

# THE RULES OF CORPORATE TAX AVOIDANCE IN THE HUNGARIAN LAW

Dr. Éva ERDŐS\*  
Dr. Zoltán NAGY\*\*  
dr. Zoltán VARGA\*\*\*

**ABSTRACT:** *The study describes the rules concerning legal tax avoidance in the Hungarian law through the rules of tax avoidance in corporation tax law. The drafting of tax reduction, tax evasion, and tax avoidance have been made with a general character in order to clarify the different methods of tax avoidance.*

*The Hungarian legal system applies two methods in the field of regulating corporation tax law; it defines the framework of tax avoidance with general clauses on the one hand and with special rules on the other hand.*

*As an important question the legal and illegal techniques of tax savings have been analyzed.*

*The comprehensive analysis of the topic, the presentation of the judicial practice, legal theory statements and legal regulations may provide help for future legislation and facilitate the theoretical foundation of the topic concerned.*

**KEYWORDS:** *tax avoidance; tax evasion; corporation tax, off-shore firms, tax fraud*

**JEL CLASSIFICATION:** K 23

## 1. INTRODUCTION

Hungarian law defines tax avoidance in the form of general clauses and with special rules on the other hand.<sup>1</sup>

---

\* Associate Professor, PhD Head of Department of Financial Law Faculty of Law University of Miskolc, HUNGARY.

\*\* Associate Professor, PhD Department of Financial Law Faculty of Law University of Miskolc, HUNGARY.

\*\*\* Assistant Professor, Department of Financial Law Faculty of Law University of Miskolc, HUNGARY.

<sup>1</sup> Simon István (szerk.): Pénzügyi Jog I. (Financial Law) Osiris Kiadó, Budapest, 2007. 405-411. p.

It is necessary to emphasize the principle of proper legal practice and the principle of classification of contracts on the conformity to their real content among the general clauses from the law about the order of taxation.<sup>2</sup>

We find special rules in the laws concerning single tax categories, so as in the law about the order of taxation, such as the special rule concerning tax avoidance:

- incomes – (profit-) minimum rule<sup>3</sup> (the establishment of taxes on the basis of 2 percentage of the corrected amount of revenues even if the company is loss-yielding );
- related undertakings' rule;
- limitations concerning the application of inner transfer pricings; the application of a usual market price;
- the severe regulation of cost accountings.

We can also find the rules concerning tax reduction in the form of general clauses and special rules between the basic principles of corporation tax, the provisions of introduction and the detailed rules. The general clause limiting tax reduction states that rules influencing taxability, taxes, tax reduction, benefit (tax exemption, tax relief) is applicable only if the content of legal transactions or other actions, serving as its basis, achieves the purpose of the rule and the tax benefit as well.<sup>4</sup>

Such general clause is the principle of single strain usage of expenses and discounts. The law about corporation taxation says, that expenses, expenditure, tax exemption, tax relief can be used only once on the same factual basis, but on a diverse title except the statute allows the repeated application of it.<sup>5</sup>

We can find the under mentioned special rules in the statute concerning corporation tax law about legal tax reduction:

- reducing titles at the time of determination of tax base;<sup>6</sup>
- loss limitation;<sup>7</sup>
- tax exemption;<sup>8</sup>
- tax reliefs;<sup>9</sup>
- rules concerning the avoidance of double taxation.<sup>10</sup>

The Hungarian tax law theory interprets tax evasion as a concept differing from tax avoidance. Tax evasion presupposes the violation of tax laws, so the violation of taxability using illegal devices. Tax evasion is a wide-range concept. Including such unlawful behaviours that have only tax law related legal consequences and those also that have to be prosecuted by criminal law.<sup>11</sup> (Typical, but not prosecuted by criminal law, type of tax evasion according to the literature, when the entrepreneur employs somebody who also

