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# The Hungarian trust - facts and misunderstandings

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*"May anyone claim that the historical background of the one or the other legal systems is more valuable or that the concept of bifurcation of ownership (legal and equitable) provides a better solution than the contractual solution? I do not think so."*

**H**ungary introduced its own trust law in March 2014 as part of the brand new Civil Code.<sup>2</sup> Since Hungary belongs to the family of continental civil law countries and follows the German-Austrian based legal traditions, the introduction of the concept of trust was not free from sharp professional debates during the preparation and drafting period which took almost two decades. However these debates also fortified a very implementable professional concept which may lift the Hungarian trust among the appreciated and successful solutions and structures of home and international wealth, estate and tax planning.

The purpose of this article is dual. First, giving an outlook to the main characteristic features of the Hungarian trust, a kind of fact sheet, to all of those who are open to new instruments and solutions and ready to think about the way of implementation, and second, clearing up some misunderstandings based on wrong, mostly academic interpretations.

## Trust in Central-Eastern Europe

The Hungarian is not the first trust legislation in the Central-Eastern European region. The Czech Republic, Romania and Russia have definitely been ahead Hungary in terms of legislation in this area. However, while the trust has remained to be practically dead legislation in these countries with almost no practical use, a new trust industry was borne in Hungary in a vibrant professional environment (congresses,

seminars, articles, books,<sup>3</sup> postgraduate university degree etc.). It seems that the Hungarian professional community is keenly interested in the concept of the trust, at least much more so than in the other countries in the region with similar legislation. Thanks to this professional interest shown, international organisations like the Society of Trusts and Estate Practitioners (STEP) have also taken a firm stand in Hungary, and currently the strongest STEP branch of the region is just in Hungary.

## The pillars of the Hungarian Trust Contract made trust

Trusts can be created in Hungary only by contract between the settlor and the trustee (or by a last will). This comes from the continental legal traditions of the country and makes the fundamental theoretical difference to the Anglo-American trust. Some authors say that the contract based trust is not a real trust, only pseudo trust or "merely a contract variant"<sup>4</sup> since "the Anglo-American trust is not contractual relationship, but a *sui generis* legal/equitable relationship".<sup>5</sup> These opinions are lost, I guess, in the jungle of the academic theories and neglect the practical approach of a legal instrument. If attention is turned instead to a comparison of the practical use of UK, US and Hungarian trusts, we would discover that at the end of the day, a similar functional identity among them.

## Trust friendly legal environment

One of the secrets of the quick "start-up" of the Hungarian trust is the fact that not only were the Civil Code rules successfully implemented, but the connecting legal environment (administrative, licensing, tax and accounting rules) was harmonised with



the new trust law rapidly and successfully. (This harmonisation is completely missing in the above mentioned countries of the region which makes their trust rules somewhat inoperative.) The swiftly harmonised comprehensive legal environment helps substantially in the daily implementation of the trust. It also serves to build confidence in a previously unknown legal phenomena.

### Permissive rules

The other important feature of the Hungarian trust is the dispositive (permissive) feature of the rules, which means that the Civil Code provides almost an absolute freedom to the parties to set up their own tailor-made trust. Only the following five rules must be considered as obligatory:

- only a written instrument (contract or will) creates a trust;
- the *maximum length* of the trust is 50 years;
- the trustee cannot be the *sole* beneficiary of the trust;
- the trust asset *must be separated* from the trustee's own assets and other trust assets;
- the trustee *cannot be instructed* either by the settlor, protector or the beneficiary.

Any avoiding from the above rules makes the trust nil and void.

### Transfer of the title of property

No trust is created without a transfer of the property from the settlor to the trustee. This also comes from continental civil law traditions which don't recognise the concept of dual (i.e. legal and equity) ownership, whereby the legal owner and the beneficial owner of a property can be different. Splitting these two positions is simply prohibited in civil law regimes. Therefore by the transfer of the property, the trustee will be not just a legal owner, but also the beneficial owner. The illusive prohibition of the bifurcation of ownership however opens certain gates and provides advantages in the era of the endless detection of the Ultimate Beneficial Owner in all parts of business and financial operations (think only to a "simple" bank account opening transaction which is becoming extremely complex nowadays). In other words, according to Hungarian trust rules, the Ultimate Beneficial Owner of the trust asset (bank account, company participation, tangible and intangible, receivable, etc.) is the trustee itself, which – with some exceptions – has no right to identify the settlor unless the settlor's prior approval has been obtained. Can any Anglo-American trustee say that about itself?

