

\$119.8bn Amount of foreign direct investment attracted by Hungary in 2015

The competitive edge

Gabor B Szabo explains the significance of Hungary's new business-friendly legislation, and assess its likely impact on trusts, in particular

The Hungarian parliament recently adopted a new act under the title of "Increasing the legal competitiveness of the business environment", a package of rules amending several other acts which are highly sensitive to business and financial issues.

Although the title of the new act is not free from some euphemism, the purpose of the law makers is quite clear: proclaiming Hungary's commitment to this competitiveness via

- rationalisation and speeding up legal and government procedures;
- decreasing unnecessary bureaucracy;



The Hungarian parliament, Budapest

Shutterstock.com

JURISDICTIONS: HUNGARY

“Hungary is determined not only to hold but develop the concept of trust in the civil law environment”

- introducing new flexible legal structures and, generally speaking;
- simplifying the life of market players.

The above measures also include amendments to the Hungarian trust regulations (let’s refer to it as “the Amendment”).

Exactly a year ago I wrote about Hungarian trusts in *Offshore Investment* (see the July-August 2016 issue). The core message of that article was that, although the concept of trust – which was introduced by the new Civil Code in 2014 after

some lively debate within the profession – is rapidly taking root in Hungarian legal thinking, we still cannot really talk about a well-grounded practice considering the short history of the new vehicle of asset management.

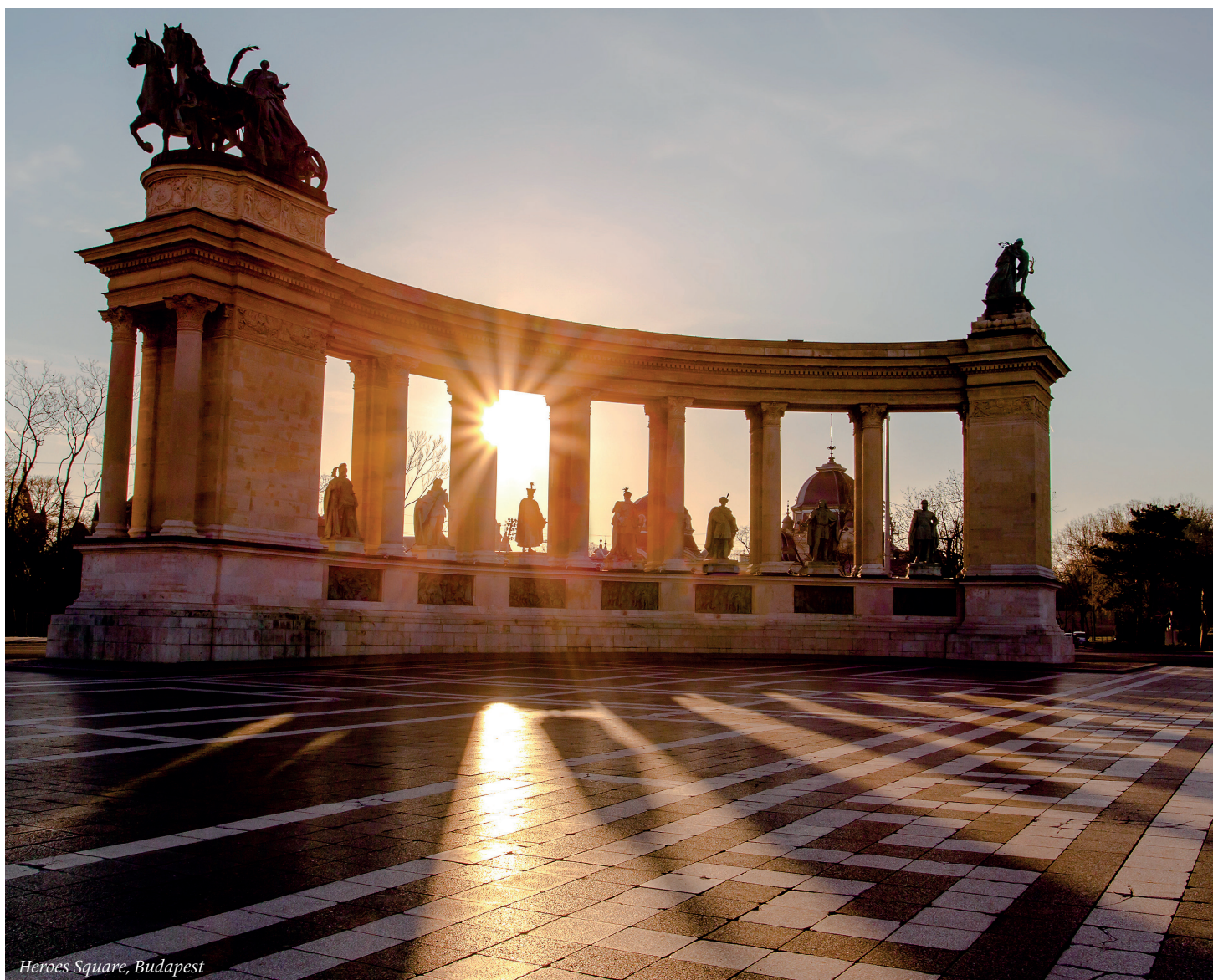
However, also thanks to the warnings and proposals of a few trust practitioners, barely more than three years from the Amendment’s introduction the government started to recognise that the act’s first fine tuning was absolutely necessary in order to avoid counterproductive

problems of legal interpretation on a dogmatic level and in order to free trustees from certain unreasonable constraints. The Amendment seeks to address the following key issues, in particular.