<sup>2</sup> Act about the tax procedure (in abbreviation: Art. 1-2.§

<sup>3</sup> 1996:LXXXI. törvény a társasági adóról és az osztalékadóról (in abbreviation: Tao. tv.) 6.§ (Act about the corporate tax, in abbreviation: Tao tv.) A törvény enged kivételeket a szabály alkalmazása alól! ( Law gives space for exceptions! )

<sup>4</sup> Tao. tv. 1.§ (2)

<sup>5</sup> Tao. tv. 11.§ (3)

<sup>6</sup> Tao. tv. 7.§

<sup>7</sup> Tao. tv. 17.§

<sup>8</sup> Tao. tv. 20.§

<sup>9</sup> Tao. tv. 21.§-23.§

<sup>10</sup> Tao. tv. 28.§

<sup>11</sup> Simon (2007.): op.cit. 409-411. p.

works in the entrepreneur's private house holding or charging family expenses as a business expenditure.)

There are various legal consequences for the infringements of tax law, which is defined in the statute on tax procedure.<sup>12</sup>

We separate two groups inside legal consequences, the sanctions and the measures. Late charge, self-control charge, tax fine and omission fine belongs to the circle of sanctions. Seizure of stocks and business closure belong to the circle of measures.

Infringements to be prosecuted by criminal law do not fall under the effect of tax law, with that comment, that the legal consequences of tax law are also applied beside criminal consequences in the practical world. So the concept of tax fraud is defined by criminal law and also applies criminal sanctions on it.<sup>13</sup>

### 1.1 The concepts of a tax evasion

The economic effects and the practical adaptability of the fiscal policy can be demonstrated in the behaviour of single taxpayers' and taxpayer groups' behaviour.<sup>14</sup>

The scale of the taxpayers' behaviours reaches from conscious tax planning, tax optimization and tax avoidance to tax evasion and tax fraud sanctioned by penal law.

The legality of the different tax savings techniques may be transferred into a category of infringements after a time, then into the sanctioned state of affairs of tax evasion and tax fraud.

Think about the existence of „tax paradise” (or „tax haven”) in the Hungarian legislation until 2004 – what granted the permission of operation by company law to organizations functioning abroad.<sup>15</sup>

The different legal and illegal taxpayers' behaviours are often blurred. By the time the authorities and legislation can handle and sanction a legal loophole it goes through many new practical tests on the basis of test - fortune. Jurisdiction may take steps earlier in a Supreme Court decision in a case like this with condemning illegal derogatory taxation behaviours - yet before those measures would be reflected in the changing of statutes, even it is an abrogation or a modification. It may happen that something, which is legal today, tomorrow will be illegal so it is hard to lay down the borders.<sup>16</sup>

Too severe rules and high tax burdens lure taxpayers into tax avoidance, but at least to exploit all opportunities of tax reduction. From tax reduction it is a short way to get to the illegal and derogatory tax evasion and tax fraud.

We look through the concepts according to this:

<sup>12</sup> Art. Adójogi jogkövetkezmények (Tax law consequences): 165.§-174/A.§

<sup>13</sup> 1978: IV. törvény a Büntető Törvényről (Btk.) 310.§ (Act about the Hungarian Criminal Law: 310.§)

<sup>14</sup> More about the taxpayers behaviour: Földes Gábor: X. Az adópolitikai döntések beszámítása az adózási magatartás alakításába in: Pénzügyi Jog I. (szerk. Simon István) Osiris Kiadó, Budapest, 2007. p. 403-411

<sup>15</sup> Hungary had to abolish this law before joining the European Union in 2004. Until 2004 „companies functioning abroad” were obligated to pay only 3% company tax instead of the normal 18% company tax rate. With this law in force Hungary realized the conditions of the Offshore, the so-called „tax paradise” status which is classified as a damaging tax competition and banned in its Code of Conduct for Business Taxation (ECOFIN Council) report by the EU.

