year in 2007.

In 2009 compared to 2008, the industrial production (gross series) was lower by 5.5%, caused by the decrease in extraction (-12%) and processing industries (-6.5%).

Declining sectors tended to experience falls in labor productivity as falls in output were not accompanied by equivalent falls in employment, indicating that further restructuring and a reduction in the industrial labor force can be expected in the future.

Industrial production (adjusted for seasonality and the number of working days) rose by 0.1% month on month and by 4.9% year on year in August 2010, and by 4.1% year on year in the first eight months. Adjusted manufacturing output remained flat in August 2010 compared with July 2010, but rose by 6.2% year on year.

Construction

The construction works have doubled in volume terms in 2008 compared to the base level reached in 2002-2006, but in the meanwhile, as a result of the economic downturn, the sector has lost ground.

Yet the activity in January-August 2010, as estimated by the statistics office's index, remains 25% above the level in the same period of 2006.

The outlook for the sector remains however rather bleak for now and the constructions activity might return to the base level of 2006 unless the key drivers see major changes in the coming quarters (2010-2011).

If the constraints for the sector's developments were until late 2008 in the supply side and to certain extent in the environment region, while the demand drivers were strong and positive, the general outlook has changed dramatically meanwhile.

Strong demand for all kind of construction works have pushed up the prices paid by developers (government included) for financing and to contractors and by contractors for construction materials and labour. The constraints came in the form of production capacities, workforce available and formal contracting of loans.

After the global financial sector crisis and the financial inflows evaporated, in line with the external demand and the hopes for fast growth rates everywhere, the constraints moved in the demand region; serious constraints remained however related to the environment – which seem to be neutral to the growth

cycle and hinders all kind of processes from the judicial procedures (litigations) to administrative procedures (permits) and financing procedures – particularly when it comes to funds from the EU budget.

The structure of the construction market has changed only slightly from 2006 to 2008, while its total value nearly doubled. Speaking of the narrow segments of the market however, there might be dramatic changes from 2006 to 2008. The money spent for the construction of collective residential buildings (blocks of buildings) surged by 3.4 times to nearly EUR 1.8bn. On the other hand, the funds earmarked for the construction or upgrade of airports (this section do not include the airports' buildings) shrunk by 40% to only EUR 9mn. The discrepancy reveals the different involvement of the private sector (collective residential buildings) and state (administration, airports) in the construction market, as investors.

The constructions market will shrink by 30-40% y/y in 2010 from EUR 12.6bn last year to stagnate at the best next year, according to the line association of construction companies ARACO. The market will not return to high growth rates sooner than 4 to 5 years, according to ARACO's expectations. The construction firms blame the lack of financing, and the lack of public financing in particular.

Smoothing the trend to iron out the effects of the VAT rate hike which took place on 1st July 2010, the construction activity remains slightly below the level of 2007 - which is neither unexpected, nor particularly bad.

The dynamics of new constructions remains particularly negative as very few projects are started in 2010 and the bulk of the activity is generated by constructors striving to complete sections of old projects.

The scarce financing in both public and private sector remains the main downward driver for the sector. Prospects for the future thus depend on the government's ability to resume infrastructure works and make its due payments to constructors, as well on the resumption of the bank financing of EU-funded infrastructure projects.

The real estate market is expected to linger for the coming years - except for the government's announced plan for building homes in the rural area for school teachers and medical doctors.

Basically, the activity in constructions lost dramatically ground since it peaked in early 2009 – but it is still at a high level compared to the average of 2000-2006.

Romania

The share of those who report lowering number of contracts was 50-60% higher than those that report rising number of contracts since last fall – which means that the pessimist ones were in the range of 75% to 80%.

Financial services

Throughout the 1990s state banks continued to grant soft credits to loss-making industries, and the financial sector was rocked by a succession of scandals that affected the savings of large numbers of the population. Privatisation and restructuring of the banking sector started late, in 1998, with the sale of the state's holding in the Romanian Development Bank (BRD) to Société Générale (France); the latter increased its holding further in November 2004. The sale of BRD was followed by the disposal of the state's share in Banc Post, and the agricultural bank, Banca Agricola. The second-largest bank, Bancorex, was placed under administration in 1999 and was absorbed by Banca Comerciala Romana (BCR).

The privatisation of BCR was a condition of the stand-by agreement with the IMF secured in October 2001, but proved difficult to accomplish. The government finally announced the sale of a 61.88% stake in BCR to Erste Bank of Austria in December 2005. Erste Bank acquired the government's holding of 36.88% and a 25% share previously held by the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC, the private-sector arm of the World Bank Group) in October 2006 for €3.75bn (US\$5bn), of which €2.2bn went to the government. As a result, the share of state-owned banks in total net banking sector assets has fallen from 75% in 1998 to 7.5% in 2006. Erste Bank, which has extensive operations in central Europe, has announced plans for a major reorganisation of the bank's activities.

In a setback to the further reform of the sector, the government announced in December 2006 that it had cancelled plans to sell a 69.9% stake in the State Savings Bank (CEC), as the only bid received was lower than expected.

Romania has developed a relatively well regulated financial market. Although the global economic crisis has highlighted vulnerabilities and hit the financial services industry, the banking sector is stable. At just below US\$125 billion (Eur 78.5 billion) in 2009, banking assets in Romania are greater than those in Bulgaria (US\$52 billion) and Slovakia (US\$76 billion), but smaller than in the Czech Republic (US\$230 billion) and Hungary (US\$154 billion). The bank sector penetration ratio (total assets as a percentage of GDP) was around 78% in 2009, and therefore lags behind the EU average. It is also much lower than in leading

east European economies such as Hungary and the Czech Republic, where banking sector penetration is above 100% of GDP.

The banking sector remains relatively concentrated. The top five commercial banks – BCR, BRD, Volksbank, Alpha Bank and CEC Bank – account for more than half of the total banking sector assets, while the ten largest banks hold around 80% of the sector's assets. BCR has a dominant 19% market share. The remaining banks are rather small and further consolidation is expected.

Foreign-owned banks account for 86.1% of the share of assets (data as of June 2010) and have expanded their retail operations by means of intra-group loans, with credits frequently denominated in foreign currencies, making households and companies vulnerable to currency depreciation. The average capitalization of Romanian banks is 14%, significantly above the statutory minimum of 8% and the 10% undertaken in the Vienna agreement and bank supervision is tight.

Under the 2009 Vienna agreement, the nine largest foreign-owned banks operating in Romania committed to maintain their exposure and strengthen the capitalization of their subsidiaries. However, Greek-owned banks may reduce their exposure to the Romanian market to build up their domestic capital bases.

Household demand for credit has risen rapidly in recent years, although it is still at a basic level, and the range of financial products held by Romanian consumers is fairly narrow. Nominal lending to the private sector grew by 60% in 2007, but moderated to a 34% expansion in 2008, owing to the onset of the global financial crisis. In 2009 the crisis curtailed credit growth, which grew by just 0.9% year on year, to less than Eur 50 billion. After registering negative y/y growth every month in January-April 2010, nominal lending to the private sector turned positive in May and June, growing by 2% and 6%, respectively, owing to a rise in foreign-currency-denominated loans (leu-denominated lending continued to decline).

The leasing sector has been a fast-growing, although small, component of the non-banking financial sector in recent years, but has been hit hard by the economic crisis. The volume of financing extended by leasing companies decreased by 30% y/y to Eur 543.7million in H1 2010, according to ALB Romania association. Besides the weaker activity this year, the leasing firms have to deal with increasing number of bad debtors under the circumstances of intricate legal procedures. The ALB statistics cover the whole market, even if the association's members

account for only 91% of the financing extended in the first six months of 2010. The financing was mainly directed for transportation means - 62%, out of which 57% was for passenger cars. Other segments financed by the leasing companies were industrial equipment (20%) and real estate (18%).

The Romanian insurance market is underdeveloped in terms of the limited range of products on offer and risks covered, including buildings, liability, motor, marine, aviation, shipping and agriculture at the commercial level. The market is dominated by motor, life, health and home policies. However, it is one of the largest untapped insurance markets in Eastern Europe, and before the economic crisis, it had been experiencing extremely rapid growth rates, with gross premiums averaging growth of more than 25% per year in 2003-08. Romanian accession to the EU brought foreign insurers to the market in larger numbers, and the introduction of mandatory house insurance in 2008 has been a spur to the market. The insurance market is expected to stagnate in 2010, when we forecast further modest negative growth in Romania, but is expected to grow robustly over the medium term. Over the past five years the insurance market has come to be dominated by international groups such as Vienna Insurance Group (VIG; Austria), Uniqa (Austria), Allianz (Germany), ING (Netherlands) and AIG/Alico (US). The top ten companies account for around 80% of gross premiums in local currency terms, and the top five hold more than 50%.

