



## Reminiscences of the last 15 years

It seems like it was only yesterday, but in fact it happened 15 years ago. I was sitting at the kitchen table in the university dormitory, racking my brains trying to think of a name for my company. Or rather our company, as my wife and I intended to grind out the enterprise together, given that that year the tax laws made it possible for anyone forming a company to reclaim a significant amount of tax.

Not much later, my wife came home from work, and we both started racking our brains to find a name for our "child". We needed to, because the registrar of companies was about to reject the company application we had filed on the grounds that there were already 4 companies with that name (to this day I don't understand why there couldn't be a fifth). After many hours of deliberation, the name LAVECO was finally born. LA from László, V from Váradi, E from Ekaterina, and CO from Company.

The next day I typed the paperwork again after work, then rushed off to the lawyer to have the contract countersigned. Then to the Registrar of Companies, the tax authorities and Social Security.

This was some kind of heroic age in Hungary, when many entrepreneurs formed their companies in this way. Little did I know at the time how useful these personal experiences gained through preparing the paperwork, standing in queues and generally building up the company would prove later on.

In reality, the whole thing was symbolic, as I formed the company in order to reduce my taxes legally, and now I form companies for others so that they can use them to reduce their taxes. Maybe fate played a hand in this. And maybe also there too, when, after a new company name has been rejected in Cyprus, we manage to put together a new name which is acceptable to the authorities.

So many things have happened over the last 15 years with the LAVECO company, or rather companies, as in 1998 we went beyond the Hungary border and established our first subsidiary in Romania; then came Cyprus in 1999, the United Kingdom in 2000 and Bulgaria in 2004. We have always remained loyal to our beginnings, and still deal now with what we dealt with then, that is international company formation. And although many people have predicted the end for us over those 15 years, stating that tomorrow it will no longer be possible to incorporate tax-free or low tax companies, and that there is no point in doing what we do, we refused to diversify. We remained simple "cobblers" to the last. Just as the cobbler must replace heels, repair soles, order new shoes, so we too have new company formation, changes in the board of directors, sale of shares, name changes etc.

**Sometimes, when clients ask me why we are better than our competitors, I reply, half jokingly, that there are 3 reasons. 1. Because when we get up in the morning, this is what we do. 2. Because at the end of the day, this is what we do. 3. And because throughout the day this is what we do.**

**And is what we do necessary? The market itself answers this question day after day. If a company which began so small, without the significant "following wind" provided by state orders, can stay afloat for 15 years purely as a result of market conditions, then the market dictates that what we are doing is truly necessary.**

**My philosophy** is that taxation is not something that we do voluntarily, but instead has been forced upon us. The state, or states, in which an enterprise operates, try to tax the income arising in their own territory in accordance with their own legislation. For the enterprise, taxation purely means that I have to share the 100 units of income I have produced with others, and as such, I lose a significant amount - or even more! - of the 100 units. Humans are mentally prepared in such a way as to try and defend themselves against all forms of force. A healthy instinct dictates this. If somebody tries to hit me, I automatically raise my arms. I am behaving instinctively.



The situation is exactly the same with taxation. If someone tries to take something away from me, I defend what is mine. I try to keep as much of it as I can through all legal means available. Today, however, it is everyone's sovereign right, constitutionally guaranteed, to establish and operate a company in the country and format which, financially, is the most beneficial for that individual. Naturally, if we go by the same logic as before, if a person can choose between a beneficial tax regime and an even more beneficial tax regime, then, logically, they will choose the one which is most appealing financially. This is dictated by the economic rationale.

All this also works within the framework of the European Union. Two years ago, when **10 Eastern European** countries were waiting to join the EU, we could feel the hesitation among clients coming to us from these countries. Is it worth racking their brains over how to reduce taxes, or will it all be different in the EU anyway? Will this be allowed by the legislation in the EU? Then came accession, and the rose-coloured dream that with one administrative "link" anything in the east could be changed soon evaporated. (It is interesting that the same air of "waiting for a miracle" can be felt today in **Romania and Bulgaria**). The essence of the matter remains unchanged: the "enforced sharing" with the state remains in place, in a sort of tug-of-war in which neither side wants, or is able, to give any ground; the state because it wouldn't have anything to distribute if it didn't collect any "goods", while the enterprise is forced to defend against centralisation, as this is dictated by the ownership logic.