<sup>16</sup> More about: Dr. Szilovics Csaba: Adózási ismeretek és adózási vélemények Magyarországon (Taxation knowledge and taxation opinions in Hungary)(2002-2007) OTKA kutatás. p.76 – p.84

## 1.2 Tax reduction or tax optimisation

It is the legal device of tax cut and with this it contributes to the budgetary loss. „Tax planning means tax optimisation based on economic, economical calculations, that is a combination of the different taxpaying obligations and the profitability that gives the enterprise the most favourable result according to the given conditions.”<sup>17</sup> One of the best-known devices of tax reduction is the application and usage of tax reliefs or giving permissions for tax sparing legal methods. Such can be for example the regulation of joint undertakings' accountancy in corporation tax law. The so-called offshore rule concerning organizations making business abroad was such a regulation.

## 1.3 Tax avoidance

According to the Hungarian tax law literature<sup>18</sup> tax evasion does not adequate with the spirit of law, while tax avoidance means abusing the law but not necessarily the infringement of the law.

Tax evasion is not equal with that amount of loss ensued in the potential tax revenues what could be collected in that case if there would be no tax evasion.<sup>19</sup>

*Tax evasion* is closely connected to untaxed economy and other kinds of crimes like fraud, money laundering, bribery, violation of accountancy disciplines.

*Tax avoidance* similarly to tax evasion is liable to prosecution, although in many cases it is the most difficult to prove. Tax minimisation (tax optimisation) is often the direct result of the application of tax motivators.

„Tax evasion – rather law abuse - happens when they evade the law but does not get to an open infringement with law.”<sup>20</sup>

No abuse happens if the individual actions not only fit with the letter of law but they are in harmony with its spirit, contributing to the integrity of law and making it obvious what is the law in force. The validity of law is in context with the just law. The just law is: the law reflecting faithfully the legal thought appearing in positive law.<sup>21</sup>

Tax avoidance is one form of legal tax minimisation and a legal activity while tax evasion is an illegal activity. The common element of tax avoidance and tax evasion is the aim to neutralise those (bad) effects of fiscal political decisions which is adverse to the interests of taxpayers. Taxpayers are using both legal (tax avoidance) and illegal (tax evasion) devices for tax minimisation.<sup>22</sup>

<sup>17</sup> Földes in Pénzügyi Jog I. (Financial law) (2007) p. 410 and more about: Deák, Dániel: Adótervezés a nemzetközi gyakorlatban (Tax planning in the international practice) (IFA) Adventura 2000 Kft. Budapest, 2000. p.1-211

<sup>18</sup> Deák Dániel: Adókijátszás és adókikerülés jogi megközelítésben, Jogtudományi Közlöny LX évfolyam 2005. May p. 191-201

<sup>19</sup> Deák, (2005) p.192

<sup>20</sup> Deák (2005) p.197

<sup>21</sup> Deák (2005) p.198

<sup>22</sup> Földes Gábor: Az adópolitikai döntések beszámítása az adózói magatartás alakításába In: Pénzügyi Jog I. (szerk.: Simon István) Osiris Kiadó, Budapest, 2007. p. 40-405

Taxpayers create such conditions around themselves that are the most favourable for their taxation. This is merely a natural behaviour and intention of taxpayers. This tax decreasing activity will be illegal when it contravenes law and therefore it will be prosecuted by law and authorities.

So tax avoidance means abusing the law without the infringement of the law, but when this tax avoiding behaviour breaks the law, we may already talk about tax evasion or tax fraud like the crimes of fraud, money laundering, tax fraud and violation of accountancy disciplines.

#### 1.4 Tax fraud

The Hungarian Penal Code (Btk.) deals with tax fraud through many states of affairs. Other prosecuted economic crime categories:

- bankruptcy crime Btk. 290 §;
- violation of economic secrets Btk. 300 §.;
- money laundering Btk. 303. §;
- omission of duty of notification connected to money laundering Btk. 303/§;
- (money) counterfeiting Btk. 304 §;
- tax fraud Btk. 310 §;
- fraud Btk. 318 §.