### Transparent taxation

The taxation of the trust is very favourable. First of all, there is no entry tax on asset putting in trust. Secondly, the taxation of the income of the trust is very transparent since the trust itself – having its own tax registration number – is subject to corporate income taxation. (The current Hungarian corporate tax rate is 10% up to tax basis of approximately EUR 1.6 million, and 19% on the exceeding part.) Finally, taxation of the distributed asset varies depending on the feature of the asset (i.e. capital or income) and the person who is beneficiary and their link to the settlor. In a properly designed trust only the income of the trust will be taxed at distribution. But since there is no gift or inheritance tax in Hungary in relation to direct ascending and descending line and also marital spouses, the trust can be a perfect tool for tax-free estate planning.

### Treaty shelters

Since the trust is considered as a corporation in tax terms, the Hungarian trust also enjoys the treaty shelters of most of the 90 Double Tax Treaties and many Investment Protection Treaties of the country. That also makes the trust the perfect tax planning and investment tool for international structures. However, Hungary is not yet a member of the Hague Convention on the Law Applicable to Trusts and Their Recognition, unfortunately this has not yet been achieved, although the Hungarian trust meets, in all sense of the definition, the trust as defined in this treaty.

### Unlimited purposes

The Civil Code does not specify the purpose of the trust. It leaves this to the liberty of the contracting parties which means that the Hungarian trust can be set to any kind of purpose that has been characterised in the law books of many centuries, there is only one exception: agricultural land. The sale of this asset is currently strictly limited by Hungarian rules in general i.e. not particularly in relation to trusts. However, outside of the agricultural land, only human fantasy can set borders to the application of trust.

### Type of trustees

The Civil Code does not specify the detailed operational rules of the trustee. However, another law<sup>6</sup> separated the "business" (or professional) and "non-business" (or non-professional) trustee. The first category falls under government license (currently provided by the Hungarian National Bank as the supervisory body of the Hungarian financial market) which can be issued only to those corporate applicants who can perform quite a lot and strict

professional, personal and financial conditions continuously during their whole operation. In complex and high profile cases or in the case of high net value assets only this kind of trustee can guarantee secured asset management. Currently only three licenses were issued and a further two applications are under licensing. The licensing procedure takes several months. Literally anyone (corporate or individual) can be the latter kind of trustee (non-business) since the law does not create any conditions like that. The only limitation is that the trustee cannot take more than one case a year and the trustee fee cannot be higher than 1% of the trust asset (currently it is debated that the 1% can be understood as a yearly fee or a fee for the whole period of the trust). The non-business trustee is obliged to file all of its contracts (trust deeds) with the Hungarian National Bank which keeps a registry of these instruments. Although this registry is not open to the public, it is open to any state authority. The business trustee has no similar filing obligations.

### Past, present, future

Since the Hungarian trust was implemented hardly more than two years ago, it is very difficult to talk about the "past". Although the industry was borne, it is still small and less developed, however there is a lot of enthusiasm and the efforts are headed by a handful of enthusiastic professionals with significant practice in the application of Anglo-American types of trusts in the last 20-25 years. Since there are no court cases yet, we cannot talk about court practice either. The responsible state bodies are at least neutral, sometimes helpful and co-operative but definitely not hostile. The interest and demand is however growing, therefore all the conditions exist to allow the Hungarian trust to be wildly used internationally in the not too distant future.

#### END NOTES:

1. Ákos Menyhei: *Development of the estate planning industry through the introduction of the trust in Hungary (In Trust & Trustees Vol. 22, No. 6, July 2016 pp. 659-664.*
2. Act No. V. of 2013, Articles 6:310-6:330.
3. *Maybe the most comprehensive of all is the handbook and university paper written by five practicing lawyers – B Szabó, Illés, Kolozs, Menyhei, Sándor: A bizalmi vagyonkezelés (HVG Orac 2014).*
4. CE Rounds, Jr and Illés: *Is a Hungarian Trust a Clone of the Anglo-American Trust, or Just a Type of Contract? Parsing the Asset-management Provisions of the New Hungarian Civil Code (In Journal of International Commercial Law 153 2015).*
5. Rounds and Illés (n 3).
6. Act No. XV. of 2014 on the Trustees and the Rules of Their Activity.