Special anti-abuse rules in a post-BEPS world

Analysis of the Hungarian specific anti-abuse rules

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ABOUT THE STUDY

The recent changes in the international tax law and its interpretation inflicted by the BEPS project of the OECD has made a huge impact on most countries, developed or developing. Tax avoidance, aggressive tax planning and their regulation turned out to be matters of great scope, which needed to be managed by countries all around the world, especially by the members of OECD.

The aim of this study is to assess the influence of BEPS and especially the special anti-avoidance rules on the current Hungarian tax system (domestic tax law and double tax conventions) and to make speculations on how the BEPS discussion will influence the Hungarian tax system.

The analysis of this study is based on the relevant articles of the OECD Model Tax Convention and its Commentary, as well as on the Hungarian tax laws, case law, double tax conventions and relevant literature in the field of tax law.

The study is split in six parts, moving from general questions to the national and treaty law, and terminating in the impact made on these by BEPS.

In the introductory part, the topic will be Hungary as a member of OECD and the Hungarian national tax law, since it is the basis, which is necessary for further examinations. In the second part (domestic law), the main tax laws will be analysed for the present specific anti-avoidance rules and their application.

In the third part (Treaty law) the analysis of the Hungarian tax treaties and the applied specific anti-avoidance rules will be made through looking at each of the rules proposed by the OECD.

In the fourth and fifth parts the potential impact of BEPS and of EU Law on the Hungarian tax law system will be reviewed.

To summarise the study, a short overview of the topic will be found in the Summary.
1.  INTRODUCTION

1.1  Hungary in the OECD

Hungary has become a member of Organisation for Economic Co-operation and Development (OECD) in April of 1996, first as an observant, then as a general member. As it is stated on the governmental site, "the membership has provided the Hungarian government an opportunity to participate in the elaboration of the international standards, to present its interests in an international environment, as well as to introduce reasonable explanations for those structural reforms which are important, but difficult to implement because of the political views." The OECD provides a platform for its members to cooperate and discuss such international topics as the international taxation and the elimination of the double-(non)taxation by giving recommendations on the foreign policy strategy and tax policy.

Hungary has established a permanent representative unit, which is conducted by the minister of national economy and the ministers required by the daily topics (finance, foreign policy, etc.) and its task is to provide professional help and advice to local experts and decision-makers.

Currently Hungary is taking part and responsibility in more than 200 commissions and working groups.\(^1\)

1.2  Current Hungarian tax law

Due to the membership in the European Union, Hungary shall implement every regulation, directive and decision and consider the (partial) implementation of the recommendations and opinions made by the European Commission on the national and/or international policy, some of which are dedicated to the anti-abuse provisions and their proper use. Naturally, the member states are free to decide on the arrangement of their national economy and economic affairs, however, there are some cases (e.g.: aggressive tax plan-

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\(^1\) Kormányportál (n.d.): Gazdasági Együttműködési és Fejlesztési Szervezet. Date of access: 2016.03.05, place of access: http://2010-2014.kormany.hu/hu/nemzetgazdasagi-minisztierum/parlamenti-es-gazdasagstrategiaert-felelos-allamtitkarsag/felelelossegi-teruletek/gazdasagi-egyuttmukodesi-es-fejlesztesi-szervezet-oecd
ning) when the national and the European tax authorities shall intervene or make recommendations regarding the taxation system. The applied regulations on the Common Consolidated Corporate Tax Base (CCCTB) shall also be compatible with the treaty requirements determined by the European Commission, even if the necessary changes are not in favour of one of the member states.

The Hungarian procedural tax law is regulated through the Act XCII of 2003 on Tax order (hereinafter referred to as ‘Tax Order Act’), where paragraph 1. states, that „the aim of this Act is the uniform regulation of the rights and obligations of the taxpayers and tax authority in order to reach the tax order, the legitimacy and the efficiency of the procedure.”

Hungary has a broad tax treaty network that generally follows the wording of the OECD Model Convention (hereinafter referred to as ‘OECD MC’). Treaties generally provide for relief from double taxation on all types of income; limit the taxation by one country of companies resident in the other; and protect companies resident in one country from discriminatory taxation in the other. The Double Tax Conventions or tax treaties (hereinafter referred to as ‘DTCs’) negotiated by Hungary are based on the OECD MC and contain OECD-compliant exchange of information provisions from 2015. Although Hungary does not apply any of the alternative wordings for anti-abuse clauses, it accepts them if requested by the contracting party (e.g.: the LOB provision in Hungary – United States DTC, covered by the part 3.2). No special procedural requirements apply to obtain benefits under Hungary’s tax treaties and Hungary does not levy withholding tax on dividends, interest or royalties paid to legal persons under its domestic law.²