We distinguish two basic cases of tax fraud in the Hungarian Penal Code (Btk.)<sup>23</sup>:

- The first basic case can be committed during the establishment of taxability; the deceptive behaviour has to result in the reduction of the income;
- The second basic case can be realized among the payment of the already

established tax: the consequences of the deceptive behaviour are the considerable delay or the prevention of the collection.

The first manner of committing the crime:

- to make untrue statements concerning a considerable fact or data;
- hiding of such facts or data from the authorities;
- other deceptive behaviours.

Tax fraud according to the first state of affairs can be committed with both active and passive behaviour (omission), can be realized both in word and in writing. A fact is considerable if it influences the amount of the payment or the title of the liability (those who hide considerable facts commit a crime).

The behaviour may aim on that either no payment liability is established or taking advantage of a discount or an exemption unduly or deceptively.

In the second case, according to this state of affairs, the criminal behaviour aims on the deception of the authorities in order to avoid the payment of the assessed amount of tax. The perpetrator in this case wishes to avoid or delay the satisfaction of the already due tax payments with the deception of the authorities.

---

<sup>23</sup> Gula József In: Magyar büntetőjog – Különös részi ismeretekben (szerk. Görgényi Ilona) Bíbor Kiadó 2009. p. 225

In the first case the result will be the decrease in tax revenues. This is an essential viewpoint in the differentiation between the tort of tax fraud and fraud. As the Supreme Court pointed it out in its ruling: 1/2006. BJE, if there is no deficiency or decrease in tax revenues only the tort of fraud can be established. The decrease in tax revenues has to be in a punctual sum of forints (HUF).

In the second case the results of committing the crime is the considerable delay or prevention of the tax collection. The prevention of the collection means the actual lag of the incomes.

The concept of considerable delay demands unique administrative assessment. The sheer exceeding of the deadline does not result a crime yet but if the delay is over one year this fact can establish a crime.<sup>24</sup>

The crime can be committed only deliberately, the first state of affairs can be perpetrated both intentionally and potentially; the second basic case can be committed only with direct intention.

Anybody can be the perpetrator of the crime, but omission can be committed only by those who are obligated to make announcements.

The subject of the crime is the person obligated to the payment of taxes. But in certain cases the employer can also commit the crime. In such a case only the employer's employee, whose responsibility was the fulfilment of the tax obligations (a natural person), is liable for the crime.

The crime bound to value limit, if the decrease in the sum of the accrued tax is not over 100.000 Ft no crime is realized. A minor offence is realized under this value limit. The punishment depends on the measure of the crime's value and of course increases according to the (bigger) value of the crime. The basic case is if the tax revenue is decreased between 100.000-200.000 Ft, following this it can be committed to bigger, considerable, particularly big value or to a value exceeding this amount.

## 2. TAX EVASION IN THE LAW PRACTICE

The inland revenue office establishes the tax evasion character of a transaction based on law regulation, considering the circumstances of the transaction, taking into consideration all the documentary and other evidences. Of course the court decides about the tax evasion character of the transaction in case of a judicial case. The opportunities to tax reliefs and tax reduction are regulated by laws. The cases of tax reliefs were defined in the rules of corporation tax. The rules of tax reduction were fixed in between the procedural law and in this case the inland revenue office has the right of discretionary jurisdiction.

The inland revenue office and the court - in appeal cases - decides on the bases of law about the legal or illegal kinds of tax evasion.

The bases of the decisions are the various tax authority governing principles, vocational guiding and court judgements in previous, similar cases.

The legally binding court decisions are made on county judicial level, which means that theoretically independent courts may represent different points of views in similar

---

<sup>24</sup> Gula József in Magyar Büntetőjog (Hungarian Criminal law) (szerk.: Görgényi Ilona) (2009.) p. 227

cases. However, litigators may usually refer to single court decisions, which are usually taken into consideration in the judicial practice of making judgements.