The pension market regulator CSSPP data shows net assets of mandatory pension funds (Pillar II) reached Eur 0.9 billion at the end of September 2010 and the number of contributors reached 5.11million, while voluntary pension funds (Pillar III) have assets of Eur 70million and 211,800 contributors. The total assets held by Romania's private pension funds are expected to top Eur 1 billion by the end of this year.

A bill on private pensions will be finalized and sent to Parliament for debates by the end of 2010 or early next year and a bill setting up a guarantee fund for the private pension system is to be sent to the government for approval by the end of October.

Private pensions are increasingly more profitable, the Romanian Association for Privately-Managed Pensions (APAPR) announces. The average annualized yield of the private pension funds amounted to 13.3% per cent for Pillar II and 10.2% for Pillar III, in the first nine months of the year, according to a release by APAPR.

Stock exchange

The Bucharest Stock Exchange became operational in 1995, having an electronic system allowing online trading of stock, fixed-income securities, money market instruments, rights and warrants. It is the main market for listed securities. RASDAQ, the system for over-the-counter share sales, was launched shortly after in 1996. The BSB absorbed in 2005 the RASDAQ securities exchange, thus providing greater liquidity and choice to potential investors.

Prior to the crisis in 2008, the BSE witnessed important growth in activity. Considering both the BSR and RASDAQ, the market capitalization declined from 45.4 billion USD at the end of 2007, to 20.6 billion USD at the end of 2008. The BET index, representing the value of the ten most liquid shares, fell by 70.5% over the year, to 2,901 at end-2008, and the BET-FI index (the financials index, which measures the growth of the state investment funds) fell by 84%, to 12,549. The BET sank to a low of 1,887 in late February 2009, then recovered to 4,691 at end-2009. However, this still left the index far short of its peak of 10,814, set on July 24th 2007. The rally lifted the market capitalization of the BSE and RASDAQ exchanges to 31.5 billion USD at the end of 2009. This equates to 19.5% of estimated 2009 GDP, which is still some way below the average of 25% for 2005-07.

The crisis brought a decrease of the expansion pace, with fewer foreign investors on the market. The BSE composite index had grown more than ten times between end-2000 and end-2006, while the BET-FI grew fifty times, and the BET index grew fifteen times over this period. In the first four years of the twenty-first century, Romania's BET Index was the best-performing stock market index in the world.

8. Industrial Parks

Industrial parks in Romania have been promoted through government ordinance no.65, approved by Law no.490 in July 2002, as the authorities showed serious commitment to boosting business investments into the Romania.

The title of industrial park is granted by an order of the Minister of Development and Prognosis pursuant to assessing the documentation lodged only by a partnership.

Establishment of an industrial park is based on the association in participation, between central and local public administration authorities, economic agents, research institutes and/or other interested partners. The purpose of setting up industrial parks is to stimulate economic and social development, to perform the transfer of technology, to induce investment inflows.

Romania

Industrial park license may be granted only to companies acting solely in the industrial parks field, called the managing companies ("Administrator –Company").

None of the business entity associates that use the utilities and/or infrastructure of the industrial park may hold control, directly or indirectly, over the Administrator-Company. The exploitation of industrial parks may be performed by Romanian legal entities and branches or representative offices of foreign legal entities, based on commercial agreements concluded with the Administrator-Company.

The following benefits are granted for establishing and developing an industrial park:

- Exemption from the payment of fees charged for changing the purpose or for withdrawing the land related to the industrial park from the agricultural circuit, for the partnership holding the title of industrial park.
- The local authorities may grant tax deductions, pursuant to decisions of the local or county councils, for the real estate properties and lands transferred to the industrial park for usage purposes, as well as other facilities, in accordance with the law.
- According to article 257 (1) in the Fiscal Code, no tax is levied on the land inside an industrial park, and pursuant to article 250 paragraph 9 in the Fiscal Code, there is no tax levied on the buildings or facilities inside industrial parks either.
- The initiative was in line with other incentives, mostly fiscal, which Romania has sought to provide, in recent years, to small and medium sized enterprises or to certain types of economic activity in areas identified as disadvantaged or in free trade zones.

In early 2009, Romania housed over 91 industrial parks completed and other 20 in advanced stages of construction. More and more companies show interest in such parks, because of the variety of fiscal facilities. In 2009, the existing industrial parks spread over an area of 1,600 hectares. In order to fully develop an industrial park, an initial investment is needed which may vary from EUR 10 Mil up to 30 Mil, however the projects may easily and rapidly attract investments of up to 250 Mil Euro. The Regional Operational Program 2007-2013 grants funding over 633 Mil Euro for the development of business structures locally and regionally. Industrial parks can be included for applications.

9. Investment Incentives

Romania's attractiveness for investment is boosted by: one of the largest markets in Central and Eastern Europe; its strategic geographic location at the crossroads of the traditional commercial and energy routes connecting the EU, Asia and the Balkans; extensive sea and river navigation facilities; a well educated yet cheap labour force; and an extensive network of double tax treaties.

Upon the country's accession to the EU on 1 January 2007, Romania took steps to strengthen tax administration, enhance transparency, and create legal means to resolve contract disputes expeditiously. Its membership has also helped solidify institutional reforms by subjecting government policies to EU scrutiny and thus offering reassurance to potential investors. However, judicial weakness, legislative unpredictability, corruption and bureaucratic inefficiencies, among others, continue to mar the investment environment.

Capital inflows are free from constraint. Romania concluded capital account liberalisation in September 2006 with the decision to permit non-residents and residents abroad to purchase derivatives, treasury bills and other monetary instruments. A broad range of (both tax and non-tax) investment incentives is available to local and foreign investors. Tax incentives include tax exemption for reinvested profit, special incentives for expenses related to R&D, dividend tax exemption for reinvestments, reduced VAT rate of 5% for the sale of buildings and local tax exemptions for businesses located in industrial parks or scientific and technological parks. In addition, there are employment incentives for special categories, as well as state aid schemes for large investments. A private investor in Romania may benefit from business aid from EU funds (structural and cohesion); incentives often take the form of development grants.

Romania has six Free Trade Zones (FTZs), all located in ports with one exception, the newly established Arad-Curtici FTZ. Because of its location, the latter could become one of the most attractive for investors. General provisions include unrestricted entry and re-export of goods and an exemption from customs duties and VAT. The law also permits the leasing or transfer of buildings or lands for terms of up to 50 years to corporations or natural persons, regardless of nationality. Foreign-owned firms have the same investment opportunities as Romanian entities in FTZs. Since 1 January 2007, the European Community Customs Code applies to Romania's FTZs.

10. Foreign Direct Investment (FDI)

Romania actively seeks FDI and it has been a leading FDI recipient in South-Eastern Europe. The country's legal framework for FDI, encompassed under a substantial body of law subject to frequent revision, provides national treatment for foreign investors, guarantees them free access to domestic markets, and allows them to participate in privatisations. Foreign investors are entitled to establish wholly foreign-owned enterprises in Romania, while there is no limit on foreign participation in commercial enterprises. Foreign firms are allowed to participate in the management and administration of the investment, as well as to assign their contractual obligations and rights to other Romanian or foreign investors. There are no restrictions on foreign investors acquiring property or land. However, for a transition period of seven years after Romania's accession to the EU, foreign investors cannot purchase agricultural land or forests and forestry land (except for farmers acting as commercial entities).

The Romanian Agency for Foreign Investments (ARIS) is the governmental body responsible for attracting FDI, providing specialised assistance to potential investors, and identifying and promoting priority investment fields and opportunities. Moreover, the government has set up regulations to support investments, e.g. the authorities issued the Emergency Government Ordinance 85/2008 on stimulation of investments aimed at supporting investments in the development of certain economic areas, taking into account Romania's development priorities, focusing particularly on those regions which attracted fewer investments in the past to ensure a balanced territorial development.

Foreign direct investments reached EUR 3.4 billion in Romania in 2009, according to data from the Romanian Central Bank (BNR), taking the entire stock of FDI to the country to almost EUR 50 billion.

The manufacturing industry was one of the main targets, with 31 percent of the investments. Oil, chemical products, plastics, metallurgy, transport industry, food and beverages industries, cement, glass and ceramics were among the target sectors for foreign direct investments.

The financial sector attracted 19 percent of the FDI, real estate and constructions, 12.9 percent, retail – 12.3 percent and IT&C, 6.5 percent, according to BNR. Bucharest got more than half of the investments, with the center, south, west and south – east of the country ranging from 5.9 to 7.4 percent of the FDI.

The Netherlands was the main country of origin for foreign investments in Romania in 2009, with 21.8 percent of the FDI, followed by Austria, Germany, France and Greece. Companies which run based on foreign investments made a 69 percent contribution on exports, while covering 60 percent of imports. The NBR study covered 6,000 companies which run with foreign direct investments.

