

TAX OPTIMIZATION, TAX AVOIDANCE OR TAX EVASION? CONTRIBUTIONS TO THE OFFSHORE COMPANIES' LEGAL BACKGROUND

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ABSTRACT: *Is it a legal or illegal activity to give money to establish offshore firms? What is the offshore practice is it a method of tax optimization, tax minimization or is it a harmful activity, which means tax avoidance or tax evasion. This question is very important in the European Union's tax law system, because the EU tax law is against the harmful tax competition. Some member states' legal system is permitted to use offshore companies' rules, but in the European Union it is prohibited to establish offshore firms in a member state. In the EU the offshore companies and tax paradise is a prohibited part of the battle against the harmful tax competition. In this paper the offshore companies' legislation and solves of Hungarian tax law will be examined. The focus also will be put on the following question: which were the rules of offshore companies in Hungarian law – 'taxable person operating abroad'. The problems of tax avoidance or tax evasion are always the most important question in the tax legislation and in theoretical background.*

KEYWORDS: *tax optimization, tax avoidance, tax planning, tax evasion, offshore, EU tax law*

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The ambition to do the economic action in the most optimal environment, with the lowest inputs has practically the age of the evolution and permeation of the enterprises. Investors has always tried to settle down in a country providing the best combination of economic and legal regulation, and they soon realized with the fortunate seat-choosing of the firm-establishment a lot of tax can be saved.

Thanks to that the role of offshore-centres valorised and in the past years, tax-saving strategies connected with this sort of firms became so popular, that these countries are in sore need of strong appearance.

Thanks to the countless profit not just the biggest corporations like Microsoft, Google, or IBM take advantage of offshore. It's a growing phenomenon that European concerns organize themselves in countries count as tax paradise, and it is more and more common that these firms organize – in different consideration - across frontier so, that tax optimization is their primal functional principle. This phenomenon did not avoided our mother country and

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what is more it became more and more popular sport not only in the elite of business and politics. It proves that in Delaware 2440 and in Cyprus 1400 companies are registered with Hungarian ownership. There is a Cyprus address where 293 Hungarian companies have its seat.¹

But how does our continent reflect to offshore, as a phenomenon? What kind of paradox and problems arise from the actions of this sort of foreign companies? Could we consider it as the tool of tax-optimization or conscious tax-planning, or does it realize tax avoidance or *maybe tax evasion*? To answer these questions henceforth the negative aspects of the establishing of company will be displayed after a previous summary, then the primal anomalies and shortcomings in the regulation.

1. DEFINITION, CONCEPTUAL ELEMENTS OF OFFSHORE FIRMS AND GENERAL APPROXIMATION

One of the most important questions has to be clarified what is called offshore at all. If we turn the page of English-Hungarian dictionary we find the meaning „close to shore, off shore”. The definition alludes to the border of land and sea, which means the shore and any activity and event across it. The definition is relevant its meaning can be demonstrated with the help of the Anglo-Saxon law system, since the British people called the foreign countries considered as tax paradise offshore. In American English offshore means „foreign” and concern countries practising low tax on profit.² In casual expression offshore is used as the synonym of „not British” and „not American” without the meaning of tax paradise. In one part of the international law, in the sea law offshore meant fishing near by the shores.³

We can see that the concept is mostly attached to activities across border and it gives the substantive elements of the offshore phenomenon. So it is concerned with a **company or enterprise founded in another country**. Which country may that be depends on certain states' tax rates, charges of registration and the infrastructure affects it as well near to a lot of other factors. Stockholders namely try to find financial stable and investor friendly foreign location, where they can realize the biggest profit with the lowest charges, money and time input.

These according to the business aspect foreign companies can establish parks interior, but with this action they don't become inland corporation according to public accountancy and taxpaying aspects. The investments of these companies, the maintaining of bank accounts and the manager activities are not qualified as offshore.