However, the Supreme Court's decisions serve better the unified application of law, because these decisions are taken fully into consideration by the courts of first instance. The fast changes in tax statutes make uniformed legal practice more difficult, since it makes necessary to apply totally different provisions in the same state of affairs. The taxation rules concerning conditional tax establishment and the determination of usual market price are meant to eliminate legal insecurity.<sup>25</sup>

Conditional tax establishments are realised between the frameworks of taxation authority decisions. Its aim is to define the taxation rules of the complicated, atypical transactions unusual in (Hungarian) domestic relations.<sup>26</sup>

The Financial Minister determines, on the taxpayer's request and on the bases of his/her detailed presentation concerning the state of affairs in possible contracts or other legal transactions in the future or on the bases of a contract type or contract packages, the taxability or the lack of it or if it is possible the bases of taxation and the amount itself. The Taxation Procedural Codex lays down special rules on the submitting of applications, its conditions and remuneration.

According to main rules, conditional tax determination is obligatory for the Inland Revenue Office beside constant state of affairs and in the given case only.

The regulation, effective from 2010, made the extension of time effect of conditional tax determination possible. On the taxpayer's request the Ministry of Finance finds out, that do the current state of affairs or the provisional changes have any effect on tax obligation or tax exemption previously decided in the conditional tax determination.

The procedure of deciding about usual market price also begins with an application. Its aim is to avoid future legal conflicts between taxpayers and the Inland Revenue Office. The tax office regulates on request in its decision the method how to decide the usual market prices, the contributing facts and circumstances and the usual market price itself in cases of future contracts between the relations of connected undertaking companies, which decision is enforceable. The Procedural Codex contains the special conditions concerning the applications and the procedure itself and the prize, obligatory for the procedure.

The law regulations make the taxpayers' law-respecting behaviour compulsory. Rules concerning single tax categories also regulate tax avoidance, but summarising the basic principles of the law about the order of taxation formulates the general rules concerning it.<sup>27</sup>

The basic principles may constitute ground for the judicial decisions directly. The principal of „*proper legal practice*” can be considered as a basic principle.<sup>28</sup> Law itself defines the essence of the principle. Contracts or other legal transactions aiming to get rid

---

<sup>25</sup> Art. 132.§-133.§

<sup>26</sup> Hadi (2008.): op.cit. 273. p.

<sup>27</sup> Art. 1. §-2. §

<sup>28</sup> Ezt az alapelvet a törvényi szabályozás bevezetése előtt az 1/1999. KJB számú Legfelsőbb Bírósági jogegységi döntés is tartalmazta. (The 1/1999. KJB Supreme Court decision also contained this principle before the introduction of statute regulation. )

of the obligations provided in tax laws are not qualified proper legal practice in the application of tax laws.

This provision does not mean the general prohibition of the tax avoidance. Actions aiming to save taxes with the use of legal devices are prohibited neither now nor in the future. The statute applies legal consequences related to tax law when the transaction does not have a real economic aim or this role is negligible, the transaction aims at the acquisition of the tax benefit significantly.<sup>29</sup> In this case the tax office establishes the tax amount upon all the circumstances (with an estimate), particularly paying attention to the normative obligation of taxpaying in case of proper practice of rights.

The rule of income-(profit) minimum, introduced in 2007, tightens the opportunity of tax avoidance on the field of corporation tax law.<sup>30</sup> The aim of this provision was the whitening of the grey economy and the widening of the base of taxpayers.

The income-(profit) minimum is 2 percentages from all the corrected amount of revenues (corrected amount of revenues are defined as a special category by law.)<sup>31</sup>

However, taxpayers do not have to count the amount of taxes on the base of this profit minimum, since law gives the opportunity to decide. It does not regard profit minimum as a tax base, but in this case it attaches a separate, complementing form to the tax return for the tax office. The other case is when it calculates tax payment on the base of profit minimum, but in this case it must not apply the increasing or reducing items on the result prior to taxation.