1.2.1 General avoidance of double-non-taxation

As Weber (2009) writes, member states generally use a combination of General Anti-Abuse Rules (GAARs) and Specific Anti-Abuse Rules (SAARs), because they can cover a greater scope of treaty and tax abuse. GAARs are applied in a broad range, that is, they are used and referred to in any case of tax abuse and allow the tax authorities to assess

tax arrangements according to their economic reality\(^3\), where SAARs target specific practices, as thin capitalization, Controlled Foreign Companies (CFC) rules or switch over clauses (mostly used in German legislation). GAARs can be applied even in those cases, when a given transaction complies with the law, therefore they are considered as a flexible tool to combat the abusive practices.\(^4\)

Hungary was one of the first Central-Eastern European countries to introduce the general anti-abuse rule in 1999 in order to limit treaty shopping. It was based on the German legislation and contained the *substance over form* clause, which is included in the paragraph 1 (7) of Taxation Order Act, which states that every contract and transaction has to be qualified according to its real purpose, not only its form. In the paragraph 2 (1) of the same act is a statement on the proper exercise of one’s rights, which says that any transaction or contract which has as its main purpose the abuse of the law and obtaining tax benefits. Besides this clause, there was included a SAAR that could attack those tax-avoidance schemes left out by the general one.\(^5\)

In December 2014 there was a discussion started by the European Commission (EC) on GAARs, which examined the attitude of every member state to change their current GAARs according to the recommended one by the EC. Hungary was one of 18 member states, which “did not see the added value of introducing or revising their current GAAR on the basis of the 2012 Commission Recommendation …[and] consider that the GAAR or GAAR-equivalent they currently have works well and/or is very similar in effect to the GAAR proposed in the Commission Recommendation”.\(^6\)

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\(^5\) Supra 3

1.2.2 Specific anti-abuse rules

As it was already mentioned in 1.2.1., SAARs are implemented in national tax law in order to combat any specific and known case of abuse. The most common SAARs are thin capitalisation rules, CFC rules, switch over clauses and rules to re-characterise the sale of shares as sale of assets to avoid the abuse of the consolidation rules in connection with the participation exemption.\(^7\) The newest provisions are provided by the working groups of the OECD BEPS project, that is, the Limitation-on-benefits (LOB) rule; the principal purpose test (PPT); LOB – derivative benefits clause; determining treaty residence; minimum shareholding period re dividends and lastly and withholding taxes on payments to permanent establishments. Some countries (e.g.: Germany) apply the subject-to-tax clause as in their national tax legislation, so in the DTCs, in order to avoid the double non-taxation.

Hungary provides for several SAARs, because of the compliance with the OECD MC for its tax treaties. The Act LXXXI of 1996 on Corporate Tax and Dividend Tax (hereinafter referred to as the ‘Corporate Tax Act’) contains the most SAARs, such as the CFC rules\(^8\) (which are also included in the Personal Income Tax Act\(^9\)), the thin capitalisation rule\(^10\), the transfer pricing and obligation of their documentation\(^11\). Besides these rules, the Hungarian Corporate Tax Act also contains a type of exit tax rule and a ruling directed at the deduction of expenses incurred not in relation with the company’s activity, according to which:

“\(d\) amounts claimed as costs or expenditures, and deducted from the pre-tax profit, including the depreciation allowances of tangible assets and intangible assets, which are not related to the business operations or the gainful activity, with particular regard to what is contained in Schedule No. 3”\(^12\)

The European Commission would also like to introduce the project on Common Corporate Consolidated Tax Base in every Member State of the European Union from the end

\(^7\) Supra 4, p.1206  
\(^8\) Act LXXXI of 1996, 8.§ (1) f)  
\(^9\) Act CXVII. of 1995, 7.§ (2)  
\(^10\) Act LXXXI of 1996, 8.§ (1) j)  
\(^11\) Act LXXXI of 1996, 18. § (1)  
\(^12\) Act LXXXI of 1996, 8.§ (1) d)
of 2016, which would contain, among the other rulings, a limitation on the interest deductions based on the EBITDA of the companies in order to discourage companies from creating artificial debt arrangements designed to minimise taxes.\(^\text{13}\) This however is still under revision and is planned to be published in the end of 2016.

The domestic GAARs, according to Deák (2014), can be considered only as a tool to interpreter tax law, but they cannot serve as a substitution for substantive law provisions. They should serve as subordinated extension on the definition of taxable income. The Hungarian domestic SAARs, in his opinion, do not support the GAARs sufficiently, however even if the Authorities cannot prove the abuse of a treaty by SAARs, GAARs should be enough, because they may prove the intent of the taxpayer to avoid taxes. Therefore, if this intent can be proved, the payable fine will be much higher.

