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in 33 jurisdictions worldwide

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Overview

1 What forms of business entities are relevant to the typical franchisor?

Pursuant to Hungarian law, there is no restriction on the forms of business entities that may be franchisors. In practice, the following forms of business entities are mostly relevant to the typical franchisor under Hungarian law: private limited liability companies, private limited companies or public limited companies.

2 What laws and agencies govern the formation of business entities?

The most prominent laws are Act IV of 2006 on Business Associations and Act V of 2006 on Public Company Information, Company Registration and Winding-up Proceedings.

3 Provide an overview of the requirements for forming and maintaining a business entity.

The concrete requirements depend on the type of business entity, but it can be generally stated that a memorandum of association, which contains the main provisions in relation to the structure and operation of the business entity, shall be accepted. Every foundation of a business entity has to be notified to and subsequently incorporated by the Company Court of Registration.

4 What restrictions apply to foreign business entities and foreign investment?

There are no specific restrictions to foreign business entities and foreign investment. The Foreign Investment Act (Act XXIV of 1988) provides a liberalised regime. Accordingly, a franchisor may also be a foreign entity.

5 Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

Effective as of 1 January 2011, foreign businesses entitled to royalties from Hungarian companies or individuals were taken out of the scope of the Act. In respect of a franchise relationship this means that no corporate tax shall be deducted upon the payment of the royalty to the franchisor. Double taxation treaties play an important role.

6 Are there any relevant labour and employment considerations for typical franchisors? What is the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor? What can be done to reduce this risk?

The relevant consideration is that the franchisor's employees shall not be employees of the franchisee since the franchisee shall be independent from the franchisor. From a practical perspective, the relevant risks are generally not likely to be significant.

7 How are trademarks and know-how protected?

Trademarks are protected in the territory of Hungary through three routes:

- as a national trademark (registered by the Hungarian Patent Office);
- as an international trademark (which has the same effect as a national trademark if it is extended to Hungary under the Madrid System); or
- as a Community trademark (the trademark automatically extends to all member states of the EU).

Know-how is protected under article 86(3) and (4) of the Hungarian Civil Code as follows:

- (3) *Intellectual products that are not regulated in other legislation but which can be used by the general public and have not yet become part of the public domain shall also be protected by law;*
- (4) *Persons shall also be entitled to protection with respect to their economic, technical, and organisational knowledge and experience that has pecuniary value.*

Know-how protection lasts until the knowledge, experience or information becomes part of the public domain.

8 What are the relevant aspects of the real estate market and real estate law?

Hungarian real estate law provides that the most important rights (ownership, mortgage rights, etc) pertaining to real estate are established once these rights are registered by the competent land registry on the basis of the relevant documents, in particular contracts. Hungarian law provides for specific rules on the lease of premises (Civil Code and Act LXXVIII of 1993).

Laws and agencies that regulate the offer and sale of franchises

9 What is the legal definition of a franchise?

There is no legal definition of a franchise under the currently effective Hungarian law. Franchise contracts are not specifically codified in Hungarian law as a type of contract. The most extensive legal regulation in relation to franchise contracts is actually provided for by competition law, but competition law regulation does not provide for a legal definition either. In practice, the definition provided for by article 1 of the European Franchise Code of Ethics is accepted, but this is not legal definition.

10 Which laws and government agencies regulate the offer and sale of franchises?

The Civil Code of the Republic of Hungary (Act IV of 1959), and in particular its chapter on the general rules of contract law, applies to all contracts, including the offer and sale of franchises.

11 Describe the relevant requirements of these laws and agencies.

The rules extend to, among others, the conclusion of the contract, rights and obligations, performance and termination. However, it must be emphasised that this is not specific legislation.

12 What are the exemptions and exclusions from any franchise laws and regulations?

Not applicable.

13 Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?

There are no such requirements pursuant to Hungarian law.

14 In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

There is no specific mandatory legal regulation pursuant to Hungarian law.

15 What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

There is no specific mandatory legal regulation pursuant to Hungarian law. However, the general principles of cooperation and good faith apply also to the pre-contractual stage pursuant to article 205(3) of the Civil Code as follows:

(3) Parties shall cooperate during the conclusion of a contract, and they shall respect each other's rightful interests. Parties shall inform each other regarding all essential circumstances in relation to the proposed contract before the contract is concluded.