Other important devices of the fight against tax avoidance are the provisions concerning the related undertakings in the rules of corporation tax law. Between its framework law regulates, that if those related undertakings whose businesses are not done on the usual market price with each other, in certain cases how should they modify their tax base.<sup>32</sup>

The Inland Revenue Office issues governing principles, guides and vocational/technical guiding because of harmonisation and precision of law interpretation and also to serve the exclusion of tax avoidance. These regulations do not concern only actual transactions since they have a general character.

In the fight against tax evasion and legal loopholes the Hungarian Tax and Financial Control Administration has no solid obligation of making public and practice – in terms of requirements. As by the 1 § (5) in Act XCII of 2003 on the Rules of Taxation enacted, “the tax authority shall provide taxpayers with all of the information necessary to abide by the law; it shall inform taxpayers regarding tax declaration and tax payment regulations and advise them in respect of exercising their rights.”

The tax authority is not only entitled to inform the taxpayers but is also bound to do that. However, this obligation causes some difficulties and leads duality, as well. Namely, the tax authority must perform its tasks, at the same time it has to be a good service supplier; it is supposed to adopt the most favourable solutions for the clients. The tax authority is an authority on the one hand, and service supplier on the other hand, but it

---

<sup>29</sup> Hadi (2008.): op. cit. 17. p.

<sup>30</sup> Tao. 6.§

<sup>31</sup> Tao. 4.§ 29.; 6.§

<sup>32</sup> Hadi (2008.): op.cit. 625. p.

cannot become an office of legal consultancy or tax adviser<sup>33</sup>. Providing taxpayers with all of the information has two critical points: the extension and the way of obligation to inform them.

What the main objective is that taxpayers ought to pay the equivalent sum of tax to their income and in terms of the law. Nevertheless, the tax payment can be modified by allowance or exemption but it is in question how much is the liability of the tax authority to give instructions and information. At this point, we need to note that in the Hungarian tax law, the tax allowances and the tax exemptions are not timeless or legal constructions with long lasting periods, but they are continuously changing from year to year which means it is difficult to follow and interpret allowances or exemptions in many cases.<sup>34</sup> The taxpayer can turn to the tax authority in order to be informed about how to interpret the rules but it is not necessary to get official answer. Since the tax authority is not engaged to provide advisory instructions. The obligation of providing information referred above has no definite term of limitation that is within how much time the tax authority is bound to give answer to the submission and there is no sanction if the answer is left out of consideration. Thus giving information and instruction is a kind of engagement which cannot be enforced.

Accordingly it would be important to resolve this duality and define specifically the mode and the method of providing information.<sup>35</sup> It would be essential to lay the information's extent and process down in a comprehensive way and also to apply sanction because of a failure.

The practice shows that the tax authority draw the taxpayers' attention to the formal and technical obligation of providing information and it does not over expand its jurisdiction, because the tax authority's engagement of informing taxpayers can not be interpreted indefinitely since the tax authority cannot play the role of a tax adviser bureau.

The Supreme Court declared in its adjudication (No. LB.Kfv. I. 24. 057/1994.)<sup>36</sup> that the tax authority is not entitled to warn taxpayers to the detrimental conclusion of law based on their written statement. At the same time it is full of contradictions that the annual annex of the tax authority's official journal<sup>37</sup> is called '101 legal tax tricks' published by the tax authority.

The question is still remaining where the taxpayers in Hungary can get information primarily in connection with taxation. According to the reviews on getting information by taxpayers<sup>38</sup>, the respondents principally mentioned the media and the expert family member as the main sources of information related to taxation.