Foreign direct investments to Romania fell 36 percent to EUR 1.9 billion in the first seven months of 2010, from EUR 2.9 billion during the same period of last year, according to data from the Romanian Central Bank.

11. Expatriate Life

For travelers, Romania offers the opportunity to see genuinely wonderful places, to meet wonderful people, to experience the last frontier-land in Europe. Romania is famous for its well-preserved historical buildings and monasteries and the natural beauty of the Carpathians Mountains, the Danube Delta and the Black Sea. Bucharest, the capital of Romania, is a true European city, overwhelming in the brilliance of its edifices.

Romania is less expensive than other European countries and offers for expatriates a wide range of international schools, fine cuisine restaurants, tasty wines and entertainment facilities. Regarding the accommodation in Bucharest and other major cities in Romania, the expatriates and their families may rent from centrally-located spacious apartments to villas located in residential areas.

12. Weather and Climate

Romania has a temperate climate with four distinct seasons. Spring and autumn are cool and pleasant, making May and June, and September and October the best months to visit. Summers are hot from July to August and winters are harsh and very cold between December and March, with snow falling throughout most of the country. Spring and summer are the wettest seasons, but rain can be expected throughout the year.

Slovakia

1. General Overview of Economy

The Slovak economy has undergone very dynamic development for last 5 years. Slovakia has been praised for the implementation of significant economic reforms. Stability in the financial sector, integration into NATO and EU, continuous improvement of business environment with many progressive reforms, such as: the introduction of a flat 19% (20% from 2011) corporate and personal income tax, the implementation of flexible labour code, launching pension reform, the completion of privatization process, continuous state support towards foreign investment, etc. have helped the Slovak economy speed up its economic growth. Steady inflow of FDI, proves that the country has become a favorite destination for foreign investors. This is especially true in the industrial sector, which saw a huge inflow of FDI during the last couple of years. Everything changed in 2008, when crisis had come.

Real GDP is growing at around 2,7 per cent for 2010, exports are expanding steadily and domestic demand was hit by crisis. The current account deficit has returned to a more sustainable level as compared to years before. Euro was set in 2009. Wages are rising in line with productivity, keeping inflationary pressures under control. Rapid acceleration in the growth of exports and imports will occur as major car plants and other foreign investment are constructed and then come online. Given this performance and Slovakia's future outlook, some have dubbed Slovakia the "Tatra Tiger", whose EU funding, reforms, low cost labour and low taxes could help lead to strong growth for years to come.

Political system

Slovakia is a parliamentary democracy with a unicameral Parliament, the National Council.

Slovakia's highest legislative body is the 150-seat unicameral National Council of the Slovak Republic (Národná rada Slovenskej republiky). Delegates are elected for a four-year term on the basis of proportional representation. The Council has budgetary as well as legislative powers.

The Slovak head of state is the president, elected by direct popular vote for a five-year term. Although mostly a ceremonial figure, the President can use his veto to stop legislation proposed by the National Council.

Most executive power lies with the head of government, the Prime Minister, who is usually the leader of the winning party. The Prime Minister is appointed by the President. The remainder of the cabinet is appointed by the President on the recommendation of the Prime Minister.

A 13-member Constitutional Court has power to challenge legislation on grounds of unconstitutionality.

2. Tax Structure

Tax administration

Registration Requirements

The entity or individual that obtains license to perform or starts performing business activities in Slovakia is obliged to register at relevant tax authorities within 30 days.

Statutory time limit to assess additional tax

The Slovak tax law allows the Tax Authorities to review tax periods, five years from the end of the calendar year (a tax period) in which the tax return should be filed.

If, prior to the expiration of such time limit the Tax Authorities initiates an action having as its aim the assessment of tax, another period of 5 years commences from the end of the year in which the taxpayer was notified of such an action. In this case, the tax may be additionally assessed no later than 10 years after the end of the tax period in which the duty to file a tax return arose. In cases when double tax conventions were applied, the statute of limitation expires after 10 years from the end of the year in which the tax return was due.

Tax returns

Generally, the tax year coincides with the calendar year. The taxpayer can elect an economic year as their tax year for corporate taxes. For certain types of taxes (for example VAT, excise duties) the tax period is a calendar month or a calendar quarter. Corporate income taxes are assessed on the basis of annual returns, which must be filed within three months following the end of the taxation period. The taxpayer must also calculate and pay the calculated tax by the filing date. The taxpayer must file an additional tax return, if he finds out that the tax liability is higher than that declared in the tax return.

Corporate Income Tax

Corporate Income Tax Rate

The corporate income tax rate is 19%.

Calculation of the Tax Base

Tax is paid on taxable profit derived from the profit reported in the financial statements according to Slovak Accounting Standards and adjusted for deductible and non-deductible items. The tax base of taxpayers using the double-entry bookkeeping system is assessed on the accruals basis. For taxpayers applying the IFRS instead of Slovak Accounting Standards, further adjustments are required.

Generally, expenses recorded by the taxpayer are tax deductible if they can be proved to have been spent on attaining, ensuring and maintaining taxable income, unless they are:

- partially deductible up to a certain limit determined either by the ITA or by a special law (for example the Act on Travel Expenses) ;
- or specifically stated as non-deductible in the Slovak Income Tax Act.

Few expenses are deductible only after being paid.

Advance Payments

For corporate income tax purposes, advance payments are required on a monthly or quarterly basis, depending on the amount of the company's tax liability in the previous tax period. They are paid on a monthly basis if the taxpayer's tax liability for the previous tax period exceeded EUR 16,596.96 or a quarterly basis if it ranged between EUR 1,659.70 and EUR 16,596.96. The tax administrator can rule on a different payment of advance payments.

Tax Credit

In general, tax credit is available in the Slovak Republic in the form of a reduction of the corporate tax liability. They provide the taxpayer with a tax relief of 100% for 10 years, but up to the amount approved up front. In summary, only entities resident in the territory of the Slovak Republic that meet the criteria specified in the law are eligible for the tax credits. It have to be reconciled by the Slovak authorities, it is a part of investment incentives. The criteria include:

- Certain amount and type of investment;
- Investing in specific underdeveloped regions; etc.

Transfer pricing

The transfer pricing rules apply to cross-border transactions between economically, personally or other business related foreign entities. An economic relationship is defined as having more than a 25% direct or indirect ownership or voting rights as well as a business relationship between related individuals, as legally defined. A personal relationship is defined as a participation in management or control of the other party, also through persons or shareholders of the company and their related individuals.

If the difference between the prices agreed between the Slovak entity and a foreign related party and the arm's length price is not sufficiently justified (and supported by appropriate documents), such a difference will be subject to additional taxation and penalties, provided the transfer pricing adjustment increased the tax base in Slovakia.

The adjustment will be determined with reference to the conditions, which would arise among independent persons in a similar business or financial relationship (the principle of independent relationship). The following methods are used to determine the adjustment:

- a comparison of the prices (the method of comparable uncontrolled prices, resale price method, cost plus method);
- a comparison of profits;
- a combination of the aforementioned methods or any other reasonable method, which is in accordance with the principle of independent relationship.

The transfer pricing documentation is required on the: managers' services purchase of stocks and material, loans and within the group.

The purpose of the transfer documentation is to record the pricing methodology of the taxpayer's non-arm's length transactions, including its relationship with the related parties, the prices for services, loans and credit granted. The documentation should demonstrate that the pricing of the Controlled Transactions are in compliance with the arm's length principle.

The documentation content depends on the circumstances and conditions applicable to individual Controlled Transactions¹ of the taxpayer and the transfer pricing method employed. The documentation should be prepared separately for each Controlled Transaction or jointly for a group of Controlled Transactions, i.e. several Controlled Transactions that are closely related, are of the same kind, have been made under identical conditions or are comparable from a function and risk perspective.

There are two types of reporting requirements, depending on the taxpayer's financial reporting. The Full Documentation requirement is applicable only to IFRS reporters and the Simplified Documentation requirement is applicable to non-IFRS reporters.

If documentation is not submitted when required, a penalty of up to EUR 33,000 per request may be assessed. Penalties are not tax deductible. If the documentation is not provided, the tax authorities will also perform their own economic analysis and may adjust the price to the most unfavorable point of the arm's length range. Adjustments may result in additional tax with applicable penalties and late payment interest.

During a tax audit should the tax authority request the transfer pricing documentation, the taxpayer is obliged to submit such documentation within 60 days from the date of the request. The transfer pricing documentation should be submitted in the Slovak language. However, upon the taxpayer's request,

the tax authority may allow that the transfer pricing documentation be submitted in a language other than the Slovak language.

Thin Capitalization

There are no thin capitalization rules in Slovakia.

Tax Treatment of Losses

Tax losses are deductible from the tax base. The taxpayer may utilize incurred tax losses within maximum five consequent taxation periods after the taxation period, in which the tax loss was declared. Losses may not be carried back. Losses after 2009 could be utilized for maximum 7 years.