This all goes to prove that there was, is and will be a need for tax-planning within the European Union as well. Whether or not the type, methods and vehicles used will change from time to time is a different question. There is no reduction, however, in the possibilities available, as some people foresaw, at the same time predicting our death. All the time that **Spain**, for example, continues to apply a **35%** rate of profit tax and **Cyprus only 10%**, then it will be worthwhile for the Spanish entrepreneur who buys goods from **Italy** and sells them in Spain to arrange his business transactions through a company registered in Cyprus, considering that the difference between the rates of profit tax of the two countries is **25%**. This means that in this way, one in four EUROS of profit could be saved. **And is all this legal?** Absolutely and completely! As a Spanish citizen, I can establish a company within the EU where I like. And if the goods in the above example don't leave the EU? They don't need to, since Cyprus is also an EU member state and can acquire an EU VAT number within a matter of days. And how easy is all this? About as easy as going to the light switch and turning on the lights with a single flick of a switch. Three years ago none of this would have been possible, as Cyprus and the other recent additions were not members of the EU. And now before we know it Romania and Bulgaria will be members, and who knows what gates that will open for business people who can think logically.

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Tax-planning is a conscious process, whereby the tax-payer, having studied and taken into account the legislation, attempts to select the most advantageous solution. So is there anything unnatural in this? On the contrary, it would be unnatural and abnormal if somebody didn't behave in this way. Just think about the multi-national companies who move from one place to another just for a legal **2%** saving in tax. This happens, for example, in the **USA**, where companies move from one state to another because the local state tax is lower. **Isn't this tax-planning?** Of course it is. Sometimes a whole battalion of experts examine the case for months on end before reaching a decision. They do this because this is expected from them by the first rule of market relations, the **profit rule**. At the end of the day, the shareholders call the management to account over this when talk turns to the payment of dividends.

**So, is it worthwhile using the services of a company like LAVECO?** I would say yes, without a doubt. The solutions we offer are tried and tested structures, which, in practice, have satisfied numerous clients. Choosing a polished, fine-tuned solution is always better than fishing for something new and uncertain. Right now we can offer our clients effective assistance in this area in our offices in **Budapest, London, Larnaca, Bucharest and Sofia**. Or whichever part of the world you come from, we will be happy to meet you, hopefully not just for the next 15 years!

**László Váradi**  
Managing Director  
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## Malta – new tax refund system

Some two years after accession, **Malta** and the EU have reached agreement on the new system of tax refunds, which will come into force on **January 1<sup>st</sup> 2007**. According to Maltese law (**The Maltese Tax Act of 1948**), companies incorporated there are subject to 35% profit tax on their worldwide income, but those **International Trading Companies (ITC)** whose shareholders are private individuals or companies not resident in Malta for tax purposes received a refund of the majority of this amount within **14** days of payment, and as such the amount of tax really paid was only **4.7%**. Existing **ITCs** will continue to enjoy this advantageous tax refund status until **December 31<sup>st</sup> 2010**, after which they too will presumably be taxed according to the general rules. The changes, however, are still somewhat sketchy, and it will only be possible to form an opinion on the final version, or rather accurately determine the actual level of tax nearer to the date of introduction.



## LAVECO tip – Investing without taxes on interest and dividends

One of the most common uses of offshore companies worldwide is in the area of investment transactions. This can be seen in the fact that today more than **50%** of the world's financial transactions are arranged through the bank or brokerage accounts of offshore companies. The rate is so high because the number of currency-related speculative or derivative transactions for which tax-free offshore companies are used amounts to several billion dollars each day. Offshore companies are no less popular among investors who trade in stocks and shares on the various stock exchanges of the world. In certain countries – **such as the United Kingdom, for example** – real estate speculators also take advantage of the advantageous tax regulations. In many cases, the offshore company is merely used to hold funds deposited in its bank account, with the interest accruing over a period of time.

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**Why are these companies so popular in the transactions mentioned above? The reason is twofold.** Firstly, these foreign companies enjoy **exemption** from **capital gains** tax, whereas in many countries local companies do not. The other area of taxation where these companies enjoy legal exemption is in the **dividend and interest** type of taxes. In many countries the rates of tax in these cases can be as high as **20-35%**. It is obvious, therefore, that in certain cases it is more profitable for investors to accumulate money through the bank or brokerage account of an off-shore company, rather than through a personal account.

This same situation arose in Hungary following the changes in taxation introduced in Hungary on **September 1<sup>st</sup> 2006**. Foreign companies are not subject to the **20%** tax on interest, so, compared to local tax residents, the funds in the account of a foreign company increase even more, with an extra fifth remaining in the hands of the **investor**.



## LAVECO news

From **October 1<sup>st</sup> 2006** we have introduced a new service. For those clients who do not want to spend time on administration, or at least one part of it, we will now **produce the invoices** to be issued by the company, and, if required, forward them to the specified address. In this case, we are not only speaking about a solution for offshore companies, as today it is an established practice in many companies for the invoicing to be done by an outside contractor. In the case of larger companies, this quite obviously is worthwhile because it is then not necessary to employ staff for this purpose. In the case of smaller companies, it may be more efficient because the production of just a few invoices a year can also cause a major headache, even if they speak very good English at the company concerned. The drafting of an official document can cause problems for even the most capable people.

We would like to remove this problem with the introduction of this new service. If you would like to take advantage of this service, please contact the staff at any of our customer services offices.



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