Naturally, apart from the existing rules, the government and the tax authorities have taken the possible amendments to domestic and tax treaty SAAR under active consideration. The National Tax and Customs Office has published a report on the recommended reviewing of the companies, where they highlighted the revision of the corporate tax, especially the statements of costs, expenses, carry forward of losses and the transfer of losses, transfer pricing, declaration of costs based on fictive bills, and the declaration of the minimum profit.\(^\text{14}\) It will be seen, that initiatives have been made especially in DTCs, e.g.: the aforementioned Hungary – US DTC, the Hungary – UK DTC, etc.

The examination of the Hungarian tax laws for this study took under consideration those changes in provisions, which have been introduced by the government from 2011, due to the slow administrative practice of modifying the laws. The list of modifications in national tax laws can be found below:

- The Corporate Tax Act has been changed in the Act CLXXVIII of 2015 28. § d) in relation to the introduction of the IFRS


Thin capitalisation rules were introduced to the Corporate Tax Act 8.§ (1) j) in 2011

23. §Act CLXXVIII on CFC modifications – the description of the CFC and the conditions of being one have been expanded

Act CXCI of 2015 39. § (15) has modified the provision on the exchange of the information between member states\textsuperscript{15}

2. **SAAR IN DOMESTIC LAW**

2.1. **Thin cap rules**

As it was described earlier, Hungary provides for the thin capitalisation rules, which are described in the paragraph 8 (1) j) of the Corporate Tax Act:

(1) Pre-tax profit shall be increased by the following:

\textbf{j}) the interests - shown under expenses or claimed as part of the cost of an asset during the tax year - on the receivables described in [...] (with the exception of receivables due from financial institutions) and the sum shown as a deduction from the pre-tax profit [...] (with the exception of receivables due from financial institutions), in an amount proportionate to the part of such receivables that is in excess of three times the amount of own funds referred to in Paragraph b) of Subsection (5)

Liabilities shall include the following payments based on the average sum of liabilities per day per tax year:

- Loans received (except for those from a financial institute)
  - This includes the loan received from a business partner, equity loans contracted by the company with the group, ignoring the fact of whether a possible interest rate was applied or not
- Liabilities derived from stocks emitted in closed matter (when all initially issued stock are acquired by incorporators) and obligation bills (except for those towards the suppliers)

\textsuperscript{15} Adózóna (2014.09.12): Az adókijátszás elkerüléséről is tárgyal hétfőtől az Országgyűlés. Published: 2014.09.12, date of access: 2016.03.22., place of access: http://adozona.hu/altalanos/Az_adokijatszas_elkeruleserol_is_targyal_he_X1W0F0
- Every other item stated not as liability, debt security or obligation bill in the balance sheet, which incurs interest payments, therefore lower the corporate tax base
  - This includes every liability, which cannot be sorted into any of the previous types, such as cash pooling
- Every other item not stated as loan, debt security, obligation bill or liability which does explain the payment of interests, based on which the taxpayer can lower its Earnings before tax according to 18. § of the same Act
  - This kind of liability can incur from bonds or shares of taxpayers from any associated enterprises, if the taxpayer decreases their Earnings before tax due to a price not based on the arm’s length principle. Loans received between associated companies do not constitute this group, as they should be accounted for in the first group

A formula exists in the Corporate Tax Act for calculating the correction item due to the thin capitalisation:

\[
\frac{\text{Interest} + \text{Pre-tax profits} - \text{Base-reducing items (18.§)}}{\text{liabilities - (3 x general equity))}} / \text{liabilities}
\]

In this calculation, general equity does not include the profit for the year or the revaluation reserve.

The introduction to the national procedural tax law can be explained with the fact that companies are always financed by a mixture of equity and debt, which implies, that the higher is the debt/liabilities proportion, the more interest deductions can a company make, which has an effect of lowering the Corporate Tax Base (CTB). In addition, if the company in question takes up a long term, profit participating loan from an affiliated company, it would be able to deduct its payments toward the associate as interests, thus reducing the CTB.

This tax-efficient mixture can be made through a cross-border activity as well by hybrids (A company in country X, B company in country Y), therefore the paid or received interest may be treated as non-taxable dividend or royalty or may be taxed at a lower rate, than at the source, depending on the tax legislation of the two countries.
2.2. CFC rules

The controlled foreign company rules were established by paragraph (1) section 22 of Act CXVI of 2009 and are effective from 1.01.2010 both in the Hungarian Personal Income Tax Act and in the Corporate Tax Act. The CFC rules were then amended by subparagraph a) section 40 of Act CXXIII of 2010, thus, are in force as of 1.01.2011. The rules on the costs of a CFC were included in the Personal Income Tax Act in 2012 and are effective from 1.01.2013. Further changes were introduced regarding the deductible and non-deductible costs from a CFC in 2015.