Depreciation

Generally, fixed assets are depreciated for tax purposes by the owner or lessee of the tangible or intangible fixed asset.

Intangible Fixed Assets

Intangible assets are capitalised and depreciated if the value of the intangible is more than EUR 2,400 and if their expected useful life exceeds one year, and if they were purchased or created by an activity of the taxpayer for the purposes of its trade. The intangibles specified above can be depreciated in accordance with the Slovak accounting rules.

Tangible Fixed Assets

Tangible assets are capitalised and depreciated if their value is more than EUR 1,700 and if their expected useful life exceeds one year.

Tangible fixed assets are divided into four categories for depreciation purposes, and for each category, a period of depreciation is prescribed, as set out in below:

Depreciation Categories

Category	Period of depreciation (Years)	Type of assets
1	4	computers, cars and certain tools etc.
2	6	machinery and equipment, furniture, vehicles for special purposes, etc.
3	12	production equipment, e.g. steam boilers and auxiliary equipment etc.
4	20	pipelines, buildings of timber construction, other buildings, etc.

A Company may choose to depreciate assets either by using the straight-line or the accelerated method. Once the method for each asset has been selected, it must not be changed for the entire period of depreciation. The accelerated method allows for higher depreciation claims in the early years of an asset's life.

It is possible to interrupt the tax depreciation of tangible assets in some taxable periods and then continue as if the taxpayer had not interrupted depreciation. In this way, the time period when the fixed assets are fully depreciated for tax purposes is prolonged.

Withholding Taxes

Withholding taxes are paid on interest, royalties and other payments such as on lease rentals. Double Tax Treaties concluded by Slovakia with a number of countries normally reduce withholding tax rates. Treaty rates can be applied directly. If the interest and royalties are paid to residents of other EU member states and certain conditions are met such payments are not subject to withholding tax.

Dividends

Dividends paid as distribution of profit after tax are not subject to any Slovak taxation.

Collateral tax

If the Slovak tax resident (company or individual) makes payment abroad (except for payments made to the taxpayers of the EU Member States) and these payments relate to Slovak source income, the Slovak tax residents are then obliged to withhold 19% of payments, unless the payment is subject to withholding tax, or unless the non-resident taxpayer submits a confirmation issued by the Slovak tax administrator that he is paying advance tax payments in Slovakia.

The taxpayer is obliged to remit withholding taxes within 15 days of the following month for the previous calendar month to the relevant tax authority. If the taxes are not paid on time or in an incorrect amount, the tax authorities may claim the due tax (including penalties) from the Slovak taxpayer that did not comply with the law.

Considerations for Groups

Tax law does not provide for consolidated tax returns. At present, each company must file its own tax return and pay its own taxes. Losses can be deducted only from the tax base of the entity that incurred the loss.

Value Added Tax

Registration

All individuals or legal entities, which perform economic activities in Slovakia, are regarded as taxable persons. The taxable person with the seat, place of business or permanent establishment in Slovakia is obliged to register for VAT after exceeding turnover of EUR 49,790 within 12 preceeding consecutive calendar months. In general, the turnover consists of all performed taxable supplies in Slovakia. Taxable person can apply for the voluntary VAT registration.

A foreign entity without registered office, place of business or permanent establishment in Slovakia performing taxable transactions with a place of supply in Slovakia is obliged to register for the Slovak VAT before the moment of starting a business activity subject to VAT in the Slovak Republic with some exceptions e.g. (when the VAT obligation is shifted to the customer.)

VAT Rate

The standard VAT rate in Slovakia is 20%. The Slovak parliament has recently approved the increase of the standard VAT rate from 19% to 20%. This new VAT rate should be effective as of 1 January 2011 and should be used until our fiscal deficit is less than 3% of GDP (3 years probably). As of January 2007 the Slovak VAT Act introduced a reduced VAT rate of 10%. This reduced rate applies only to books, antibiotics, certain pharmaceutical and sanitary products as mentioned in the Attachment 7 of the VAT Act.

VAT Returns

The standard assessment period is the calendar month or the calendar quarter (depending on turnover.) VAT returns must be submitted by the 25th day of the month following the tax period concerned. Where returns are submitted monthly or quarterly, payment in full must accompany the return, i.e. VAT for a relevant tax period is payable by the 25th day of the following month.

Claiming Input VAT

In general, the taxpayer is entitled to deduct VAT applied on goods and services used in course of his business performed as a VAT registered payer. However, input VAT cannot be deducted from supplies linked with certain supplies, which are VAT exempt without right to deduction and from certain specific purchased supplies, e.g. (purchase and lease of a passenger car, passenger car accessories including their installation, refreshments and entertainment, etc.).

In order to qualify for input VAT deduction, the following conditions have to be met:

- A taxable liability arose for the taxpayer performing business activity;
- In case of domestic supply the taxpayer has an invoice issued by a supplier;
- In case of reverse charged services and goods supplied with installation or assembly the entry of the VAT in the company's records for VAT purposes is sufficient for the deduction;
- For the acquisition of goods from other Member States the taxpayer has an invoice issued by a supplier or the transfer document in case of a transfer of own goods from another Member State;
- In case of importation the taxpayer has the underlying customs declaration and the import VAT has been already paid to the customs authorities.

Input VAT that relates to VAT exempt taxable supplies cannot be deducted and becomes an expense of the taxpayer. These are for example:

- Financial services (e.g. including provision of consumer loans);
- Insurance services; or
- Supply and lease of real estate under certain conditions.
-

The supplies exempt from VAT with the right to deduction. These are for example:

- Delivery of goods to other Member States to a person registered for VAT in another Member State;
- Transfer of own goods by a taxable person to another Member States for his business purposes;
- The international transport of passengers;
- Export of goods or services,

VAT deduction

The refund of VAT happens under normal circumstances automatically in Slovakia. The procedure is that if taxpayer is in a VAT refund position for a certain month (month A), the tax authority will wait for the VAT position of the following month (month A+1) and off set the VAT due (month A+1) against the deductible VAT (month A). The remainder will be reimbursed within 30 days of filing a VAT return for month A+1. If the VAT return is subject to a VAT audit by the tax authority, the excessive VAT deduction VAT will be returned within 10 days of the completion of the audit.

VAT refund for foreign entrepreneurs

Foreign entrepreneurs without a place of business, a branch or a permanent establishment registered in Slovakia, which are not VAT registered in the Slovak Republic and incurred Slovak VAT can ask for a refund. If such persons have incurred VAT in Slovakia on the purchase of goods or services or on the import of goods, they will be entitled to a refund, provided they meet the conditions laid out in the VAT Act:

- They are VAT registered in the country of their establishment;
- Their country of establishment gives VAT refunds to Slovak entities (reciprocity principle);
- The goods or services purchased or goods imported must be used for the foreign entrepreneur's business activities abroad.
- During the period for which the VAT refund is claimed the foreign person must not have made any sales of goods or supply of services within Slovakia (with certain exceptions, e.g. transport services and complementary services relating to exported goods and goods under a customs regime, a supply of goods with installation or assembly).

The refund can be claimed not later than six months after the end of the calendar year, in which VAT was incurred. Generally, VAT shall be refunded within six months of the submission of the application.

Customs legislation

As the Slovak Republic is a member state of the European Customs Union, the customs legislation of the EU is directly applicable in the Slovak Republic as well as in the other EU Member States. The customs duties for goods are also unified in all EU Member States.

Customs code allows the use the following customs regimes when trading with third countries:

- release into free circulation;
- transit regime;
- customs warehousing;
- inward processing of goods;
- processing under customs control;
- temporary admission;
- outward processing of goods;
- export of goods.

Taxation of individuals

Slovak tax residents are liable for personal income tax on their worldwide income. Slovak tax non-residents are liable for personal income tax only on Slovak source income. Any individual with a permanent home registered in Slovakia or who spends in Slovakia more than 183 days in a calendar year is considered a Slovak tax resident.

A person commuting to the Slovak Republic on a regular basis (even daily) only for the purpose of performing dependent activities is not considered a Slovak tax resident solely because he spends more than 183 days here, i.e. 183-day rule does not apply to commuters.

The concept of economic employment was introduced from 1 January 1999 and also applies to employees seconded by a foreign company to a Slovak company. It is no longer important in relation to income tax prepayments whether it is a foreign or a domestic employer that pays a foreign employee for his or her work. If a Slovak company issues orders regarding how the work should be done, it is considered to be the employer of the expatriate even if the expatriate receives salary from abroad. The economic employer has a duty to make income tax prepayments to the Tax Authorities toward the foreign individual's Slovak personal income tax.

Personal income tax of 19% applies on the tax base. The tax base is calculated as the gross salary decreased by the mandatory employee social security contributions and also the tax deductible allowances.

Social Security Contributions

The social security system in Slovak consists of social security contributions and health insurance contributions. If the individuals are on the Slovak payroll, the monthly social security withholding is done by the employer on the monthly basis.