The other important conceptual element is that the companies **don't do any business activities** in the country where they were established, only beyond. Mostly the offshore enterprises do not come into existence in another country to do their activities there. Investors are motivated by the fact that a company cheap established overseas with friendly taxing and reliable business environment are hit by lower tax and affixes than in the root country. The costs of establishing and maintenance of new company's are minimal in the most beloved offshore centres. The countries can make conditions in certain cases, for example majority from the citizen of the host country has to be in the leadership of the established company,

¹ http://www.fn.hu/cegek/20090519/megfoghato_off_shore_vagyon/

² http://www.fn.hu/cegek/20090519/megfoghato_off_shore_vagyon/

³ <http://www.offshore.com/docs/A%20MAGYAR%20OFFSHORE.doc>

or citizens of the host country have to be the counsel of the company. It is common the taxpayer buys ready made companies. These companies have typical attributes: until marketing they can't do any business activities, they won't have tax number, taxpaying and booking obligation. The client chooses from the registration of the companies dealing with these, and the consulting offices do the establishing and registration of the companies.⁴

From the nature of the activity comes the third conceptual element: **the income that makes the rateable value of the offshore company cannot come from the country of the registration**, only offshore. Company with a status like this purchase only inland the implements needed to work, it doesn't provide any services, doesn't sell any merchandise, doesn't get any income from the country of the registration.

It's not the part of the element of the definition, but it's worth to notice that the offshore companies enjoy simultaneously the benefits of the agreement about avoiding double taxpaying and the preferences of being offshore. It is a misbelieve that these companies do not pay tax. Taxes determined in the country of the registration pertain to these companies but not in that rate like to a domestic company and they have to pay registration costs too. Moreover the registration costs are more than 2500-3000 Euro in the most popular regions, so it is rewarding to invest in an offshore company if the price of the company and the maintaining are fewer than the tax that can be saved. There is no doubt there are countries where the registration and other costs are vanishing, but the EU and the OECD try to step up against offshore.

The offshore companies can do nearly all kind of activities and they are present everywhere, but they are typically in the international trade: they appear mostly as the mediator of export-import activities since there can be saved a lot of tax with an offshore company.

On the whole it can be determined that the offshore companies mean: companies, which do not do any economical activities in the state of the foundation, in the economical and legal sphere, meant to be foreigner in the point of business view, which were founded in such areas, where the tax and allowance measures are low, and maybe just the costs of registration must be paid by them. It is significant that a company is not offshore because it's established overseas; it is offshore because it's established in a tax heaven expressly as an offshore company.

These companies enjoy simultaneously the benefits of the agreement about avoiding double taxpaying and the preferences –given by the tax heaven - of being offshore, so practically they have to pay a vanishing amount of common charge in the state of the registration, which is in the country of the tax heaven, hereby they make a lot of profits through their economic activities.

This kind of activity is characteristic for the international trade, namely a significant amount of tax can be saved inserting offshore companies. The most current way of it is when an offshore company buys the product from the seller and passes on to the purchaser firm with a raised price. The difference between the two prices will be the profit of the offshore company, after which it has to pay no or very low tax. The profit from the selling flows back to the owner of the enterprises. The rateable value generated by the unreal margin will be

⁴ Seres Attila –Bohner Tamás: Adóparadicsom II. Contractor Kft Kiadó 1994,p.20.

streamed with a billing within the companies to another offshore companies, where because of the low tax key only the fragment of tax will be pay that had to be pay by the company.⁵

Offshore companies with an asset protection purpose bring on the most moral and legal anxieties. These are those enterprises which anonymous leaders and owners try to make their fortune invisible using foundations, trusts and holdings. They form the organization so that the personality of the real owner stays hidden during an execution or an incidental confiscation.⁶

The most beloved off-shore centers in Europe are in Cyprus, Lichtenstein and Luxembourg. Real tax heavens are the Cayman-Islands, the Bahamas, Delaware, British Virgin-Island and the Seychelles Island, where a lot of allowance are provided to the established companies and individuals. Allowances: simply and more liberal registration, exemption from the paying of the capital return tax, property tax and income-tax, moreover the companies established here don't have make declaration of income-tax. Nevertheless they hold free from every accountancy and auditorial obligations.⁷

The head of offshore on our continent created a specific situation in the growing European Union: using out the different tax measures of the countries having 27 different tax systems, customs for taxation and different structures, a significant amount of money disappear from the budgets of the state of the foundation.