The rate of mentioning official experts, tax advisers was quite low based on the research. On the one hand, the reason for this result is the fact that tax experts give advice for fairly high price (i.e. the high price is one of the reasons) but on the other hand, tax

---

<sup>33</sup> See also more: Szilovics, OTKA (2007), p. 83

<sup>34</sup> Here we can mention the 39 § - 41 § in the Act CXVII of 1995 on Personal Income Tax, which has been modified in 2010. As compared to the previous year's tax allowances such as household allowance and insurance allowance are left off.

<sup>35</sup> Szilovics also jumped to the same conclusion, OTKA (2007) p. 83

<sup>36</sup> See reference Szilovics, OTKA (2007) p. 83

<sup>37</sup> TAX world

<sup>38</sup> See more Szilovics OTKA (2007) pp. 84-86

advisers are willing to take the responsibility of their own and countersigned tax return under certain circumstances. This means that tax experts do accept responsibility for both the quantification of the acquainted data and the professional part of the tax return, however, taxpayers are left responsible for the authenticity of the data.

The tax authority attempts to solve this problem with introduction of a new establishment. This new institution is the tax authority's completion of tax return which can be postulated within the frame of self-taxation.<sup>39</sup> Besides the tax authority tries to call the taxpayers' attention for the most important taxation knowledge with the help of short educational films using media.

### 3. THE SPECIAL RULES OF THE INTERNATIONAL TAX AVOIDANCE

The application of the so-called „tax paradise” (off-shore) rule was a legal device of tax avoidance and tax optimisation until 2004 when Hungary joined the European Union. The Act on Corporation Tax<sup>40</sup> dealt with the preferential taxation of 'taxable person operating abroad' (off-shore firm) – until 1 January 2004. Such a foreign (non-resident) company is incorporated and established in Hungary according to the Hungarian Act on Business Associations, a limited liability company or share company with its headquarters in Hungary, that is owned in 100% by a foreign private person or legal entity<sup>41</sup>, the incomes from sales may originate only from abroad, proceeds commerce abroad, it has a license granting concessions to companies that operate in free zones<sup>42</sup>, it employs Hungarian auditors, head senior executives, members of the board of supervisors, attorneys and employees, and the company and its members (shareholders) have only issued registered shares and do not have any direct or indirect business shares in other domestic business associations. Off-shore companies in Hungary had to pay 3% corporation tax instead of 18%. The elimination and abrogation of this rule, that is the complete eradication of it from the body of law on corporation taxation, can be evaluated as a special provision.<sup>43</sup> Off-shore firms, in case of existence of all the conditions detailed above, could be created in Hungary until 31 December 2002 and could claim for paying 3% corporation tax until 31 December 2005, so the off-shore firms and their tax reliefs were completely gone from the Hungarian legal material after January of 2006, so these firms pay taxes like any other domestic firm does since then.

---

<sup>39</sup> 12 § in Act XCII of 2003 on the Rules of Taxation

<sup>40</sup> Act on Corporation Tax 1996.évi LXXXI. Tv. 4.§ 28.point: 'taxable person operating abroad' ( off-shore). This rule was put into force by the alteration of Act on Corporation Tax in 1998, with the paragraph 1998.évi LXI tv. 1.§(2).

<sup>41</sup>1996: LXXXI. 4.§. 28.f.): „, the company has no members (shareholders) who are domestic persons; nor is there any domestic person among the members of the company's members (shareholders), or if one of the company's members (shareholders) is a public joint-stock company, no more than three per cent of the member's (shareholder's) subscribed capital is held by domestic person(s);”

<sup>42</sup>It has a license issued by the Minister of Finance after 31 December 1992 registered by the Minister of Finance prior to 31 December 1996 and thereafter by the state tax authority.

<sup>43</sup> 2002: XLVII. 303.§.(10) abrogated the favorable corporation tax regulations on „taxable person operating abroad (off -shore firms). Valid establishment until 31 December 2002, taxation validity (3%) until 31 December 2005.