The social security contributions in Slovakia are relatively inexpensive and are capped as follows:

Insurance System in Slovakia	Assessment Base		Contributions %		
	Min (EUR)	Max (EUR)	Employer (%)	Employee (%)	Self-employed (%)
<i>Old-age Insurance*</i>	307.7	2978	14.00	4.00	18
<i>Sickness Insurance</i>	307.7	1116.75	1.40	1.40	4.4
<i>Disability Insurance*</i>	307.7	2978	3.00	3.00	6
<i>Accident Insurance</i>	307.7	gross income	0.80		
<i>Health Insurance</i>	307.7	2978	10.00	4.00	14
<i>Unemployment Insurance</i>	307.7	2978	1.00	1.00	
<i>Reserve Fund</i>	307.7	2978	4.75	4.75	
<i>Guarantee Fund</i>	307.7	1116.75	0.25		
TOTALS	35.2	13.40	47.15		

* old-age and disability = pension

Source: Deloitte Slovakia, 2010

Local Taxes

Local Taxes include various payments (real estate tax, dog tax, accommodation tax, etc.) administered by municipalities.

The most important tax is real estate tax, which is assessed on land, buildings and flats (hereinafter "real estate"). In general, the owner of real estate is the taxpayer of the real estate tax.

An annual tax return must be filed by 31 January of the current tax period. No other tax return must be filed unless the conditions decisive for the levy of the tax are changed (e.g. change of type of land, sale of property) or if the taxpayer applies for an exemption from tax. The tax administrator (municipality) assesses tax by 15 March each year. Usually, the tax is due on 31 March. However, it is possible to agree with municipality on payment of tax in several installments.

The tax base is determined based on the area of land in square meters (in the case of land tax) and/or the area the buildings cover (in the case of tax for buildings) and the basic tax rate. The tax base for land and buildings is determined based on the status of property owned as of January 1 of the relevant tax period.

The individual tax rates and coefficients are declared annually by individual municipalities and can vary greatly.

3. Legal Entities

As a result of the decisions made as part of a foreign investor's structuring of an investment, some legal form of doing business in Slovakia must be established. The most common legal form of conducting business in the Slovak Republic is via the limited liability company (hereafter "LLC", "spoločnosť s ručením obmedzeným", "s.r.o.") and the joint stock company (hereinafter "JSC", "akciová spoločnosť", "a.s."). Both types of these legal entities provide the investor with limited liability in the Slovak Republic, however there are differences, which the investor should be familiar with. There is also the option to create a general partnership ("verejná obchodná spoločnosť", "v.o.s.") and a limited-partnership company ("komanditná spoločnosť", "k.s. ").

Limited Liability Company

The minimum registered capital of a LLC is EUR 5,000. A LLC can be established by as few as one shareholder or as many as 50 shareholders. A company with one shareholder may not be the sole founder or the sole owner of another company. While this provision may complicate a Slovak holding structure it can be dealt with rather easily.

A LLC is an administratively easy entity to operate. One executive who is appointed initially in the foundation deed or memorandum of association can then represent the LLC alone.

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Thus, a formal board of directors is not needed. In addition, there is more flexibility regarding the allocation of profits and distribution of cash among owners.

Joint Stock Company

The minimum registered capital of a JSC is EUR 25,000 divided over a number of shares with certain value. Slovak law recognizes private and public JSCs. JSC can be created by one shareholder, provided that such shareholder is a legal entity. The total number of shareholders is in general unlimited.

The administrative obligations of a JSC are more complex than those of a LLC. For example, the statutory body of a JSC, the Board of Directors ("BOD"), has to be created. In addition, a JSC must create a Supervisory Board, which has a certain level of control over the BOD. Last but not least, a JSC does not have much flexibility regarding the distribution of cash, as it must be done with respect to the shareholders.

General partnership

According to the Slovak Commercial Code, General partnership is a partnership, in which two or more parties conduct business under a common business name and bear joint and several liability for the obligations of the partnership with all their properties. PLC as a partnership is established for a mutual business purpose and it has to be established by at least two parties – natural persons and/or legal entities – foreign or local. There is no registered capital requirement (although it is possible to make a contribution) and all partners can represent the company.

Limited-Partnership Company

This is an entity where one or more members are liable up to the amount of their unpaid contribution into the registered capital registered in the Commercial Register (limited partner) and one or more members are liable with all their property (general partner). In this sense it is a mixture between an Limited liability company and a General partnership. The limited partner is obliged to make a capital contribution of an amount established by the memorandum of association, minimum EUR 250.

4. Labour and Wages

Slovakia still maintains its place as the country within Central Europe as the country with one of the lowest salary levels. Regarding specific sectors, the telecommunication and financial intermediaries had the highest average monthly salary in Slovakia in 2006. Conversely, salaries in the hospitality industry were one of the lowest.

Within Slovakia, there is a wide gap among salaries levels with respect to individual regions. The Bratislava region has the highest salary level. Some of the reasons are the Bratislava's

proximity to Vienna and also that it is the capital city of Slovakia and finally it has been receiving a high inflow of foreign investment heading to the Bratislava region. The lowest salary level belongs to the regions in eastern part of the country. The region is disadvantaged by its location, poor infrastructure and low volume of foreign investment.

Labour Legislation

As part of any investment in Slovakia, it is natural that the investor will eventually hire some Slovak employees. The Slovak Labour Code has recently undergone a series of amendments to make it more "employer friendly" but it still has many provisions designed to protect the employee. Therefore, before embarking on a program to hire any employees in Slovakia, the investor must understand the labour legislation and prepare employment contracts and human resource policies accordingly. Hereby, we discuss some of the most relevant aspects of the Labour Code, although at a very high level. Therefore it is recommended that the investor obtains a legal counsel to review this area in more detail.

The Slovak Labour Code governs the area of employment and industrial relations in Slovakia. Under this code, employment relationship is founded through a written labour contract between the employer and the employee, which represents the mutual agreement of the contractual parties.

The labour relation is created from the day, which was agreed upon in the labour contract as the first day of work. The employment relationship can be concluded for a definite period of time or for an indefinite period of time. Within the labour contract, it is possible to agree upon a trial period, the duration of which is maximum three months and cannot be extended; the trial period must be agreed in writing, otherwise it is not valid. During this trial period, either party can terminate the labour relationship without ramifications.

Generally, the working time of an employee in Slovakia is limited to 40 hours a week. It is possible to require or to agree with an employee on some overtime work. An employer may (subject to some specific exceptions) require from an employee additional 8 hours of overtime work per week during a period of maximum four consecutive months (if they agree, 12 months). The total overtime work requested by an employer may not exceed 150 overtime hours per calendar year. Provided there are serious reasons, the employer can agree with the employee on an additional overtime work up to a maximum of 250 hours per calendar year.

The Labour Code also specifies the minimum salary conditions for Slovak workers. The minimum wage is EUR 1.768 per hour {EUR 307.7 per month} and additional increases are mandated for the following conditions:

Working hours in Slovakia

	salary + minimum increase of
<i>overtime work</i>	25%*
<i>work during state holiday</i>	50%*
<i>night work</i>	20%**
<i>hazardous health working conditions</i>	20%**

* of employee's average salary

** minimum hourly increase for night work and hazardous health working conditions is calculated from minimum hourly wage of EUR 1.768.

Source: Deloitte Slovakia, 2010

The law strictly limits reasons for termination of a labour contract from an employer's side by means of a written notice. The notice period is the same for the employer as well as for the employee and takes at least two months. If the notice is given to an employee who has worked for at least five years for the same employer, the notice period is at least three months.

The minimum annual holiday to be provided to employees is four weeks. Any employee who has worked for 15 years or more is entitled to five weeks of annual holiday. The Labour Code also specifies the length of maternity leave, which is 28 weeks (37 weeks if the mother is a single parent or gives birth to more than one child). Both men and women are entitled to retirement pension at the age of 62.

5. Education

Before 1989 when Slovakia entered the free market economy, the education system was characterized by a strong focus on technical fields such as mathematics, physics, electrotechnics and chemistry. At that time, the Slovak education system provided an adequate technical knowledge and abundance of graduates in areas such as mechanical and electrical engineering, civil engineering and chemical production, military and energy production for the existing Slovak economy.

Currently, in Slovakia there are about 340 primary schools, within secondary level of education there are 371 high school, middle and associated middle schools, and 37 universities as schools of higher education. In 2005 more than 91% of the Slovak population reached secondary or university education.

However, Slovakia is still behind the European average with respect to the number of university graduates to total number of students. Only about 11% of the population has a university diploma, a much lower percentage than in other developed countries. Compared with 1990, the number of university graduates has increased by more than 65%. Many Slovak students are expanding their education skills by studying abroad as EU membership provides ample opportunity for students to study and travel abroad. This way many Slovaks improve their language skills and obtaining valuable international working experience. Young Slovaks are very keen to take advantage of such opportunity and the overall education levels and language skills of these young students are quite high.

