

THE HUNGARIAN SOLUTION

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The tax planning opportunities of the Hungarian tax regime are still less known by the international tax experts although Hungary continuously extends the elements and structures which can be perfectly used by the international tax planning industry since the 1989 systematic turn in politic and economy. The peak of this more than twenty years was the period of 1994-2005 when Hungary had its own classical offshore regime with 3% and later 4% corporate income tax rate. Although the offshore area was forced to close by joining to the European Union in mid of 2004, the Hungarian tax regime still holds structures which count on attention to the experts with good reason. The purpose of this article is to introduce shortly the most important structures and demonstrate with some basic calculations the available tax advantages.

There is a continuously strengthening trend in the qualified international tax planning industry in the last twenty years to change the classical offshore structures to those one which although guaranty the low taxation further on, however indemnify the clients from the shadow of the offshore image. Hungary can certainly be one of the good solutions. The first thing to know about the structures will be introduced below is that those are not particular Hungarian patents or inventions. Most of those can be found in the tax system of other EU member countries (e.g. Austria, Bulgaria, Cyprus, Luxembourg, Malta) as well. However two features make the “Hungarian solution” quite unique:

- Most of the above mentioned countries holds only occasionally one or some of the structures in question, however the synergy come from the combination of the structures can be exploited only in Hungary, Cyprus and with some limitation in Malta;
- The entire lack of any offshore connotation, or in other words the fact that Hungary – contrary to e.g. Cyprus, Luxembourg or Malta (although the scope of the tax advantages are more or less the same) – was never considered by the international “tax public opinion” as “offshore country” just as was never black listed by the national governments and their multinational organisations (e.g. OECD/FATF). This fact may create the image of the “safe harbour” which results better starting position to the country.

It is also worth to mention that the real attraction of the following structures is not in pure itself, but much rather in their build in to the network of more than seventy bilateral Double Tax Treaties and similar number of Investment Protection Agreements.

Finally one more fact has to be put down in advance in order to the easy understanding of the following tax benefits and calculations: the rate of the Hungarian Corporate Income Tax (CIT) is 10% under HUF 500.000.000 (appr. EUR 1.850.000 or USD 2.630.000) tax basis and 19% on the exceeding tax basis.

The Hungarian Holding

At least three things can be expected by aspect of taxation from a good working holding regime:

- no levy tax on dividends received;
- no levy withholding tax (WHT) on dividends distributed;
- no levy tax on capital gain income.

The Hungarian solution

The Hungarian holding regime corresponds to the above expectations almost in hundred percent. The only exception is the received dividend paid by controlled foreign corporation (CFC) to the Hungarian mother company which creates taxable income. (However the dividend distributed by the Hungarian company to a CFC is absolutely free of WHT.)

The conditions of tax exemption of the capital gain income are as the follows:

- at least 30% participation;
- minimum one year holding period;
- report to the tax authority about the purchasing (or obtaining in other title) of the participation in 30 day (less attractive element of the regime that fail to file the report in 30 days the tax exemption will be lost forever, therefore the deadline must be taken care to a marked degree).

The Hungarian Royalty Wizard

Many people say that the big issue of the 21st Century is the international trading of the royalty products (trademarks, patents, know-how, designs, copyrights, etc.). Indeed, the trend of the first decade of the new century shows that the turnover of the royalty products and services have multiplied, and there is no sign – out of the elements of the global financial crises – shows that this trend would decline. On the contrary, these several billion EUR and USD transactions are always looking for safe tax planning structures, those non classical offshore jurisdictions which however apply significant tax benefits to royalty incomes. Hungary duly corresponds to this expectation, since only the half of the royalty income creates tax basis, or in other words, the royalty incomes enjoy 50% tax benefit.

Translating this to the language of the numbers it means that the total tax burden of a let's say EUR 1.000.000 royalty income related tax basis is only five percent i.e. EUR 50.000. In other words: the most favourable in Europe and probably is among the first three worldwide also.

The Hungarian Trading House

The above mentioned 10% CIT rate makes us encouraged to say: Hungary provides a perfect tax environment to the formation and management of international trading houses which would provide agency based purchase or sale services first of all to small and medium sized enterprises. The activity of the trading house is based on an agency agreement between the client as principal and the trading house as agent. The agent either in its own name or for and on behalf of its client is handling the purchase or sale commissions against an agency fee. The taxable income of the trading house will be this fee only of course, and the rest of the income will be subject to a kind of escrow account to the favour of the client.

Translating again to numbers it means the following. In the case of a EUR 1.000.000 value of sale commission, calculating with let's say 5% agency fee (EUR 50.000) and a modest 20% tax basis decreasing overhead costs projecting to the agency fee (EUR 10.000), the payable CIT will be only EUR 4.000.

It is utmost important to emphasize again that the combination of the three basic structures shortly introduced above is also applicable in one company. This result great flexibility and cost effective solutions.

Beside to this structural freedom however the warning is imperative: the general expectations of any tax authority to the justified and reasonable nature and also to the real substance of the trading and connecting financial transactions, just as the place of management and control have to be strongly considered also in the case of the Hungarian structures. The structures have to be fit into safe contractual and documentary environment which is strongly advised to be controlled and daily managed by local Hungarian management. In this case the success of the "Hungarian solution" can be forecasted.