The exact definition of the ‘controlled foreign company’ is determined in the Corporate tax Act and can be read below:

“corporate foreign company shall mean foreign persons and non-resident entities whose head office is located abroad (hereinafter referred to as “non-resident company”), in which there is a beneficial owner who is considered a resident according to the Personal Income Tax Act concerning the majority of the non-resident company’s tax year (hereinafter referred to as “share-holder”), as well as the non-resident company whose revenues for the tax year originate from Hungary for the most part, in either case if the quotient of the tax amount paid (payable) by the non-resident company for the tax year - less any tax refund - and the tax base [in the case of group taxation arrangement the amount of tax paid (payable) at group level, less any tax refund, and the tax base] is less than 10 per cent or the non-resident company did not pay any tax equivalent to corporate tax on account of its tax base being zero or negative, even though it has made a profit.\textsuperscript{16}

A company is not considered a CFC, if:

- a person or their associated enterprise is present on a stock exchange for min. 5 years and holds min. 25\% of all shares of the foreign company during the whole tax year OR
- It is established in an OECD/EU state AND
- It has real economic presence in the state of residence

\textsuperscript{16} Act LXXXI of 1996, 4.§ 11)
Real economic presence is defined as any economic activity (manufacturing, processing, service-providing, investing, trading) performed by own assets and registered employees of the foreign company and its associates placed in the given state, if the income stemming from this activity is min. 50% of the overall revenues.

The real economic presence can be also treated as an activity clause, which is generally applied in the LOB clause in the US legislation.

If a company is qualified as CFC, then in order to avoid tax avoidance the CTB shall be increased by the amount of profits realised in the tax year by the company, which were:

“f) the amount of profit after tax shown for the last day of the tax year (financial year) of the controlled foreign company - as commensurate according the taxpayer’s direct holding in the controlled foreign company on the last day of the tax year - less any dividend paid out, provided that the taxpayer controls at least twenty-five per cent of the voting rights or the capital of the controlled foreign company, or has a dominant influence by definition of the Civil Code, and provided that private individuals regarded as resident in accordance with the Act on Personal Income Tax have no holding in the taxpayer; [...]”

Apart from the rules directed at the CFC itself, there are further provisions in the Corporate Tax Act regarding the non-deductible expenses or dividends from the CTB of other companies affiliated with the CFC:

“(9) the consideration paid to a controlled foreign company is not qualified as costs or expenses incurred in the interest of business operations, unless the taxpayer is able to prove that it serves the purposes of his business operations taking also into consideration the provisions set out in Point 13.”

“(3) Income claimed in respect of the remission of any unpaid dividend may be deducted from the corporate tax base; expenses claimed in respect of cancelled liabilities shall not increase the tax base for any member of the company from which the dividend originates.

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17 Act LXXXI of 1996, 8. § (1) f)
18 Act LXXXI of 1996, Schedule No. 3
(except if the liability remitted was due from a controlled nonresident company), regardless of whether or not any affiliation with the company from which the dividend originates exists.”

Those costs and expenses cannot be deducted, which arose from providing any support to a CFC as a donation:

“(13) the book value of any grant or support provided for reasons other than donation by the taxpayer (other than public-benefit organizations) without obligation of repayment, non-repayable liquid assets and assets provided without consideration during the tax year (excluding samples of goods under the Act on Value Added Tax), debts assumed by the taxpayer without consideration and deducted from the pre-tax profit for the tax year, the direct cost of services rendered without consideration during the tax year, and the value added tax charged for these benefits and shown under expenses, if provided to a foreign national or a nonresident entity whose head office is located abroad, or the taxpayer does not have a statement in his possession from the recipient stating that it the benefit was shown as income under his pre-tax profit for the tax year when the benefit was provided and that it will not be negative without the income this benefit represents, that is to be verified following the completion of his annual account by means of a statement;”

As it is stated in the Commentary on Corporate Taxation Act, the dividend cannot be deducted from the CTB, because only this way the government is able to impose tax on dividends at the level of domestic resident and prevent the tax avoidance. Also, the initial hypothesis is that in market economies two or more independent enterprises sign contracts and make deals with each other, therefore in this case there can’t be a transfer of wealth from one party-taxpayer to another, because it is not their principal aim.

The transactions, which aim to avoid taxes, are made, however, between non-independent/associated enterprises, thus the Authorities must pay increased attention to these. Here I must refer to the transfer pricing ruling, which was introduced and to be applied to every associated enterprise, regardless of which tax system is applied to it. However, because it

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19 Act LXXXI of 1996, Paragraph 29/Q (3)
20 Supra 15
is difficult to prove that the prices applied are not market-based, the country of residence shall impose tax on the income in the other country with the lower tax rate, regardless of the fact that this income should not be taxed by the first country.

2.3. Exit taxes

Exit tax is considered as one of the SAARs applicable in order to protect national tax revenues and avoid purely artificial transfers, the sole purpose of which is to achieve a lower tax rate in another jurisdiction. This provision can be applied to both individuals and companies, and is generally triggered when there is a change in tax residence or the move of taxable assets\(^{21}\) of a taxpayer.