Universities

Currently, higher education in Slovakia comprises 33 universities, among them 20 public, 3 state including military and police academy and 10 private. Approximately more than 225 000 students were enrolled at these universities during in 2004. A significant number of university students were enrolled economics and technical faculties. In 2004 there were more than 60 000 students at economic and technical faculties in Slovakia.

6. Infrastructure

Road network Slovakia's first and the second category roads are in fair condition. While only 415.425 km of highways are currently operational today, the highway network is currently under construction and is planned to reach about 705.924 km in length by 2017. Current gaps in the highway connection between Bratislava – Kosice are a cause for the vast difference in the economic development of the east compared to the Bratislava region. These two cities are expected to connect by highway by the year 2013 through the northern corridor and by 2017 through the southern corridor. Improvement of the highway connection between Bratislava and Vienna had been completed in 2007.



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Railway network

The railway network in Slovakia is a result of 150-years of development in various state and economic conditions and numerous political agendas. From the point of view of railway transport Slovakia is a transit country. Main international railway routes have a direct link to rail lines in Slovakia. Many local companies and foreign investors heavily utilize the railway as a means of transport. One of the major advantages of the Slovak railway network in the Eastern part of Slovakia is the existence of large gauge rail, which is compatible with the Russian network.

Air transport

There are 15 public airports in Slovakia, however, only the airports in Bratislava, Kosice, Poprad, Slac, Piastany, and Zilina have international importance. The Bratislava and Kosice airports are by far the most actively used in Slovakia with the Zilina and Poprad airports likely to be the next to develop because of the Hyundai-KIA investment in Zilina and the increase of tourism in the mountainous Poprad region. Current trends show a significant interest for major development of Bratislava international airport. It is ideally located in a triangle 65 km from Vienna and 193 km from Budapest but for many years, it has been underutilized. Its recent, rapid growth has been fueled by the low-cost airline RYANAIR. RYANAIR is based out of Bratislava and it has direct flights to many major Western European cities such as London, Paris, Brussels and Rome. Bratislava's airport was reconstructed in 2010.

Water transport

Approximately 200 km of Danube River forms the western border of Slovakia and the capital city of Bratislava sits on its banks. The Danube is the trans-European artery, flowing 3 500 km between the Northern European states and the Romanian coast of the Black Sea. In the Slovak section there are two ports – Bratislava and Komarno.

7. The Most Active Industries/Sectors

Automotive Industry

Slovakia, with its 5.4 million people, is expected to produce more than 500,000 cars a year by 2011 – the most of any Central European nation and the most per capita of any country in the world. Slovakia's location in Central Europe, its EU membership, competitive production costs, low taxes and other factors has influenced the remarkable growth in the automotive sector. According to the Automotive Industry Association of the Slovak Industry (AAI) as of Feb. 16. 2010, there were approximately 140 Tier 1 and Tier 2 suppliers to the automotive industry in Slovakia. Currently, there are more than 76,000 people employed in the automotive industry and it is expected that in next 4 years this number will be more than 80,000.

Key players in the market

VW was the first automotive manufacturer to enter Slovakia, doing so in 1991 through the acquisition of the Slovak manufacturer of car components BAZ. Up to now the company has grown into one of the most sophisticated production plants within the entire VW group. Currently, VW employs more than 8,000 employees and it plans to reach a production target of 150,000 cars per annum by 2010/2011.

In January 2003, Slovakia emerged as the winner in a Central European site selection competition for another major producer. A joint venture between PSA Peugeot and Citroen selected the city of Trnava (cca. 50 km from Bratislava) as the site to build a new production plant. The facility should be operational by the end of 2006. Again in March 2004, Slovakia was chosen over Poland as the site for a third major car manufacturer. The Korean company KIA Motors announced that Zilina would be the site for its first production facility in Europe. The 1,1 bn EUR investment is expected to produce 450,000 cars per annum, with a total employment of 2,500 people by 2007.

Investment opportunities

Having such a critical mass of car producers makes Slovakia a very attractive place for supply chain companies, many of which are already in Slovakia. Together with other neighboring countries, the production capacity of the Central European region should reach between 3-4 million cars by the year 2010.

Engineering

During socialism, Slovakia was a major manufacturing center for the member states of the Warsaw Pact. Slovakia produced massive amounts of heavy armory, weapons and machinery. As such, mechanical and electrical engineering have a long tradition in Slovakia and present foreign investors many opportunities such as a pool of qualified and available workers an existing infrastructure and potential acquisition targets.

This industry is closely related to and feeds other industries such as automotive, construction, agriculture, mining, machines tools, white goods appliances and special production (weapons and ammunition).

Key players in the market

Slovakia's history of manufacturing bearings attracted the second largest European bearing manufacturer INA, the German concern Danfoss, which has been producing compressors in Slovakia since 2001 has extended its production to Povazska Bystrica by relocating its Danfoss Bauer and Danfoss Gearmotor divisions from Germany. American company Whirlpool has a large washing machine manufacturing facility in the Northeastern city of Poprad. Within the same city is also rail wagon production of the Slovak companies Tatravagónka in Poprad. Other Slovak companies are: Kinex in Bytca, and Tatramat in Poprad. For the past several years, companies such as Mobis in Gbelany, Emerson Electric in the city of N. M. n Vahom and Brazilian company Embraco in Spisska Nova Ves and Johnson Control International, which now employs more than 10,000 people, have recorded successful growth. Other major foreign companies are: Sachs in Trnava, Siemens Automotive in Michalovce; Volkswagen Electrical systems in Nitra; BSH Drives and Pumps in Michalovce.

Electronics Industry

The electronics industry represents a traditional industry in Slovakia. As a sub-sector of electrical engineering it is, together with the automotive sector, one of the most active sectors of the Slovak economy. As statistics show, the sector employs 10% of the Slovak work-force and a well-established tradition and specialised education system guarantees that Slovakia will continue to produce qualified workers for this sector.

Key players in the market

The German company Yazaki Wiring Technologies Slovakia and BSH Drives and Pumps all located in Michalovce, are a major producer of office electrical machines and devices. Other major electronics producers are: Japanese Sony Corporation, which produces television sets in Trnava; Matsushita Electronics, with production facilities in Krompachy, Trstena and Stara Lubovna; Molex, which produces electrical devices and connectors in Kosice; Punch, the biggest Belgian investor in Slovakia in the electronics sector is located Trnava and Namestovo; On Semiconductors in Piestany, which produces semiconductors for variety of industries; Osram, producing lighting components in Nove Zamky; Alcatel with their plant in Liptovský Hradok, which produces telephone devices; OVP Orava located in Trstena; Sky Media Manufacturing, with its production of CDs and DVDs in N. M. n. Vahom will become the company's largest production facility in Europe; Korea's Samsung Electronics had also built a production facility and regional logistic center which will be its largest in Europe.

Information & Communication Technologies (ICT)

The Information and Communication Technologies (ICT) sector has long been very active in Slovakia. Even in the past, when there was imposed embargo on IT products, so called eastern "clones" of mainframes were being produced. The historical evolution of ICT in Slovakia took a similar path as in Western Europe. Evolving from centralized mainframe computing, through the PC and LAN revolution in the 1980s and 1990s, then towards the more recent Internet and extranet technology. Today, the ICT sector in Slovakia is up to speed with the most recent technological advances and most major ICT players are present in Slovakia.

Currently, Slovak IT firms are competing successfully on international markets with Internet and intranet applications, and software solutions for the business, banking, and financial sectors, as well as for the government, telecom, manufacturing, and small and medium-sized enterprises. Major growth areas in the Slovak market include hardware, software, IT and telecommunications services.

Mobile, Wireless & Internet

By the end of 2009, the mobile penetration in Slovakia was already reached with 100% of Slovaks owning a mobile telephone. Competition is already strong in this sector together similarly as in the Internet services. The mobile services are provided by foreign companies O2, Orange and T-Mobile. The network infrastructure is maintained mainly by the fixed-line operator, German operator T-Mobile, which possesses an extensive infrastructure for fixed-line telecom throughout Slovakia.

Key players in telecommunications

Orange is a mobile operator which is owned mainly by its French parent company Orange as well as minority interest controlled by private financial investors and the European Bank for Reconstruction and Development (EBRD). The second mobile operator is company T-Mobile.

Key players in software development

Many world-class companies are engaged in software development and shared services, including Siemens Software House (Switzerland), Eset (Slovakia), Accenture (Netherlands), Alcatel (France), IBM (US), Hewlett Packard (US), Infineon and Telenor (Norway). In January 2004, German company Infineon announced the establishment of its software house in Bratislava. There is also an extremely buoyant domestic software development sector, comprising around 64 companies that employ over 3,000 people. In addition, more than 1,000 people are employed in up to 200 small companies that are involved in a range of other software support services.