Fortunes rescued into tax heavens abridged the budget of EU member states with 7000 billion euro according to certain estimations. That's why is necessary the instant action.

2. THE DANGERS OF OFF-SHORE'S LEGAL REGULATION

Everybody knows the advances of investing in an offshore company. It is doubtless that it has many advantages, but it hides many dangers, which can effect the whole economy. An offshore company is often the tool of money laundry and tax evasion, because the wrongly acquired incomes are preferred to rescue in companies like this, and it's also a fact that individuals interested in speculation have been searching for forms similar to offshore.

Besides the lack of transparency and actual business activity cause the biggest problem to the investigator authorities. Establishing company like this is not against the law in itself, the company itself does not achieve crime, but then the tax can ensure efficient income to individuals behind the company, whose goal is to wash their money that comes from committing crime without any actual activity.

Beside this the offshore companies undo the requirement of neutrality in the field of competition and they distract a huge amount from the budget, because they reduce the tax income of the source country. It is an basic problem that the requirement of neutrality in the field of competition is especially damaged, because the being of offshore heavens distract the tax competition making this way a harmful tax competition. The harmful tax competition manifests itself, that the taxpayer registers himself in a country, where he does not do actual activities, does not act and he conduces to the public services – even if with a small amount - in this country, but in the country where he actual acts and where he actual uses the public

⁵ Donato Masciandaro: Global Financial Crime Terrorism, Money Laundering and Offshore Centres Ashgate Publishing Company, USA, 2004. p. 62.

⁶ Kiss László: Tipikus offshore helyszínek: kivezető utak Hvg Nr. 2004/10. , pp. 57-59.

⁷ www.tropicalsolutions.eu, www.taxsolution.hu

services he does not conduce to the public services with taxpaying. So he is not in accordance with the principle of neutrality in the field of competition known by the international tax law and with the principle of taking common charge, because he does not conduce to the public services with tax, where he actual uses them. That's why the jurisdiction of European Union prohibits the offshore activity.⁸

2. THE LACK OF LEGAL NORMS WITH BINDING POWER

Almost every country try to prohibit in some way or try to slow this procedure at any rate, which means the escape to an offshore company. Besides the European Union and the OECD the states try to step up against investing fortunes into offshore companies with creating strict regulations.

The legal regulations of certain countries try to bind the hands of the investors with the tool of withholding tax and tax amnesty. The states are trying to escalate their tax collecting authority to those type of incomes, that up to now they could not charge or just in limited degree. For example in Austria the income resultant from abroad can not be deducted from the rateable value, if the will of tax avoiding can be assumed.

For the sake of transparency the company law of Cyprus prescribes for all companies to run financial registration and publish acceptable exact information's about its financial situation, on the basis of which the economical relations of the company can be represented and interpreted.⁹

On of the hurdles of the effective appearance is, that most of the countries meaning tax paradise are not members of the European Union. The information- sharing questions are defined in bilateral agreements with one part of them, but at the same time an agreement with several Asian bank centres (Singapour, Hong-Kong) in order to avoid double taxation or to cooperate has not been succeeded in making yet.

The other hurdle is that nor the OECD neither the Union has got any compulsory measures, so they are on to orient each member states with commendations. Directives appeared on the field of taxation of parent- and subsidiaries and on the field of the common tax system of interest and royalty between cooperating companies founded in different countries. In 1997 the ECOFIN accepted the Code of Conduct for the Business Taxation, in which the Members took the obligation to inform each other about introduction of new tax laws, and not to take measures which do not harmonize with common law. The regulation mentioned – Code of Conduct – is a prescription not meaning source of law, acts through voluntary law pursuing, consists of no sanctions.

