

Hungary: born to be a tiger?

Reflections on Hungary's possible role in International Financial Services

By Dr Gabor B. Szabo, Budapest, Hungary

Almost a year ago, *Offshore Investment* invited me to introduce Hungary's new and little known offshore legislation (see February 1999 issue). I acknowledge with some satisfaction the welcome and inquiring feedback of readers of the magazine and the fact that more and more foreign investors are discovering the benefits of the Hungarian regime.

The past year has shown signs of the growing interest by international investors and tax planners in the unique opportunities provided by Hungary. It is perhaps unnecessary to say that this lively interest has not effected an immediate and significant boom in the number of non-resident companies (which still do not exceed a couple of hundred), however the amount of high volume offshore investments have multiplied. An investment of up to US\$2 billion is now not unique. It is beyond dispute that the "multies" and also those who prefer refined and discreet tax planning structures have discovered Hungary. Let us examine some of the reasons for this progress.

As I see it, there are several particular professional reasons and also more general grounds as determined by the political-economic development of the country. The professional reasons can be characterised as follows.

An industry under fire

The heat on the offshore industry by both supranational organisations (EU and OECD) and national governments (the Edwards Report, and recent developments in Ireland) continually encourages the international investor to find new low tax jurisdictions. Such jurisdictions should satisfy other vital requirements, including political and financial stability, legal transparency, good infrastructure etc. The list of requirements is too complex to be

met by any one country and only a lucky combination of circumstances may provide the optimum solution.

The "I want to hide" psyche

Sometimes the psyche of the international investor is more crucial than any other aspect. He is ready to sacrifice perfect professionalism on the altar of security and move to a location that is perhaps less sophisticated and traditional, but holds the umbrella of a non-offshore image over the investment. Our investor will remain calm if his classic offshore operation runs without offshore recognition in a country that is above public suspicion of tax avoidance.

Synergy of the offshore and treaty benefits

The trend of the last decade shows that qualified international investors do not like to base their own tax planning systems on traditional "tax haven" legislation, which is sometimes blacklisted by the tax laws or revenue practice of other countries (e.g. Russia, Spain). They prefer those "low tax" regimes that provide,

- A significant network of double tax treaties; and
- Low tax non-resident or quasi investment opportunities being the subject of the treaties.

Hungary is one of the very few countries that can provide the complex benefits of this kind.

All of the above preliminary reasons are favourable to Hungary to obtain new business in the international financial services. Nevertheless, neither the non-resident tax regime nor the treaty network are enough to fulfil the political-economic aspirations to the role of regional financial centre.

Undoubtedly Hungary is destined to become a vital regional centre in Central-Europe.

The favourable geopolitical situation of the country, the relatively fortunate historical development in the last fifty years, the firm political determination of the recent governments, the radical revision of the legal system and last but not least, the almost revolutionary but definitely speedy restructuring of the economy are all promising. On the other hand, being or rather becoming an international financial centre, is not a question of the intention or will of any country. It is much more the outcome of evolution and, more importantly, the need of the outer world and appreciation by the whole region. Moreover, the appreciation will never be voluntary but will be created by the tightening necessities in the "peripherals" of the region. Therefore in the case of balanced regional development (does it exist at all?) the phrase of "regional centre" can not be more than a red rag to the neighbourhood. This is particularly true in the countries of Central-Eastern Europe where mutual distrust and historic jealousy remains an organic part of national development.

Nonetheless, Hungary has a good chance of becoming a regional centre and the signs all indicate that the country is ready to take the opportunity.

In spite of existing and sometimes sharp political debates, governments and oppositions of recent years have agreed that Hungary has a historic chance to seize the leading regional role. The country took the initiative in the regional political co-operation of the Central European countries just as it did in the creation of CEFTA (Central European Free Trade Agreement).

The regulation of the financial sector is also part of this endeavour and due to it most of the major international financial institutes are present in Hungary. Many of them devote a regional headquarter role to their Hungarian foothold.

The system of taxation benefits (the non-resident regime, significant tax allowances for substantial investors in manufacturing or hotel projects) and the continuous extension of the treaty network are also devoted to fulfilling the requirements of a financial centre.

And above all, thanks to the fortuitous timing of its development, Hungary is now reaching the top of the financial ladder.

But perhaps saying so remains the sole prerogative of the silver-tongued politicians who frequently mention the “Hungarian miracle” and talk of the “Hungarian tiger”.

This author, for one, admires the tiger and hopes to see him go from strength to strength!

HUNGARY IN A NUTSHELL

TERRITORY: 93.000 KM2

NEIGHBOURHOOD:

Slovakia (N),
Ukraine and Romania (E),
Serbia, Croatia and Slovenia (S)
Austria (W)

POPULATION: 10.1 MILLION

POLITICS

- Stable and almost risk-free political environment
- Parliamentary democracy
- Multiparty system, political rotation of parties
- Central-right coalition government since mid 1998
- Firm determination to obtain EU membership (expected deadline: 2003)
- Membership of UNO, OECD and NATO (since March 1999)
- Appreciated initiations in the Central European regional co-operation

LEGAL SYSTEM

- “German type” continental law
- Radical revision in the last 10-12 years
- Increase in transparency and predictability
- Continuous harmonisation with the EU legal system
- Non-discriminative state administration

ECONOMY

- Free enterprise, market economy
- Ongoing privatisation
- National and international legal guarantees for foreign investors
- Continuously decreasing rate of inflation and unemployment
- Rapidly emerging public infrastructure
- Stable and multilaterally controlled financial sector

TAX REGIME

- Continuous stabilisation of the inland taxation
- Extensive treaty network (more than fifty treaties) with unique characteristics
- Non-resident tax benefits without offshore recognition
- Synergy of the treaty and non-resident benefits