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Investment opportunities

Despite a relatively short history of outsourcing IT processes, which means more than a 10-year delay compared to the West, insiders predict IT success in Slovakia just as in international markets. IT services have been outsourced in Slovakia for about five years, but it only started to bring actual results three years ago. From the global point of view, Slovakia is still only at the beginning of the outsourcing track, outsourcing of IT services in Slovakia provides significant opportunities for foreign companies supported by a high quality workforce with international experience.

International Business Services

In addition to moving manufacturing facilities to Slovakia, western companies are also relocating administrative support services to Slovakia. This recent trend is being fueled by an available and inexpensive workforce that is highly trained in IT, finance and language skills. Also, the favourable individual and social insurance tax rates and the easy access to the Vienna and Bratislava airports makes Bratislava an attractive place for such administrative centers. Through these consolidated administrative centers, multi-national companies can provide a consistent level of support for their entire European operations at a fraction of the cost of keeping these functions embedded in the various operating units.

In Slovakia, this sector includes a broad range of services, including:

- Professional consulting services;
- Back Office Support Services;
- Data processing;
- Financial services;
- On-line services;
- Software development;
- Technical support services;
- Customer service call-in centers.

While many multi-nationals have elected to establish their own shared service centers in Slovakia, it is also possible that such services be out-sourced to existing Slovak companies.

Major Shared Services & Call Centers in Slovakia

The most suitable location for shared services in Slovakia proves to be Bratislava as this city hosts several shared and call centers such as: Dell Computers, IBM, Hewlett Packard, Johnson Controls, Kone, Henkel, Checkpoint, Kraft Foods, etc.

Investment opportunities

International business services is becoming a very active sector in the Slovak economy. Global competition from low cost countries forces many international companies to reduce their overhead by transferring part of their business activities into less expensive territories. Slovakia with its language efficient, IT literate, skilled and low waged labour is becoming the favorite location for such services.

Traditional Industries

Chemical Industry

The production of chemicals and chemical products is growing into one of the strategic sectors of the Slovak economy. It includes the production of chemicals, agrochemicals and pesticides, cleaning agents, chemical fibers, coating composition, pharmaceuticals and other chemical products. This sector, more so than others, is dependent upon the importation of raw materials. Foreign capital started penetrating the Slovak market in early 1990's through the establishment of new companies and joint venture operations. Major areas of chemical production in Slovakia are as followed: heavy chemistry, the production of chemical fibers, petrochemicals, cosmetics & cleaning agents, coating chemicals, agrochemicals, pesticides and explosives and synthetic fibers.

Key players in the market

The leading companies in heavy chemistry are Chemko in Strazske, Duslo in Sala, Novacke Chemicke Zavody (NCHZ) in Novaky; in the production of chemical fibers Nexis Fibers located in Eastern Slovakia in the city of Humenne; in the petrochemical production Slovnaft/Mol (MOL) in Bratislava and Petrochema in Dubova; in synthetic fibers Chemosvit in Svit and Slovensky Hodvab in Senica.

Metallurgical Industry

Slovakia has a long tradition in metallurgy. Massive military output had substantially contributed to the development of Slovak metallurgy during socialist era. After 1989 a rapid decline of military production had driven metallurgy production into decline. Slovakia's steel production is not expected to change significantly by 2013 since it will be restricted by production quotas of the European Union.

The key players in the market

The Slovak producer of seamless tubes, pipe bends, welded tubes of large diameters is Zeleziarne Podbrezova; The largest company employing about 13,500 employees is the American company U.S. Steel Kosice. Bigger companies are Slovalco located in Ziar nad Hronom and Kovohuty in Krompachy.

Glass Industry

The production of glass in Slovakia includes the production of glass and mineral fibers, handmade glass products, package and lighting glass. The strongest export destinations are Germany, USA and UK.

Key players in the market

The representatives of the Slovak producers are as followed: Slovglass in Poltar and Rona in Lednicke Rovne – glassware producers; Izomat Nova Baňa, a producer of mineral fiber thermal insulation materials that is a member of Austrian Radex Heraklit; the American company Johns Manville Company a producer of fiber optic; producer of glass packages Vetropack in Nemsova.

Rubber Industry

In 2004, the total number of employed people in the manufacturing products from rubber and plastic were about 15,000. The most significant situation is a fact that Slovakia has received a massive investment from automotive sector.

Key Players in the market

The Matador Group in Púchov associates several companies. Its core business is in the manufacturing of tyres and industrial rubber products; German Continental Matador that acquired a branch of Matador is also tyre producer. New investment into plant for injection molding will be made by German company Mannesmann Plastics Machinery in Martin.

Investment opportunities in traditional industries

Aforementioned industries represent a significant opportunity for foreign investment. The knowledgeable work force is still one of the lowest paid in the EU. High exports are typical for these types of industries and Slovakia, with its central location is a very attractive spot for investment in this industry.

8. Industrial Parks

Slovakia has been experiencing a significant inflow of FDI since 2001. As the privatization process is essentially complete, the majority of new foreign investments are in the form of green-field projects. This process has created a high demand for suitable land with good logistics and proper infrastructure. One of the priorities of the Slovak government together with local municipalities is to support the development of new industrial parks that can accommodate this demand. The land within industrial parks meant to be properly zoned for construction with all necessary permits and utility connections that are required by a foreign investor. Foreign investors can then either buy or lease the land. Despite this uniform vision, the structure of industrial parks varies in Slovakia, with some being owned directly by municipalities and others by private owners. As a result, the pricing structure and degree of development can vary drastically among the parks.

The most highly developed industrial parks are typically home to the major automotive companies and their suppliers. These investments are significant enough to allow the major manufacturers to dictate some terms to the Slovak government and to attract major finance and development companies to develop the parks properly. In these parks, the pricing structure and level of infrastructure and service is at a uniform and commercial level.

9. Investment Incentives

Availability of Investment Incentives

The availability of investment incentives represents an attractive part of investing in Slovakia.

All investment incentives granted in Slovakia are a specific form of state aid. The current rules are based on the applicable legal regulations of Slovakia and the valid legislation of the European Union (EU). Investors completing an application for investment incentives should adhere to the Act No. 565/2001 Coll. on Investment Incentives as amended. The Slovak Republic is currently preparing a new set of rules for the granting of investment incentives. According to available information, the new legislation should be available in the second half of 2007. The new rules should encourage investors to invest in less developed regions with high unemployment, and to attract investment into sectors with higher added value.

In general the forms and intensity of state aid depend on the type of investor project (activity), the volume of investment, and the geographical location of the investment. According to the valid legislation as of March 2007, Slovakia provides the following forms of investment incentives:

- Tax relief from corporate tax (“tax credit”) (up to 10 years);
- Subsidies for the retraining (re-qualification) of employees;
- Subsidies for job creation (“employment incentives”);

According to Act No. 565/2001 Coll. on Investment Incentives, some of the major conditions that an investor must fulfil in order to be eligible for tax credit are:

- The creation of a new place of business (factory, workshop, service operation, etc.), the extension, upgrading or modernization of an existing place of business in order to manufacture new products or provide new services.
- Investment of at least EUR 10 million in a region with an unemployment rate of less than 10% or EUR 5 million in a region with more than 10% unemployment, where at least 50% of this amount derives from the investor’s own funds; i.e. from equity and not loans.

Slovakia

In general, the intensity of state aid is calculated as a certain percentage of eligible investment made by the investor within 3 years. The maximum limits for state aid in a specific region that an investor can apply for is set as the average GDP per capita compared to the EU GDP per capita average.

The following table shows the aid ceiling for individual regions of Slovakia. For investment projects with eligible expenditure not exceeding EUR 50 million, the maximum ceiling may be further increased.

Aid ceilings for 2007 – 2013 (maximum)

<i>Bratislava region</i>	0% (after 2009)
<i>Western Slovakia</i>	40%
<i>Central Slovakia</i>	50%
<i>Eastern Slovakia</i>	50%

It is important to understand that there is no legal right to obtain incentives in Slovakia, thus incentives can still be denied even in the case that an investment fulfills all the required Slovak and EU rules and regulations. The investor must go through an application and approval process. When preparing the application, the investor must review the EU state aid legislation and demonstrate that their investment qualifies for legal state aid. This application is then submitted to the Slovak government which ultimately decides whether the particular investment will be granted any incentives.

EU Funds

On December 13, 2006 the final draft version of the National Strategic Reference Framework for the EU's 2007-2013 budget period was approved by the Slovak government. It outlines what the country intends to do with the EU funds. In a total amount of approximately €11,24 billion over the next six years. By utilizing EU funds, Slovakia is expected to increase the competitiveness and economic performance of its regions, as well as increasing employment. The focus will be on infrastructure, human resources, and building a knowledge-based economy.