Directive 2002/1 (IX.18) of the Hungarian Franchise Association on pre-contractual disclosure obligations is applied in practice, but the directive is not law. This directive recommends that a franchisor prepares an information brochure regarding its system and provides this to the potential franchisee. According to the directive, disclosure may be made either in one step or in several steps.

16 What information must the disclosure document contain?

There is no specific mandatory legal regulation pursuant to Hungarian law.

Directive 2002/1 (IX.18) of the Hungarian Franchise Association on pre-contractual disclosure obligations is applied in practice, but the directive is not law. The directive recommends that the franchisor hands over the draft franchise agreement to the potential franchisee at least 14 days before the conclusion of the contract. Furthermore, the directive recommends that the franchisor prepares an information sheet in relation to the system, which contains the following in particular:

- a short description of the system;
- an introduction of the franchisor;

- the number of franchisees in the system;
- intellectual property rights; and
- a list of goods or services, financial obligations and confidentiality obligations.

17 Is there any obligation for continuing disclosure?

There is no specific mandatory legal regulation pursuant to Hungarian law. There is no specific relevant directive of the Hungarian Franchise Association either.

18 How do the relevant government agencies enforce the disclosure requirements?

Not applicable.

19 What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

There is no specific mandatory legal regulation pursuant to Hungarian law, but the general civil law provisions may apply.

20 In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

There is no specific mandatory legal regulation pursuant to Hungarian law.

21 In addition to any laws or government agencies that specifically regulate offering and selling franchises, what are the general principles of law that affect the offer and sale of franchises? What other regulations or government agencies or industry codes of conduct may affect the offer and sale of franchises?

The European Franchising Code of Ethics of 1991 was adopted by the Hungarian Franchise Association and may affect the offer and sale of franchises. Directive 2002/1 (IX.18) of the Hungarian Franchise Association may affect pre-contractual disclosure obligations.

22 Other than franchise-specific rules on what disclosures a franchisor should make to a potential franchisee or a franchisee should make to a sub franchisee regarding predecessors, litigation, trademarks, fees etc, are there any general rules on pre-sale disclosure that might apply to such transactions?

There is no specific mandatory legal regulation pursuant to Hungarian law, but general civil law provisions, such as the general principles of cooperation and good faith, may apply. Furthermore, the Hungarian Franchise Association's code of ethics and directive 2002/1 (IX.18) of the Hungarian Franchise Association on pre-contractual disclosure obligations may affect pre-sale disclosure obligations (see questions 15 and 16).

23 What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under the franchise sales disclosure laws?

In the case that the franchisor engages in fraudulent or deceptive practices, the franchisee may rely on the general contract law regulation of the Civil Code (article 210), which allows the aggrieved party to claim avoidance of the contract on the basis of deception, duress or mistake as follows:

- a person acting under a misapprehension regarding any essential circumstance at the time a contract is concluded shall be entitled to contest his contract statement if his mistake had been caused or could have been recognised by the other party.
- a contract statement may be contested on the grounds of misapprehension of a legal issue if such misapprehension is deemed significant and if the advice of legal counsel, acting within the scope of his competence, to the parties affected has been patently erroneous in terms of the contents of legal regulations.
- if the parties had the same mistaken assumption at the time the contract was concluded, either of them may contest the contract.
- a person who has been persuaded to conclude a contract by deception or duress by the other party shall be entitled to contest the contract statement. This provision shall also apply if deception or duress was committed by a third person and the other party had or should have had knowledge of such conduct.

The avoidance shall be claimed within one year. The time limit for avoidance shall commence upon recognition of the mistake or deception or, in the case of unlawful menace, upon the cessation of duress.

Legal restrictions on the terms of franchise contracts and the relationship between parties in a franchise relationship

24 Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

Franchise contracts are not specifically codified in Hungarian law as a type of contract; however, the general contract law provisions of the Civil Code of the Republic of Hungary do apply to franchise contracts.

Due to the lack of specific comprehensive legal regulation of franchise contracts, franchise relationships are primarily governed by the franchise agreements between the parties; therefore, franchise contracts must be drafted very carefully.

25 Do other laws affect the franchise relationship?

Antitrust laws do affect the franchise relationship: primarily, the Hungarian Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices. Government Decree 205/2011 (X.7) on the exemption of certain vertical restraints provides for exemptions from restrictive market practices in relation to franchise agreements. Government Decree 205/2011 (X.7) basically corresponds to Commission Regulation (EC) 330/2010 of 20 April 2010 on the application of article 101(3) of the Treaty to categories of vertical agreements and concerted practices.