The European Commission published a press release on Anti-Avoidance Package in January of 2016, where exit taxation is described as preventive method for relocating assets purely to avoid taxation.\(^{22}\) According to their opinion, exit tax should be based on the value of the assets at the time of re-location, because then the Member states could track the “disappearance” of the asset from the balance sheets provided by the companies yearly. Certainly, the member states are not obligated to implement the given tax into their national law - to support this statement a part from the press release can be read below:

“There is no attempt to interfere with countries' sovereign right to decide their own corporate tax rates. However, countries also have a right to protect their tax bases against aggressive tax planning and unfair tax competition. If one country's policy decisions (e.g. no or low tax rate) encourages tax planning schemes that negatively impact another country's revenues, the latter has the legitimate right to take measures to protect its tax base. The Package aims to ensure that each Member State is able to effectively tax profits that are generated in its territory, in line with its own national rate and rules.”

Despite a statement made by Cerioni (2015), according to which Hungary never applies exit tax, a similar provision can be found in the Corporate Tax Act 16. § (7) regarding the case of bankruptcy or liquidation proceedings. As it is established in this provision, a


\(^{22}\) Supra 12
dissolution with liquidation happens, if the taxpayer is excluded from the scope of this law by any means or relocates the head office of the company. Hence, the taxpayer is obligated to establish its pre-tax profit according to 16. § (1) ca)-ck) and pay the required corporate income tax. However, this provision shall not be applied to European companies limited by shares and the European cooperative groups.

The rationale behind any exit taxes is to tax the embedded profits before the asset leaves the jurisdictions. Without the exit taxes the taxpayer could simply relocate his company to any low-tax jurisdiction he desires without any consequences, and, in addition, move the accumulated profit without paying any CIT as well. The exit taxation ensures that the balance of taxing rights is preserved and that the country does not give up taxation right on unrealised gains and profits.

The other explanation for the ruling on the reserve is the fact that many companies intend to reduce their tax base by the amount of the equity loan contracted by the company. If these are found during the tax audit, then the tax authorities shall consider these as foregone liabilities and increase the tax base.

2.4. Other SAAR in domestic law

Besides the aforementioned SAARs, Hungary has a ruling on the costs and expense deductions, which were realised not in relation with the company in question, to which the majority of the legal cases refer to:

Pre-tax profit shall be increased by the following:

\[ \text{d) amounts claimed as costs or expenditures, and deducted from the pre-tax profit, including the depreciation allowances of tangible assets and intangible assets, which are not related to the business operations or the gainful activity, with particular regard to what is contained in Schedule No. 3;[...]} \]

\[ \text{23 For further information see: Complex Jogtár: 1996. évi LXXXI. törvény – a társasági adóról és az osztalékdadoról, 8. § (1) d) BHGY} \]

\[ \text{24 Act LXXXI of 1996, 8.§ (1) d)} \]
3. **SAAR IN TAX TREATY LAW**

3.1. *General interpretation*

The Hungarian SAARs are generally applicable for treaty purposes and any cross-border activity conducted in Hungary, due to the reason that if any treaty does not provide for the necessary ruling, then the national tax law provisions shall be applied.

The treaties concluded by Hungary shall be divided in two different groups based on their exhaustiveness: the first group contains those DTCs, which were signed with developed countries (e.g.: Germany, UK, etc.) in the previous several years and are more in line with the latest requirements on the implementation of the SAARs, as it may be seen in subparagraphs on Subject-to-tax rules or Real estate investment entities. The other group contains all the remaining treaties, which were not modified since their signature (some treaties were not changed since the 1980s).

In the following, the presence of the SAARs will be examined, which were listed in part 1.2.2.

3.2. *Limitation-on-benefits (LOB) clauses*

As it is widely known, the original Limitation-on-benefits (LOB) clause proceeds from the US Model Treaty and limits the residents of third states in exploiting the benefits of the tax treaties by applying the “qualified person” conditions to the resident in question. The resident is deemed as “qualified person”, defined by the US Model Treaty, if at the time of applying the treaty, he is:

a) an individual;

b) a Contracting State, or a political subdivision or local authority thereof; or

c) a company.

In case of the latter, the fulfilment of the stock exchange clause or the activity clause is required. As Manokhin (2013) states, the stock exchange clause can be satisfied directly, that is, the company can be listed on a recognised stock exchange; or indirectly, when „at least 50% of each class of shares is owned directly or indirectly by companies directly accessing treaty benefits, provided that in cases of indirect ownership each intermediary
owner is entitled to benefits of the treaty under the indirect access rule.”25 The activity clause is also based on the US Model treaty and requires a derivative benefits test, a headquarters companies test and a substantial presence test, content of which is not part of this study.26

Part 1 of the 2015 OECD Treaty Draft presents a proposed alternative “simplified” LOB rule to that in the US Model Treaty. Both the long-form and simplified LOB rules are generally modelled on the LOB provisions found in most U.S. tax treaties, and are intended to deny treaty benefits where a resident of a treaty country does not have a sufficient nexus to that country based on objective criteria (such as majority ownership by persons resident in the country or a sufficient business connection to the country).27 The simplified LOB rule retains most of the basic architecture of the long-form LOB rule, such as including a list of “qualified persons” who qualify for all applicable treaty benefits and some alternative ways of qualifying for more limited treaty benefits, including an active business test, a derivative benefits test and competent authority relief.

