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NEWSLETTER

Is the taking of performance-enhancing drugs legal? Changes in corporation tax in Hungary Tax changes in Liechtenstein About Trusts, again The LAVECO Christmas Dinner in Cyprus

IS THE TAKING OF PERFORMANCE-ENHANCING DRUGS LEGAL?



It was during a maths lesson at secondary school that I first came across the term axiom. The triangle is an axiom. There is no definition of what can be defined as such, but

we probably all have a pretty good idea what we are talking about and what a triangle looks like. Obviously there can be grey areas here too, such as whether we want to draw the figures on a flat surface or maybe a convex or concave one.

In today's world, where things change at lightning speed, none of us can take in and comprehend the mountains of information which bombard us day after day. I for one am prepared to admit it: I can't do it. It would be impossible to try and take in every scrap of information if we want to be perfectionists, and I am sure it would drive us mad. And on top of it all, along comes the LAVECO Newsletter every quarter. If I am perfectly honest with you, I should add that certain marketing gurus suggest that business-wise it would be more effective more LAVECO to send out its Newsletter even more

frequently. However, I see no point in sending out information which will only be of interest to a very restricted number of clients to all our readers. The changes in the income tax laws in Bangladesh, for example, which include a 2% increase in the tax on household heating oil, would be a particularly specialist topic in our business circles. And although the country has a population of some 150 million, it is somewhat of a rarity for us to entertain clients from Bangladesh or European businessmen with interests in that part of the world. So it is pointless bombarding you on a monthly basis with this or other equally useful information.

I, therefore, will stick to the quarterly newsletter, containing information useful to our readers, as, in my opinion, both the amount of information to be taken in and the time involved are acceptable. Just as I enjoy reading the quarterly newsletter of my favourite vitamin supplier, telling me which vitamins and dietary supplements should be taken each season to strengthen my system. Yes, unfortunately even the most conservative dieticians recommend supplements as our bod-



ies are unable to extract sufficient nutrition from the ever more lacking foodstuffs placed before them, and in our increasingly polluted modern world, we become a bit like the car which should be run on 95 octane petrol, but whose engine constantly receives 76 octane.



Something similar is happening all around us in the business world. In my almost exactly 20 years of working with LAVECO, I have noticed that a significant number of our clients use offshore companies out of necessity. It is rather a strange paradox, but if your business competitors have been using tax-optimising techniques for several years, then you have no choice: if you can't beat them, join them. If not, your expenses will be higher, you will have to charge more for your goods or services, and you will get left behind by your competitors. Believe me, I am not trying for one moment to incite anyone – the constantly profit-driven world of capitalism does that for me.

Not long ago I came across an article in a business weekly in Hungary about family businesses which had established a society to protect their interests. The question was particularly significant: more than two thirds of the enterprises in Hungary are family businesses, and they employ more than half of the working population. The post script to the article concerned the continuation of such businesses, and how the heirs can manage the estate built up by the father. The question is very topical at the moment, as those companies which were established in the rush of the 90s – which is how LAVECO was established in 1991 in Hungary – are now facing the question of continuation. Now, the newly-established society is "selective" when it comes to new members, and will not accept members owned by offshore companies.

I have the greatest respect for the people who wrote the group's regulations, but I would like to point out that while ownership is one thing, the business connection or contractual relationship established with a foreign, possibly offshore,

company is something totally different. Perhaps the company in question has no offshore owners amongst its members, but a significant amount of its funds are transferred in that direction through its "suppliers". Maybe they can help me by providing me with a definition of "offshore company", as with all my 20 years of experience, I'm still having trouble. It has to be all or nothing. How "offshore" is a company from London or Stockholm? I can establish tax-free structures in both these places. Can we declare a Maltese company, where the rate of corporate tax is 35% and actually has to be paid in, to be offshore? Is an investment fund registered in Abu Dhabi which manages a mere 500 billion dollars offshore, considering that the territory of the Emirates is completely tax free? Or is the notorious Cyprus, with its 10% corporate tax and a company register as transparent as the one in Hungary, offshore? To name but a few... but I have no intention of calling on my expertise for the full expansion of the list.