According to currently available information, the funds should be distributed among 11 operational programs: the Regions, Environment, Transport, the Informatization of Society, Science and Research, Development and Innovations, Employment and Social Inclusiveness, Education, Technical Assistance, Competitiveness and Economic Growth, Healthcare, and the Bratislava region programs. Most of the EU funds should be allocated to transport projects, specifically to the improvement of the highway network.

Distribution of EU funds 2007-2013 (as of October 2010)

Operational Program	Allocation (in EUR millions)
<i>Regional</i>	1.445
<i>Environment</i>	1.800
<i>Transportation</i>	3.207
<i>Information society</i>	993.1
<i>Research and development</i>	1,209
<i>Education</i>	617.8
<i>Employment and social inclusion</i>	881.8
<i>Technical assistance</i>	97.6
<i>Health Care</i>	250
<i>Competitiveness and economic growth</i>	772
<i>Bratislava region</i>	87
<i>Total</i>	11.360

Source: Ministry of Construction and Regional Development

10. Foreign Direct Investment (FDI)

According to National bank of Slovakia (NBS), as of September 30, 2005 aggregate volume of FDI in Slovakia totaled USD 14bn. The Netherlands accounted for the biggest share with 22% of all FDI dollars. coming from German investors. German companies especially represented by Volkswagen, Siemens, and Deutsche Telekom with significant investments in Slovakia accounted for the second place. French companies have also been very active in Slovakia, especially by an investment in automotive industry made by PSA Peugeot Citroen and its suppliers. Some of the biggest Dutch companies are Heineken and the Kappa Packaging Group. Following close behind is Slovakia's neighbor to the West, Austria. The bulk of Austrian investment has come from banking sector and small and medium sized entities. Massive investments into infrastructure projects should be coming from Austria after the final ruling of the winners of airport and rail cargo privatization projects. The leading capital in 2005 came from Korean automotive sector as major OEM's especially a consortium Hyundai-KIA has started realizing its robust investment in northern Slovakia. Companies such as US Steel, Molex, and On Semiconductors represent major US investments.

11. Expatriate Life

The recent inflow of FDI into Slovakia has also brought many expatriates and their families who have chosen to live and work in Slovakia. While the expatriates are scattered throughout the larger cities, the major expatriate communities are in Bratislava, Zilina and Kosice. The expatriate's community is growing with large representation of expatriates from Germany, USA, France and Korea. The living conditions are approaching standards found in the larger cities in Western European countries and at the same time, the cost of living is remarkably lower. The 19% flat personal income tax rate also makes Slovakia a very attractive place to live and work. Concerning accommodation, Slovakia provides a wide selection of high standard luxury apartments and houses for rent.

12. Weather and Climate

Slovakia has what is considered a mild continental climate, with generally cold, dry winters and warm (sometimes hot), moist summers. Temperatures will vary according to elevation in the many mountainous areas. The warmest and driest regions are the southern plains and the eastern lowlands. In those areas the average temperature is 10° C, and the average annual rainfall is near 500mm. Heavy snow with significant accumulation is common at higher elevations in the Tatras mountains during the winter months.

Bratislava, the capital, experiences temperatures ranging from a chilly minus 2° C in January to 25° C in July, with approximately 26 inches of precipitation per year, most of which occurs during the summer.

Introduction

Over the past 20 years, Central Europe has experienced one of the most remarkable economic transformations ever, and Deloitte has played a major part in this changing landscape since we first established an office in the region in 1990. The dynamic changes of this region have created a wealth of opportunities for doing business. Deloitte has been involved with assisting our clients, including governments, large national enterprises, multinational companies, and small and medium-sized high growth companies in this new competitive environment.

Now in 2010, Deloitte Central Europe spans 17 countries divided into 4 clusters, with more than 30 offices and over 3,400 professional staff – but we still operate as one cohesive organization. This Central European structure was formed in 1997. At this time we integrated our national practices to form Deloitte Central Europe because we realised that to best serve our clients we needed to be able to share our knowledge, expertise and manpower throughout the whole of our geography.

Our integration has allowed us to manage regionally and deliver locally, adding value to our services and allowing them to be performed in the most efficient manner. At Deloitte Central Europe we are dedicated to finding solutions for our clients: solutions which create value for them. Our mission has been, and continues to be, very simple: to help our clients and our people excel. Our vision is to be the standard of excellence.

All the Central Europe offices of Deloitte refer to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee and its network of member firms, each of which is a legally separate and independent entity.



Our Expertise

At Deloitte Central Europe we believe in having strong industry practices to support our service line expertise. Many of our industry experts have worked in key industry sectors. They developed the know-how and experience to understand industry-specific issues and are ready to share their resources and knowledge of best practices. By utilizing our industry practices, we are able to provide value-added, industry-specific services to our clients.

FDI Site Selection Services

To assist foreign investors in their initial, and most critical, stages of their investment process, we have developed a specialised service line focused on the specific needs of FDI. We are offering a uniform co-ordinated approach and a full range of FDI specific services across the whole CE region.

Our FDI specific services include but are not limited to:

- Country analysis and sector overview
- Site selection (in co-operation with our site selection team in Brussels, Belgium)
- Investment incentives advisory and management
- Negotiation support with local/national government, municipalities, etc.
- Business assistance to other service lines (Tax & Legal, Financial Advisory Services, Audit & Advisory incl. Enterprise Risk Services and Consulting Services)

Tax & Legal Services

Keeping up with changing tax requirements, opportunities, and risks can pose a challenge to any organization, from a local business to a multinational. Your tax planning must keep pace with – even help shape – your company's operations. This means that your tax experts must manage all of the intricate details in local jurisdictions while understanding and strategically planning the global flow of transactions.

We offer our clients a broad range of fully integrated tax services. Our approach combines insight and innovation from multiple disciplines with business and industry knowledge to help your company excel globally.

- International Corporate Tax Services
- Local Corporate Tax Services
- Indirect Tax Services – VAT and Customs Duty
- Transfer Pricing Services

- Merger and Acquisition Services
- Personal Tax Services
- Global Employer Services
- Employee Benefit Services
- Bookkeeping
- Legal Services
- Grants & Incentives
- Business Process Outsourcing
- Payroll Services

Financial Advisory Services

For the past years, governments throughout Central Europe have dramatically reformed their economies by moving commercial enterprises from state control to private ownership. A myriad of opportunities and pitfalls have arisen for local entrepreneurs and foreign multinationals, and traversing this new landscape can be difficult. The potential for growth in Central Europe is enormous, but this region also presents unique challenges not found in more developed markets.

Whether you are interested in privatization strategies, cross-border acquisitions, corporate finance transactions, development and venture capital, business and asset valuations, value enhancement strategies, corporate recovery or fraud investigations, our Financial Advisory Services professionals can help you. Areas of specialization focus on:

- Mergers & Acquisitions – Transaction services
- Post-Merger integration
- Strategic Acquisition or Investor Search and Analysis
- Privatizations
- Project Finance and Debt Raising
- Commercial/Financial Due Diligence
- Business, Real Estate and Equipment Valuations
- Business Modelling
- Non-Performing Loans
- Public Private Partnerships

Audit & Advisory Services

In a world where business is confronted with new challenges at an unprecedented speed, the need for solid financial reporting and forecasting has never been more critical. Annual audits are a start, but they are not enough. When it comes to coping with market analysts and wary shareholders with 24-hour trading at their fingertips, you need to know where you stand today.

Our network of Audit and Enterprise Risk Services professionals provide a range of audit and advisory services to assist clients in achieving their business objectives, managing their risk and improving their business performance – anywhere in the world. We offer credibility, assurance and independence. Our Audit & Advisory services include:

- Statutory & International Audits
- Financial Statement Transformations
- Financial Reporting
- Review of Accounting Systems and Internal Controls
- Sarbanes-Oxley Compliance & Advisory
- Accounting Consultation
- Training
- Financial Due Diligence
- Audit Committee Services
- Control Assurance
- Internal Audit Services
- Capital Markets
- Forensics Services

Consulting Services

Our professionals can help you to plan, grow and structure your business to address key issues such as strategy, technology and change management. We provide integrated consulting services focused on large national entities, multi-national corporations, growth organizations, and public sector entities.

With our unique, collaborative approach, we offer not only industry and functional business performance knowledge, but also the insight of others through our consulting alliances. We work closely with clients to improve business performance, drive shareholder value and create a competitive, sustainable advantage, regardless of where in the world your business takes you. We provide the following services:

- Strategic Planning and Management Including Balanced Scorecard
- Performance Improvement and Cost Reduction
- Process Optimisation
- Customer Relationship Management
- Supply Chain Management
- Production Management
- Cost and Corporate Performance Management
- Treasury Management
- Selection and Implementation of Information Systems
- Human Capital Advisory Services
- Advisory Services Related to the Acquisition of EU Funding

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