In broad majority of the cases, the limitation-on-benefits clause does not apply to the Hungarian jurisdiction and/or treaties due to several reasons. First, the preferable Hungarian company forms are small and medium enterprises (SMEs), because they do not require a big general equity at the time of establishment (the establishment of a limited liability company requires 3.000.000 HUF (~9500 €), where the establishment of a company limited by shares requires a general equity from 5.000.000 HUF to 20.000.000 HUF).

Secondly, according to the data of 2015, out of 1.701.805 companies registered in Hungary only 6.105 are companies limited by shares28, from which only 33 are listed on the

25 US Model Treaty, Article 22 (2)
26 Detailed information on these tests can be found in: Manokhin, V. (2013): Limitation on Benefits Clauses in tax Treaties. In: Simader, K., Titz, E. (edts): Limits to tax planning. Series on International Law, Volume 79.
Further information of the differences between the presented LOB rules can be found in the Draft on the 2015 OECD Model Convention.
28 Központi Statisztikai Hivatal: A regisztrált gazdasági szervezetek száma – GFO’14, date of access: 2016.03.12, place of access: http://www.ksh.hu/docs/hun/xstadat/xstadat_eves/i_qvd010.html
Hungarian stock exchange, and not all of them trade more than one class of shares on the secondary market.\textsuperscript{29}

Thirdly, Hungary does not have such a complex national legal system as the United States, therefore it may be difficult to interpreter and apply this kind of successive objective tests. Similar opinions are stated in the Comments on the public discussion draft on Action 6\textsuperscript{30}.

In spite of this, in 2010 Hungary has renewed its double tax treaty with the United States of America\textsuperscript{31}, which already includes the Limitation-on-benefits article\textsuperscript{32}, however, the US Senate has not ratified this DTC since, due to the resistance of Senator Paul Randal. Until the full approval of the US Senate, the previous 1979 treaty will remain in force. The new treaty would bring changes regarding not only the LOB clause, but also regarding the income from immovable property, the permanent establishment, the associated enterprises and the exchange of information between the two states.

Despite the fact that Hungary does not apply the LOB clause because of the reasons mentioned above, there are five DTCs out of more than 80, which contain articles with meaning similar to the LOB clause, or rather, principle purpose test (PPT) discussed in the OECD BEPS, which will be discusses in subpart 3.6.

The introduction of LOB clause in the treaty between Hungary and United States can be explained with the fact, that under the current treaty, Hungarian tax residents and third-country entities are generally exempt from withholding tax on US sourced interest and royalties while the withholding tax on US sourced dividends is limited to 5\% in certain cases.\textsuperscript{33} The new treaty is also more closely aligned with the present US Model Tax Treaty and other DTCs signed by the US, and in opinion of the Tax authorities of the latter, the introduction of this article will make treaty shopping more difficult, if approved.

\begin{flushleft}
\textsuperscript{29} Budapesti Értéktőzsde, Tőzsdei kereskedő cégek listája. Date of access: 2016.03.04., https://bet.hu/topmenu/tozsdei_kereskedok/kereskedocegek
\textsuperscript{30} OECD (2014): Comments received on public discussion draft – BEPS Action 6: preventing the granting of treaty benefits in inappropriate circumstances. OECD, 2014.04.11.
\textsuperscript{31} As it is stated on the US Department of State website on 2016.03.04, http://www.state.gov/s/l/treaty/pending/
\textsuperscript{32} Act XXII. of 2010, Article 22
\end{flushleft}
It is important to add, that the aim of the US tax Authorities is not only the limitation of treaty shopping, but also the mapping of foreign interests of the American taxpayers.

As it was mentioned previously, Hungary applies the LOB clause only in this given treaty and the PPT rule in several others, but the application of these two provisions are following the OECD recommendation on the treaty abuse provisions on using the two rules.

The LOB clause of the Hungary – United States DTC includes the activity clause in the Article 22 (3), which requires an active conduct of trade or business in Hungary and the income derived from there is in connection with the trade or business as well as the ‘qualified persons’ rule (since the main target of the United States was to sign a DTC which included this rule) and the stock exchange clause among others stated in the US Model Treaty.