The common peculiarity of these documents is that they don't give a comprehensive regulation, only parts have been harmonized through commendations, opinions, reports, which are not obligatory, so which can not be enforced. However, the strength of a decision is defined by that fact how it can be executed.

The source of the anomaly in regulation is the tax sovereignty of the states. In the European Union taxation doesn't belong to the common policies, it is under the authority of the member state. On the one hand it means that the states has got the right to decide freely

⁸ see the Code of Conduct for Business Taxation accepted by the European Union's ECOFIN Council in 1997. and the OECD Report about the Harmful taxation

⁹ Cyprus- End of a tax paradise? Accountancy, tax, auditory, Nr. 2002/10.szám, pp. 458.

– with the exception of international agreements and agreements about avoiding double taxation- about the type and measure of the common charges, the tax cases aren't under the effect of the regulations of the base contracts of Union concerning to the internal market law making.¹⁰

But in an other point of view, tax sovereignty means the decisions which need unanimity, majority cramping can't be born until each countries will agree in financial questions and sacrifice a part from their sovereignty. A special European paradox has appeared: the national sovereignty is harmed by the created tax competition, but the only way to control this harmful competition (and at the same time offshore expansion) is giving up the sovereignty.

The tax harmonization could be a possible solution for the international tension and for the under taxation induced by the offshore incident, has been stagnating, because the states are not able to get to an agreement in such an important question, saying: the obligation for harmonization can't be derived from any community laws, it appears only through recommendations, but a legal obligation is not created by it.

3. USING THE OFFSHORE TERM WRONG

The unified aplomb is strengthened by the fact that - however the legal experts use this term - the laws of the states don't know, and don't regulate the offshore term as a legal category either. Instead of this the law makers circumscribe it in the text of the norm, and use such general definitions like 'business company', company which works abroad or controlled foreigner company, or foreigner entrepreneur.

It derives from that wrong practice, that the offshore term appears in a pejorative sense in several countries. The phenomenon is held the same as the behaviour of those investors who use out the possible advantages of doing business outside the borders in a corrupt, crime committing way.¹¹

So most of the law makers are averse from using such a misty definition which is not free from prejudices either. But the exact consequence of this is that only general terms can be used those taxpayers who potentially can not be convicted for avoiding tax can only be defined by.

It would be worth clarifying: offshore means those companies, which work in offshore areas in a way detailed above, maybe creating a uniform definition, regarding the two large organizations, the OECD and the European Union defines the offshore situation different either, which takes more difficult to create uniform regulations.

4. THE RIGHT TO ENTERPRISE AND THE OFFSHORE

The offshore phenomenon is often connected to the right to enterprise. The Hungarian constitution also makes fast the freedom to enterprise, and besides being the member state of the Union even more opportunities open up for the foreign investment because of the free flow of the four basis freedom. The right to enterprise of an individual is to establish or buy

¹⁰Hajnalka Vágvölgyi: The tax policy strategy of the European Union (Az Európai Unió adópolitikai stratégiája) , Adóvilág Nr. 2009/6. pp. 21-26.

¹¹ Offshore cégek, adóparadicsomok Mozgástér 2005/8 - <http://cegvezetes.cegnet.hu/2005/8/offshore-cegek-adoparadicsomok>

a company where he wants, and he can plan legal in which region can he does his activities the most optimal taken all around.

The determination of the enterprise's place is a deliberate and well planned strategic movement, in the course of it the tax on profit, the income tax and the property tax become primary.

Establishing an offshore company or investing in foreign firms like it come true with conscious tax planning. Its goal is the systematic assessment of the financial and legal environment of an enterprise and aims to understand the legal concepts, to the reveal able advantages, and to the law restriction.¹²

The citizen with his attitude (establishing an offshore firm, or invest in an offshore firm) does not offend any legal regulations, however he makes a tax profit in such a way that he „utilizes” the leaks and paradoxes in certain law systems. In case it is his certain aim to earn gains from the chaos of the regulation of common financial affairs, from the consistence disorders by avoiding taxes, the unlawful activity hardly could be evidenced.