Or rather, there is one more I should add: with its broadly beneficial new tax laws, from January 1st 2011, Hungary can be included in the list, as profits up to 500 000 000 forints will be taxed at



the rate of 10%. So does this mean that Hungary is also "offshore", or has it merely joined the search for international profit through tax competition, by trying to attract foreign investors? Or should we just ignore tax competition,

which itself has been around for thousands of years, or since the first introduction of taxation?

Is the triangle an axiom? Are vitamins performance-enhancing drugs? Is the offshore company...?

Yes, let's finish the sentence together in 2011. I wish all our readers success in their business ventures and happiness and good health in their private lives in the New Year.

With warm regards

László Váradi
Managing Director
LAVECO Ltd.

CHANGES IN CORPORATION TAX IN HUNGARY

If our assessment is correct, January 1st 2011 may bring a significant change to the international opinion of Hungarian companies. The amendments to the existing laws will be so significant that they will ensure certain taxation benefits for both trading and investment companies registered in Hungary with foreign owners. This breakthrough will be provided by the reduction in the rate of corporation to 10%, which will apply to annual profits up to 500 000 000 forints from next year, with the current 19% rate applying to any profits over this amount.

Corporate tax rate:

Section 19

(1) Subject to the exceptions set out in Subsections (2) and (4), the corporate tax rate is 19 per cent of the positive tax base.

(2) The corporate tax shall be 10 per cent of the positive tax base up to five hundred million forints.

(3)

(4)

This change will mean that Hungary will be the third country in the European Union behind Cyprus and Bulgaria to apply the lowest open, non-refundable, corporate profit tax rate (it is important to emphasise that this is non-refundable, as in the case of Malta, for example, there is a tax refund system for foreigners allowing for the refund of the 35% profit tax which does actually have to be paid initially).

In international tax competition, which is becoming ever more present in the business world and which, we should emphasise, is totally legal, Hungarian companies which actively operate (trading, production, services etc.) will pay less tax than before.

Looking at the other tax burdens, it is important not to forget the local industrial tax, which naturally will still have to be paid and typically is

2%. The basis of this is different from the corporation tax, but is calculated similarly.

Foreign-owned holding companies registered – or to be registered – in Hungary may also receive a boost. In our opinion, the biggest winners in the current Hungarian tax system are foreign-owned companies, whether they carry out active operations or merely passive investment activities.

In the case of investment holding companies, it is basically important to examine the Hungarian taxation of three types of income:

- interest
- fees paid for rights and royalties
- dividend

In the case of Hungarian companies, 100% of interest received forms part of the tax base. From the point of view of the country of source, however, it is possible to take advantage of the generally beneficial conditions of agreements for the avoidance of double taxation signed with Hungary.

Interest payments from Hungary are no longer subject to the 30% tax previously imposed on the Hungarian company, as according to the regulations to be in force from January 1st 2011 the tax on payments made to foreign structures will be removed from the tax laws. This change means that the Hungarian company will become an ideal vehicle for international corporate loans, since Hungary appears on no tax haven blacklists, not even those of the strictest western countries.

The partially advantageous regulations on the taxation of incoming royalties are contained in paragraph 7 of the Corporate Tax Law:

Deductible at the time of establishing the tax base:

Section 7

(1) The following shall be deducted from the pre-tax profit:

s) 50 per cent of the amount of royalties claimed as income under pre-tax profit for the tax year, in due observation of the provisions in Subsection (14)

A beneficial regulation will also apply to royalties paid from Hungary abroad, as from January 1st 2011 it will no longer be necessary to pay the 30% tax on royalties transferred to foreign structures.

Dividends received by Hungarian holding companies are not considered as taxable income from the tax point of view, except in the case of dividends received from controlled foreign companies.

Similarly, there is no tax on dividends paid abroad by Hungarian companies, so foreigners are free to take their after tax income out of the country without having to pay an additional dividend tax.