Certainly, because the aforementioned treaty was introduced five years before the final reports on BEPS project, a connection cannot be made between the amendment and the project. I strongly doubt it that any new treaties initiated by Hungary will contain the US-type LOB clause, because of its complex functioning and conditions. Nevertheless, as mentioned before, Hungary accepts those treaties where the other Contracting Party requested a specific article.

Regarding the juridical application of the inserted article it can be stated that, based on the examined case law, the national courts and the tax authorities have not had yet time to apply the newly introduced article in practice, due to the pending ratification of the US Senate.

3.3. Subject-to-tax clauses

Subject-to-tax clauses provide for the contracting state the possibility to reclaim their taxing right when the other state does not make use of their taxing right, which is allocated to them by the DTC. A subject-to-tax clause can take up two forms, one of which is a specific clause, which targets only certain income and can be found in the allocation articles, where the other is a general one, therefore applicable to any kind of income, and is inserted in the method article. It states that the obligation of a contracting state to exempt
income shall only apply if the same income is subject to tax in the other contracting state.\textsuperscript{34}

Neither the OECD, nor the European Commission does include a general subject-to-tax clause as one of the SAARs in the OECD MC or the Anti Treaty Abuse Package. However, the OECD makes a recommendation in the Commentary on the MC, according to which the member states shall use a general subject-to-tax provision for cases where conduit companies are involved.\textsuperscript{35} A partial recommended paragraph is inserted in the Commentary in order to provide a textual basis for the contracting states, which can be inserted in the DTC:

“Where income arising in a Contracting State is received by a company resident of the other Contracting State and one or more persons not resident in that other Contracting State

\begin{itemize}
\item[a)] have directly or indirectly or through one or more companies, wherever resident, a substantial interest in such company, in the form of a participation or otherwise, or
\item[b)] exercise directly or indirectly, alone or together, the management or control of such company,
\end{itemize}

any provision of this Convention conferring an exemption from, or a reduction of, tax shall apply only to income that is subject to tax in the last-mentioned State under the ordinary rules of its tax law."\textsuperscript{36}

Nevertheless, there is a common interpretation of the subject-to-tax clauses, as Andersson (2014) writes in her study:

“The income or the economic activity should be subject to tax. If one state does not makes use of the taxing right under the double tax convention, the other state is free to tax the income instead.”

\textsuperscript{34} Andersson (2014): \textit{Subject-to-tax clauses in Swedish double tax conventions}. Lund University, School of Economics and Management Department of Business Law, p.22.
This definition can be applied to various articles of a DTC or may be used as described above. In case of Hungary, subject-to-tax clause can be found in some DTCs in form of the added paragraph in the Elimination of double taxation article and also in the Taxation Order Act. The latter was introduced in paragraph 195 of Act LXXIV. of 2014, and is in force from 1.01.2015. The content of the article follows almost fully the recommended text, with several deviations or clarifications regarding the method of the exemption of income in question from tax in one state:

“The Taxation Order Act provides for those cases, when a different interpretation of the provisions of international treaties or of the facts presented on the income in question results in non-taxation by both contracting states, then Hungary will not grant benefits and exemption from tax on this income.”

Among the Hungarian double tax treaties only several contain the subject-to-tax clause in the form of an added provision, all of these can be found below with the relevant paragraph cited.

The DTC negotiated between Hungary and the United Kingdom is one of the Hungarian treaties, which contains a subject-to-tax rule in Article 22 (1) a) and requires not only the fact that the given income shall be taxable in the other state, but the effective taxation of the income in question must happen as well:

„In Hungary, double taxation shall be eliminated as follows:

(a) Where a resident of Hungary derives income which, in accordance with the provisions of this Convention, may be taxed in the United Kingdom, and is so taxed in the United Kingdom, Hungary shall, subject to the provisions of sub-paragraph (b) and paragraph (4), exempt such income from tax.

(b) Where a resident of Hungary derives items of income which, in accordance with the provisions of Article 10, may be taxed in the United Kingdom, Hungary shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in the United Kingdom. Such deduction shall not, however, exceed that part of the tax, as

37 Act XCII. of 2003, 2. § (2)
38 Act CXLIV. of 2011
computed before the deduction is given, which is attributable to such items of income derived from the United Kingdom.”