Nevertheless the Hungarian law makes fast that the rights should be used according to the rules in tax relationship. Contracts and legal transactions which aim to pass round the Act on the Rules of Taxation are not qualified according to the rules. (Art. 2.)¹³

It is problematic by the previously written, that does anybody have the right to query the legitimacy of incomes resultant from offshore companies and of legal transactions connected to it. That's way it is so hard to step up against offshore on the one part.

The Commission of the European Community formulated in an announcement why do we have to call a halt for the mass-establishing of offshore. In a world where the money moves freely tax heavens and the not adequately regulated international financial centres, which are not willing to accept the principle of transparency and information-switching facilitate, moreover encourage the tax evasion and avoiding taxes.¹⁴

The freedom for undertaking and the step up against offshore raise a more important problem: the collision between the strict public law and the civil law principles, and between the state claim and free market behaviour. On the one hand it is a legal claim from the state to see through the order of economy and to hamper the erosion of the budgetary incomes, but on the other hand, the taxpayers have the right to look for and use out the chances which make it possible to pay lower taxes.

In the offshore question, like in most tax avoidance cases, it is about exercising the claim of the thesauri, so it is about using strict law norms, but it must be taken sides in such cases, which are typical of business life, so where the state claim and the free market behaviours meet. But on the other hand, the content of such transactions and the economical effect must be examined, which needs public law interventions.

¹² Deák Dániel: Adótervezés a nemzetközi gyakorlatban (példák, esetek, kommentárok) 13.old. Adventura 2000 Kiadó

¹³ 2003.évi XCII. tv az adózás rendjéről (Art.) ,Act about the Hungarian Tax Procedure , shortened as (Art)

¹⁴Contribution of the Committee for the Council, European Parliament and the Social Committee. Promoting good government on the field of tax cases. Bruxelles, 28.4.2009COM

5. LACK OF INFORMATION AND INSTITUTIONAL PRESENCE

The national tax authorities do not have enough experience nor capacity to deal with assets saved into offshore companies, and now there isn't any international organizations or institutions, which would directly examine the strategies for cross border transactions for saving or sparing taxes. The fact that the authority does not have any registrations concerning to the offshore companies does not help its work, so the basis could be the dates of the registry court, but this does not consist of the data of the owners. Most of these registrations show only the parent- subsidiary relationships, on the basis of which the number of the offshore states with Hungarian roots is about 1700. But there are much more offshore companies, according to the estimates 700-800 offshore companies are founded per year by Hungarian taxpayers.¹⁵

The other main problem is that sharing information between the countries is not solved neither concerning to its organization, nor to its conception. Namely it is a presentment that the OECD standards for sharing information. The problem derives from that the countries which mean tax paradise – in the lack of an agreement for avoiding double taxation, or bilateral agreement- don't give any information about the financial situation of their clients, or on the request of the tax authority, moreover- on the basis of bank secret- they don't help the enquiry on suspicion of tax evasion either.

On the other hand, giving information is not self-service, it is given only in special cases. For example in Austria is the strictest in giving out bank secret, dates can only be given out on the basis of legally binding warrant. The most special cases are in Switzerland, where owners of the safes full of million dollars were given out for the enquiry authorities through promising serious consequences.

It is not allowed to forget that it is not the interest of the states either to lose investors, so they are on to save as much bank secret as it is possible, but on the one hand it is true that the pressure on the states is very high in this area.

6. THE HUNGARIAN REGULATION OF THE OFFSHORE, PAST AND PRESENT

Hungarian law defines tax avoidance in the form of general clauses and with special rules on the other hand.¹⁶

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.¹⁷

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

- incomes – (profit-) minimum rule¹⁸ (the establishment of taxes on the bases of 2 percentage of the corrected amount of revenues even if the company is loss-yielding);
- related undertakings' rule;

¹⁵ Tax authority is incapable against offshore companies. http://www.penzcentrum.hu/cikk/1017451/1/az_adohatosag_tehetetlen_az_offshore_cegekkel_szemben

¹⁶ Simon István (szerk.): Pénzügyi Jog I. (Financial Law) Osiris Kiadó, Budapest, 2007. 405-411. p.