Intellectual property laws also affect the franchise relationship: primarily, Act XI of 1997 on Trademarks and Geographical Product Markings and Council Regulation (EC) 207/2009 of 2 February 2009 on the Community trademark.

26 Do other government or trade association policies affect the franchise relationship?

The Hungarian Franchise Association adopted the European Franchising Code of Ethics of 1991. Membership of the Hungarian Franchise Association is only possible if the candidate company's franchise contract corresponds to the provisions of the European Franchising Code of Ethics. Furthermore, the Hungarian Franchise Association has issued two directives: namely, Directive 2000/1 (IX.15) on the concept of independence and Directive 2002/1 (IX.18) on the pre-contractual disclosure obligations.

The directives of the National Tax and Customs Authority are also relevant in relation to the interpretation and application of Hungarian tax legislation, such as Directive 1994/322 on franchise contracts, among others.

27 In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

The franchisor may terminate a franchise relationship if the law or the contract itself enables the franchisor to terminate the contract. In the latter case, termination may be claimed pursuant to the provisions of the contract. In practice, the right of unilateral termination is provided to the franchisor in case of material breach of the contract by the franchisee. Material breach could be but is not limited to the failure of the franchisee to pay the franchise fees or violation of the provisions on confidentiality, non-competition or supply.

If Hungarian law is applicable to the franchise contract and the parties have stipulated so, the contract may be terminated in accordance with the general provisions of the Civil Code: primarily the provisions on default, which is relevant in relation to late payment of franchise fees.

Article 298

An obligor shall be in default:

- a) if the time of performance, as stipulated in the contract or as can be inferred beyond doubt from the intended purpose of the service, has elapsed without any result;*
- b) in other cases, if he does not perform his obligation in spite being requested to do so by the obligee.*

Article 300

(1) An obligee shall be entitled to demand performance, or, if performance no longer serves his interest, he shall be entitled to rescind from the contract irrespective of whether or not the obligor has offered an excuse for his default.

(2) It shall not be necessary to prove the cessation of an interest in performance if, according to the agreement of the parties or due to the imminent purpose of the service, the contract had to be performed at a definite time and none other, or if the obligee has stipulated a reasonable deadline for subsequent performance and this period too elapsed without result.

28 In what circumstances may a franchisee terminate a franchise relationship?

The franchisee may terminate a franchise relationship if the law or the contract itself enables the franchisee to terminate the contract. In the latter case, termination may be claimed pursuant to the provisions of the contract. In practice, the right of unilateral termination is rarely provided to the franchisee, but is primarily used if the franchisor breaches its obligations of exclusive supply.

Update and trends

The Hungarian Civil Code (Act IV of 1959) does not contain any franchise specific regulation and Hungarian civil law provides no mandatory contract law regulation either. According to the latest draft, the new Hungarian Civil Code, which will likely be adopted during autumn 2012, will maintain this approach, but it will at least contain a legal definition for franchise. This draft Civil Code will modify the regulation in relation to know-how and it will regulate know-how as a business secrets.

- 29** May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Yes, a franchisor may refuse to renew the franchise agreement with the franchisee unless the parties have agreed on mandatory renewal in the franchise contract or unless the parties have concluded a preliminary contract to renew the franchise contract.

- 30** May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Yes, a franchisor may restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity provided that such restrictions are provided for in the franchise agreement or the franchisor does not consent to the franchisee's proposal to transfer its franchise.

- 31** Are there laws or regulations affecting the nature, amount or payment of fees ?

Article 201(2) of the Hungarian Civil Code provides that the fees shall be proportionate to the services offered by the other party. If the fees are not proportionate, the aggrieved party may claim avoidance of the contract within a one-year term.

Article 201(2) of the Civil Code provides:

If at the time of the conclusion of the contract the difference between the value of a service and the consideration due, without either party having the intention of bestowing a gift, is grossly unfair the injured party shall be allowed to contest the contract.

- 32** Are there restrictions on the amount of interest that can be charged on overdue payments?

Pursuant to article 301(4) of the Civil Code, the court shall be entitled to reduce the rate of the default interest if the interest fixed by parties is excessive.