Further international - extending over borders – rules for the prevention of tax avoidance in the Hungarian tax law:<sup>44</sup>

- the taxation of undivided profit (CFC Rules),
- tax emigration rules,
- the survey of transferring incomes between interwoven undertakings (arm's length clause.)
- the acceptance and application of interest- royalty convention (2003/49 EGK governing principle)
- placing of the burden of proof on the taxpayer,
- the exclusion of reductional opportunities according to the convention on withholding taxes imposed on the investments of persons connected with 'tax haven',
- the exclusion of accountability of functional loss and loss of value in capital present in tax haven for capital sender domestic undertakings,
- unlimited taxability in the case of companies paying taxes in Hungary,
- In case of controlled foreign companies using the opportunities of 'tax paradise' in the given year, we have to take the profit, which is in proportion to the property shares of the person who has Hungarian tax relations in the capital sender country, according to the law of the capital sender state as the whole profit would have been divided between themselves, independently from the fact that it was divided or not.
- Who actually benefits: if the beneficiary and the person who enjoys the incomes are not the same persons then Hungary, as a source country, can deny the usage of discounts for foreigners. (This is the limitation of availability of the conventional status that is the prevention of „treaty shopping”.)
- The charge-back of foreign corporation tax: the foreign incomes should be established according to the Hungarian tax rules, those expenditures and expenses which cannot be allocated should be proportioned.
- Domestic and foreign incomes in corporation tax: the definition of domestic incomes is wider in the Hungarian law than in the convention.<sup>45</sup>
- If the taxpayer is a company owning a real estate property the taxpayer is obligated to inform the authorities about the fact or the ceasing of the fact not later than 90 days after the expiration date of the corporation tax return. The announcement should contain data about the alienation of the shares of foreign member(s)' of the company and other data of these transactions as well. The Inland Revenue Office publishes every year on its website the list of those companies which owns a real estate property until 30th of September. No separate tax return is needed from foreign members but the company have to file in a tax return and pay the tax until 20 November following the year of taxation. In this case they establish the foreign person's inland taxability.

In order to suppress tax evasion the rules concerning invoicing and the suspension of a tax number became stricter.<sup>46</sup>

Further provisions concerning the prevention of tax avoidance related to corporation tax:

---

<sup>44</sup> See more: Deák (2000) p. 134-136.

<sup>45</sup> Deák (2000) p. 135.

<sup>46</sup> Braun Gábor- Kovács Zoltán László: A lisszaboni stratégia és az adópolitika kapcsolata a gazdasági válság tükrében Pénzügyi Szemle, 2009/4. sz. LIV. Évf. p. 576.

-Bringing the incomes and properties, rescued into tax heaven, within the tax base: They corrected the concept of controlled foreign companies founded in tax havens. At the time of the existence of a joint relation taxability involves not only the rescued but the produced incomes as well, so the taxability was extended over the produced incomes, ensuring the avoidance of double taxation with this. This rule concerns the produced but not brought home incomes before 2010 also.

- They extended the rules concerning the joint undertakings over transactions between taxpayers and their subsidiaries abroad in order to prevent the withdrawal of allocated devices from the taxation.

- They introduced source taxes on a 30% rate to pay the interest, royalty and service fees in those countries which Hungary does not signed a convention to avoid double taxation. The paying company has to deduct the tax.

The abolishment of the usage of tax amnesty rule on that money which was brought home from tax paradises.

#### 4. SUMMARY

*The adoption of GAAR rules were motivated* by the growing inclination to tax evasion which increased in parallel with the complexity of rules. Tax statutes had to follow the changes of social relations thus the increasingly more complicated contract constructions and business intertwining in economic life. It has also been done to correct the rules and to close all the loopholes providing an opportunity for tax avoidance.

Anyway the application of rules against tax evasion can be considered successful. It has retarding force for the taxpayers on the one hand, and on the other hand it is an important device for the inland revenue office in order to protect the tax revenues in judicial cases.

Since newer and newer tax-avoiding techniques take shape as a result of the economic development, the regulation has to correct and expand its rules with new provisions against tax evasion.