¹⁷ Art. 1-2.§

¹⁸ 1996. évi LXXXI. törvény a társasági adóról és az osztalékadóról (in abbreviation: Tao. tv.) 6.§ (Act about the corporate tax) A törvény enged kivételeket a szabály alkalmazása alól! (Law gives space for exceptions!)

- 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.¹⁹

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.²⁰

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 what have to be prosecuted by criminal law.²¹ (Typical, but not prosecuted by criminal law, type of tax evasion according to the literature, when the entrepreneur employs somebody who also 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.²²

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 applicated 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.²³

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.²⁴

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

¹⁹ Tao. tv. 1.§ (2)

²⁰ Tao. tv. 11.§ (3)

²¹ Simon (2007.): op.cit. 409-411. p.

²² Art. Adójogi jogkövetkezmények (Tax law consequences): 165.§-174/A.§

²³ 1978. évi IV. törvény a Büntető Törvényről (Btk.) 310.§ (Act about the Hungarian Criminal Law: 310.§)

²⁴ 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

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.²⁵

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.²⁶

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:

Tax reduction or tax optimization

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, what is a combination of the different taxpaying obligations and the profitability that gives the enterprise the most favourable result according to the given conditions.”²⁷

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

Tax avoidance

According to the Hungarian tax law literature²⁸ 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.²⁹

²⁵ 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.

²⁶ More about: Dr. Szilovics Csaba: Adózási ismeretek és adózási vélemények Magyarországon (2002-2007) OTKA kutatás. p.76 – p.84

²⁷ 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

²⁸ Deák Dániel: Adókiátszás és adókikerülés jogi megközelítésben, Jogtudományi Közlöny LX évfolyam 2005. May p. 191-201

²⁹ Deák, (2005) p.192

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 abusement - happens when they evade the law but does not get to an open infringement with law.”³⁰

No abusement 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.³¹

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.³²

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.

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.)³³:

- 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.

³⁰ Deák (2005) p.197

³¹ Deák (2005) p.198

³² Földes Gábor: Az adópolitikai döntések beszámítása az adózói magatartás alakításába In: Pénzügyi Jog I. (szerk.: Simon István) Osiris Kiadó, Budapest, 2007. p. 40-405

³³ Gula József In: Magyar büntetőjog – Különös részi ismeretek (szerk. Görgényi Ilona) Bíbor Kiadó 2009. p. 225

The first manner of committing the crime

- to make untrue statements concerning a considerable fact or data;
- hiding of such facts or dates 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.

In the first case the result will be the decrease in tax revenues. This is an essential viewpoint in the differentiation between the offence 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 offence 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.³⁴

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.

Offshore rules in Hungary

The application of the so-called „tax paradise” (off-shore) rules had been a legal way for tax evasion and tax optimisation until Hungary joined the European Union in 2004.

³⁴ Gula József in Magyar Büntetőjog (Hungarian Criminal law) (szerk.: Görgényi Iлона) (2009.) p. 227

The Act on Corporation Tax³⁵ regulated the preferential taxation of 'taxable persons 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 entity³⁶, the incomes from sales may originate only from abroad, proceeds commerce abroad, it has a license granting concessions to companies that operate in free zones³⁷, it employs only 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 only 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.³⁸ 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, since then these firms pay taxes like any other domestic firm does and no special provisions or denominations or other related preferences can be used by them. So the rule of tax haven ceased to exist in Hungary from 2006.

Legislators have brought tax haven regulation to an end and according to this there is no regulation like this.