In connection with the above, it can be stated that the taxation of companies owned by foreigners is much more favourable than the taxation of companies owned by Hungarian individuals. If the owners of a Hungarian company are individuals resident for tax purposes in Hungary, then from January 1st 2011 they will be subject to 16% dividend tax on any dividends received, plus 14% social security contributions on the first 450 000 forints received. It is true that the 16% rate is more attractive than the previous 25%, but the whole picture quite clearly shows that the tax laws are designed to favour foreigners investing in Hungary. And in this respect there is no distinction between one foreigner and another. Although there has been a lot of noise about offshore companies over the last couple of years, the tax laws in Hungary do not contain any restrictions regarding investment by foreign companies



in Hungary. In our opinion, it is still worth making foreign companies the owners of Hungarian subsidiaries, as members or shareholders, in order to take advantage of the legally offered tax benefits. From January 1st 2011 Hungary can assume the role of the ideal holding centre.

TAX CHANGES IN LIECHTENSTEIN



The small alpine country of Liechtenstein has for decades been the very symbol of reliability and stability in the

financial world. However, in the face of pressure from international organisations it now seems that Liechtenstein will be forced to introduce such changes to its tax system as will help it to be removed from the "blacklists", which place sanctions on tax havens, of numerous western countries.

The changes will come into force in Liechtenstein gradually, with profits being taxed variously depending partly on the type of company and partly on different asset elements and types of income. The basic rate of corporation tax for legal entities will be 12.5%, while the tax on capital will no longer apply. Losses from previous years can now be carried forward indefinitely, and taxation of a group will be introduced as a new element in the tax system. The earlier 4% dividend tax will be removed, though as a temporary measure reserves from earlier years paid in dividends within the following two years will be subject to tax at 2% initially, but then later rising to 4%.

The most significant international effect of the changes comes in the extending of Liechtenstein's network of agreements. Before 2008 Liechtenstein had entered agreements for the avoidance of double taxation with only two other countries. They entered agreements with Switzerland in 1955 and Austria in 1969. Then on December 8th 2008 a Tax Information Exchange Agreement (TIEA) was signed with the USA, together with a general agreement on legal assistance. During 2009 a total of 11 new agreements on the exchange of information were signed, including ones with Germany and France. And although the tax experts from Liechtenstein continue to insist that the agreements do not mean the automatic supply of data, the door has been opened for

countries with high rates of tax to start requesting information. This may lead to Liechtenstein steadily losing the image it has guarded for decades in international business spheres as the epitome of reliability and confidentiality.

ABOUT TRUSTS, AGAIN



In several earlier issues of the LAVECO Newsletter we have spoken about Trusts. For businessmen from countries operating a continental legal system, the concept of the Trust as a business solution, the essence of which is that the Settlor legally hands over his assets to a Trustee, who is then obliged to maintain and manage the assets in accordance with the terms of an agreement and in the interest of the Beneficiaries, is somewhat difficult to comprehend and swallow. The Trust is a private law agreement between the two parties, and no legal entity is established through the agreement. So the Trust itself has no concrete owners, just Beneficiaries, who can include the Settlor himself. Therefore, no controlled foreign company is formed, as in the case of the Trust there is no separate entity. In the continental legal system this is not a recognisable concept, so in a number of these countries there is no requirement for the private individual to declare such beneficial ownership to the tax authorities.

Although it may seem a little inconceivable as an asset protection vehicle, its viability in practice is proven by its 800-year history in countries following the anglo-saxon legal model. And that does not mean just England, but all of its former

colonies. The vast majority of the jurisdictions currently offering advantageous tax climates have adopted the English Trust laws, including the USA, which also followed in the footsteps of English tradition in the further development of Trust laws.

THE LAVECO CHRISTMAS DINNER IN CYPRUS

On December 17th 2010, the LAVECO Larnaca office held its 4th annual Christmas Dinner. In addition to our staff, the party was attended by representatives of the offices of local lawyers, accountants and tax consultants, as well as our major banking partners. The venue was also somewhat special, as the event was housed in a restaurant built into an art gallery. In this way, during breaks in the dinner, guests were free to wander around the adjacent rooms and view the thousands of owl statues from the collection of the head of the Cypriot Orthodox Church. The un-



paralleled collection even took the local guests by surprise, as many were visiting the gallery for the first time, so they too had a memorable evening, enjoying fine food and Greek wines and being entertained by Latin dancers.

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