- 33** Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

Generally there are no regulations restricting a Hungarian franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency (Act XCIII of 2001).

- 34** Are confidentiality covenants in franchise agreements enforceable?

Yes. Hungarian law provides for the protection of business secrets. It is advisable to put explicit confidentiality covenants into the franchise agreements. If the confidential obligation is explicitly put down in the franchise agreement and a party breaches this obligation, damages and other potential consequences established in the contract (eg, a penalty) may be enforced.

Article 81(2) of the Civil Code defines business secrets as follows: *Business secrets shall comprise all of the facts, information, conclusions or data pertaining to economic activities that, if published or released to or used by unauthorised persons, are likely to imperil the rightful financial, economic or market interest of the owner of such secrets, provided the owner has taken all of the necessary steps to keep such information confidential.*

- 35** Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

Yes, under Hungarian law the parties shall deal with each other in good faith, with mutual respect and in cooperation (article 4(1) of the Civil Code). Pursuant to Hungarian law, the principle of good faith and cooperation primarily means that the parties shall notify each other of important circumstances and shall act in a manner that helps the other party to perform its obligations arising from the agreement.

- 36** Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

No. Pursuant to Hungarian law, 'consumer' shall mean any person who is a party to a contract concluded for reasons other than economic or professional activities (article 685(d) of the Civil Code).

- 37** Must disclosure documents and franchise agreements be in the language of your country?

No. The parties may agree that the disclosure documents are provided to the franchisee in a language other than Hungarian and may also agree that the franchise agreement is drawn up in a language other than Hungarian. It is suggested that such an agreement should be put into writing by the parties. Agreement on the language may also constitute part of the franchise contract.

- 38** What restrictions are there on provisions in franchise contracts?

Regulation 330/2010/EC (for agreements having a Community dimension) and Government Decree 205/2011 (X.7) (for agreements having a national dimension) contain the main restrictions and conditions in relation to exclusive territories, customers, prices, etc.

Pursuant to the Hungarian Private International Law Act (Act 13 of 1979), the parties are free to choose the governing law for their franchise contract, provided that there is an international element in their relationship. In other words, a Hungarian franchisor and a Hungarian franchisee shall not agree on the application of a foreign law for their franchise contract, but if the franchisor is not a Hungarian entity, then the parties may freely decide which law governs their franchise contract. The choice of law shall be made in writing and in an explicit manner. It shall be noted that for contracts entered into after 17 December 2009, Regulation 538/2008/EC will be applicable.

Pursuant to the Hungarian Private International Law Act (Act 13 of 1979), the parties may stipulate the jurisdiction of a certain domestic or foreign court (regular court or arbitration court) for potential disputes arising from their franchise contract.

- 39** Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

Competition law is highly relevant for franchise contracts – in particular, but not limited to, the issues of exclusive territories, customers, prices and noncompete obligations. Government Decree 205/2011 contains essentially the same provisions as Commission Regulation 330/2010.

40 Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

Regular courts

According to the general rules for civil and commercial disputes, where the case value is below 5 million forints, the lower courts have competence in the first instance and the county courts and the Metropolitan Court are the second instance courts. Where the case value is above this threshold, the county courts and the Metropolitan Court are the first instance courts, while the regional Court of Appeal is the second instance forum.

Arbitration

The parties may stipulate the jurisdiction of a Hungarian or foreign arbitration court in their franchise contract. The most common arbitration forum in Hungary is the Arbitration Court attached to the Hungarian Chamber of Commerce and Industry. Pursuant to article 46(3) of the Act LXXI of 1994 on Arbitration, in the case of international arbitration, the Arbitration Court attached to the Hungarian Chamber of Commerce and Industry is the permanent arbitration court.

41 Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction.

Under Hungarian law and legal practice, the principal advantages of arbitration are that the procedure is in general significantly quicker than the procedure before the regular courts, and that the proceeding judges/arbitrators may be chosen by the parties and generally have more expertise and specific knowledge in business issues. As a further advantage, it is to be noted that oral hearings are not open to the public (while publicity is a basic principle in regular court cases).

Relatively higher costs can be a potential disadvantage of arbitration. Furthermore, arbitration judgments may not be appealed (however, under certain circumstances invalidation of the judgment may be requested before regular courts).

42 In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

Foreign franchisors may be treated differently from a tax law perspective. Generally, there are not likely to be significant differences in the treatment of foreign and domestic franchisors.

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