Legislators gave tax amnesty³⁹ to the owners of money invested into foreign off-shore firms last year which regulation may be considered as a tax refuge. The point was in tax amnesty that if one part of the income brought home from the off-shore firms (approximately the half of it) was invested in Hungarian State Papers until - at least - two years the incomes of off-shore firms - rescued into abroad - could be brought to home with a preferential taxation (10%) in 2009. This condition does not fit to the European Union regulation of the free movement of capital since the purchase of state papers are not motivated by market devices. According to this the parliament altered the amnesty provision on the government's proposal so that now on it will not clash into the norms of the European Union any more. However, tax amnesty was not applicable if it may have derived from crime only if the source of the incomes had a fully legal source.

³⁵ Act on Corporation Tax :1996.évi LXXXI. Tv. 4.§ 28.: 'taxable person operating abroad' (off-shore). This rule was introduced by the Alteration of Act on Corporation Tax in 1998 (1998.évi LXI tv. 1.§(2)).

³⁶ 1996. évi LXXXI. Tv. 4.§. 28.f.) says: „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);” „

³⁷ 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.

³⁸ The 2002 évi XLVII. tv. 303.§.(10) abrogated the favourable corporation tax regulations on „taxable person operating abroad (off -shore firms). Valid establishment until 31 December 2002, taxation validity (3%) until 31 December 2005.

³⁹ see: 2008.évi LXXXI. tv. 276.§ and 277.§ modifications of tax laws about tax amnesty provisions (implicated until 30 June 2009) ; and 2009.évi LXXXVII. tv. 175.§ ,231.§. and 233.§ about the extension of the deadline and the alteration of the public burdens policy. According to them the tax amnesty provisions could be used until the end of 2009 (31 December).

Still problem that the fact that incomes originating from a potentially legal source could have originated from tax avoidance since we are speaking about untaxed incomes which the taxpayers rescued legally into off-shore firms residing abroad – even outside Europe. But this regulation ceased to exist by 31 December 2009.

In order to suppress tax avoidance they introduced the extension of taxable value over the incomes and properties rescued into tax paradise by 1 January 2010.

The legal correction⁴⁰ of the concept of controlled foreign companies founded in tax paradise and the extension of tax obligation over rescued and even produced incomes in the context of joint relationship ensured the avoidance of double taxation. This rule is authoritative even in cases where the incomes were produced, but not brought home before 2010.

In order to suppress tax haven and tax evasion they extended the rules concerning joint undertakings over transactions between taxpayers and their subsidiaries abroad in order to prevent the withdrawal of allocated devices from taxation.

The introduction of source taxes on a 30% rate to pay the interests, with those countries which Hungary does not signed a convention to avoid double taxation, to pay the interest, royalty and service fees. 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, off-shores.

CONCLUSION

We may conclude that founding offshore companies is very popular nowadays, despite that the EU does prohibit the application of offshore rules and giving them permission for settlement. The appear and spread of offshore is problem for the countries, because they have to solve double claims: on the one hand, they – at least EU member states- have to act actively in the battle against off-shores on the basis of their international obligation, but on the other hand in order to raise their tax income, in the big competition they have to create such a legal and financial background, which can attract and hold the foreign capital at the same time.

Modifying the tax laws often, the aggravations which often looks pointless, the high taxes force the entrepreneur to settle down in a place which is more attractive concerning to investment, even at the expenses of saving their income gathered at home into offshore companies. Spreading the offshore has been getting such a level, where owning a company like this will have a prestige value.

It can be concluded as well that it cannot be spoken about the holistic and world-wide prohibition of the establishing off offshore firms. These firms can be qualified wrong and unethical, but they are legal establishments to this day – namely they are not against the law – in the sates outside the EU, where the establishing firms like these is authorized.

Adventurous investors often forget that companies like this do not have only advantages, they have pitfalls, what the transmitter firms and consultant offices acting like professionals do not mention of course. Hopefully the legal regulation will be able to fight effectively against those saving their assets as soon as it is possible.

⁴⁰ see the Act on Corporation Tax