RELATIONSHIP OF THE TRUST AND ITS HEIRS

It was mainly the public notaries, who have a central role in probate process, who rang the alarm bell signalling that the old rules did not provide clear directions in this case.

It was not clear if the trust asset



Heroes Square, Budapest

Shutterstock.com

1.4% Proportion of Hungary's GDP invested in civil research and development, the 25th highest ratio in the world

can be taken into consideration when the basis of forced heirship is calculated. (The measure of the forced heirship, by the way, is one third of the "clean bequest". It was cut down by the new Civil Code from the half of the bequest.)

The Amendment gives a clear directive when declared that the trust assets have to be included in the basis of the forced heirship, just like any other asset which was given by the testator *inter vivos* to a third party without consideration (e.g. donation).

ASSIGNMENT OF THE POSITION OF SETTLOR

The Amendment gives the right to the settlor of the trust to appoint a third party in the deed of the trust who can exercise the settlor's right and fulfil his obligations in the case of his death or its termination.

The third party must approve this appointment and send a written approval to the trustee. Without this approval the assignment of settlor's position is null and void.

IRREVOCABLE TRUST

In many ways this is the issue which shows most clearly the difference way of thinking between equity and civil lawyers.

According to the old rules it was not absolutely unequivocal if an irrevocable trust can be set or not. Some say that the irrevocability of a contract (but do not forget that the Hungarian trust is a contract-based trust!) is against the Hungarian public order.

These lawyers are saying that every contract can be terminated even by a unilateral notice to quit, and if the contract can be terminated, the irrevocability is a legal nonsense.

Others say that although the trust regulations do not specifically mention the possibility of settlor taking a decision to unilaterally quit and terminate, the rules of mandate, which are the substitutional rules of the trust, give the right to do so.

This messy situation has been pre-empted and clarified by the

Amendment once and for all when declaring that the deed of trust can be unilaterally quit by the settlor unless the deed clearly orders that the termination is not possible.

FORTIFYING THE ASSET PROTECTION FUNCTION

According to the old rules the bailiff had right to "exercise settlor's right of notice to quit", and terminate the trust upon the request of settlor's creditor and also the arrest, pledge the trust asset to the favour of the creditor. (By the way, this rule also made it impossible to set up a real irrevocable trust.)

This right of bailiff has been cancelled by the Amendment, which also accomplished one of the basic functions of trusts in the modern age, that of asset protection.

PROFESSIONAL vs AD HOC TRUSTEES

The original concept of the Hungarian trust classified two kinds of trustees: professional who need to meet with many strict conditions in rem and also in person, and ad hoc (or nonprofessional) who could be virtually anyone without any professional compliance.

In the latter case the law limited only the number of the trust assets that the ad hoc trustee could manage. It was one asset per annum. The law makers realised, however, that the ad hoc trustee bears a very high risk and can be substrate of mismanagement or fraudulent behaviour of the trustee. This simply endangers the future of the whole nascent trust industry. Therefore the Amendment minimised the activity of the ad hoc trustee to a "one case per life time" basis and also obliged the ad hoc trustee to meet with almost the same strict compliance requirements akin to those the "professionals" must themselves meet.

THE STRONGEST FEATURE OF THE HUNGARIAN TRUST IS THE FORTIFIED ASSET PROTECTION IT OFFERS. THIS MAY SOON LIFT THE HUNGARIAN TRUST INTO THE CLASS OF SOME OF THE MOST POPULAR STRUCTURES IN THE WORLD

SIMPLIFYING THE LIFE OF THE TRUSTEES

The old rules burdened the trustees with some irrational administrative and reporting obligations. The Amendment – holding the strict compliance requirements – terminated this bunch of antiquated and obsolete rules and has made the lives of trustees that much easier.

DEVELOPING THE CONCEPT OF TRUST

The above bears witness to the fact that the legal practice of the last three to four years has brought to light a new set of circumstances which needed to be reflected in law.

At the heart of this is what makes the trust industry more strong, and sophisticated.

The Amendment also proves that Hungary is determined not only to hold but develop the concept of trust in the civil law environment. This is a measure for the longer term and offers the industry the framework within which a better and deeper understanding can be gained and, in time, implemented further into the legal system.

This is vitally important if we consider that the number and volume of trust assets have grown rapidly over the past two years or so.

Although, by the nature of this business, there can be no official statistics as such, cautious estimations would indicate that the total volume of the trust assets registered in Hungary now exceeds €500m.

In addition, and not very surprisingly, Hungarian trusts are currently just as popular among foreign investors as domestic settlors.

This fact may show also that the strongest feature of the Hungarian trust is the fortified asset protection it offers. This may soon lift the Hungarian trust into the class of some of the most popular structures in the world. ■

Dr Gabor B Szabo is Managing Director of Primus Trust Corp. in Budapest