The Article 22 (1) a) of the Hungary - Germany DTC\textsuperscript{39} has a similar wording, therefore it is also accounted for as a subject-to-tax clause:

„Tax shall be determined in the case of a resident of Germany as follows:

\textit{a) Unless foreign tax credit is to be allowed under sub-paragraph b), there shall be exempted from the assessment basis of the German tax any item of income arising in Hungary and any item of capital situated within Hungary which, according to this Agreement, is \textit{effectively taxed} in Hungary.}

\textit{In the case of items of income from dividends the preceding provision shall apply only to such dividends as are paid to a company (not including partnerships) being a resident of Germany by a company being a resident of Hungary at least 10 per cent of the capital of which is owned directly by the German company and which were not deducted when determining the profits of the company distributing these dividends.}

\textit{There shall be exempted from the assessment basis of the taxes on capital any shareholding the dividends of which if paid, would be exempted, according to the foregoing sentences.”}

This provision establishes the proportion of the necessary capital ownership by a German resident company as well in order to apply the tax benefits to the payments made by a Hungarian company

On 10.03.2016 Hungary has signed the DTC with Iran\textsuperscript{40}, which also contains the subject-to-tax clause in Article 22 (2) a) and includes the required effective taxation condition:

\textsuperscript{39} Act LXXXIV. of 2011
\textsuperscript{40} Act IV. of 2016
“In Hungary, double taxation shall be eliminated as follows:

(a) Where a resident of Hungary derives income or owns capital which, in accordance with the provisions of this Agreement may be taxed in the Islamic Republic of Iran, and it is effectively taxed there, Hungary shall, subject to the provisions of subparagraph (b) and paragraph 3, exempt such income or capital from tax.”

All other DTCs negotiated by Hungary, however, do not contain the effective taxation condition, but state that where a resident of one Contracting State derives income which, in accordance with the provisions of this Convention may be taxed in the other Contracting State, the first-mentioned State shall…[subject to the provisions of subparagraph (b) and subparagraph (c)] exempt such income from tax.

3.4. Beneficial Ownership

The ‘beneficial ownership’ is a legal concept, which is still not completely defined in the Commentary on OECD MC, since the exact wording of this definition is the following:

“The term “beneficial owner” is not used in a narrow technical sense; rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.”

Nevertheless, a further explanation was inserted in the Commentary on OECD MC in October of 2014 to clarify the meaning of the beneficial ownership. It now states, that benefits of the treaty will not be granted automatically, if the beneficial owner is a resident. If he/she acts as an agent or nominee, the benefits will not be granted either, because he/she is not treated as the owner of the income for tax purposes in the State of residence. The Commentary on the OECD MC highlights, that the explanations concerning the meaning of “beneficial owner” must be distinguished from any other meanings given to it (e.g.: Financial Action task Force, International Standards on Combating Money Laundering and the Financing of terrorism & Proliferation – The FATF Recommendations (OECD-FATF, Paris, 2012).

41 Supra 25
The Hungarian tax law does not specify the concept of beneficial ownership with respect to companies in the national tax law either; nonetheless, the phrase itself is included in the Hungarian DTCs, which are based on the OECD MC. Apart from the interpretation of the beneficial ownership in DTCs, the concept for national transactions can be found in Schedule no. 7 of the Taxation Order Act, subpart 10, however, this refers only to the individuals and concerns interest payments (it does not include the payments of dividends and/or royalties):

“According to this Annex, beneficial owner shall be an individual who is a resident of the other State, to whom an interest payment is made, or secured for. An individual is not qualified as beneficial owner, if such individual can provide evidence that the interest payment was not received or secured for his or her own benefit, that is, if he or she acts:

a) as the payer of the interests;

b) as a legal entity, subject to corporate income tax based on the state of residency, organisation defined as UCITS\(^{42}\), or on behalf of an organisation described in paragraph 3 [agent or nominee];

c) on behalf of the recipient of the income and discloses, in the case of a legal arrangement, the name and the permanent address of the person, who primarily holds legal title, to the economic operator making or securing the interest payment.”

It should be emphasized, that the Taxation Order Act prescribes – in contrary to the interpretation in the international tax law\(^{43}\), that if the payer of the interest cannot successfully identify the beneficiary, then the person acting as a representative shall be considered the beneficial owner.

The National Customs and Tax Office issued a notice on the change of the Commentary on the Model Convention on taxation of income and assets\(^{43}\), where they highlight the fact, that through the accession to the OECD Hungary has accepted the obligations pro-

\(^{42}\) Undertaking for Collective Investment in Transferable Securities

\(^{43}\) Nemzeti Adó- és Vámhivatal: Tájékoztató a jövedelem és a vagyon adóztatásáról szóló Modellegyezmvény és Kommentár módosulásáról - A tényleges haszonhúzó fogalmának értelmezése, 2015.01.23.,date of access: 2016.03.13., place of access: http://www.nav.gov.hu/nav/ado/tarsasagi/Tajekoztato_a_jovedel20150123.html
ceeding from the membership, therefore, the documents issued by the OECD and, consequently, shall apply the provisions of the Commentary on the Model Convention at the time of the interpretation of DTCs and international tax operations.

This solves the legal paradox created by the Article 3 (2) of the DTCs and the national tax law, according to which “[…] any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which this Convention applies, any meaning under the applicable tax law of that State prevailing over a meaning given to the term under other laws of that State.”

3.5. *Real estate investment entities*

Taxes on capital gains in Hungary are equal in percentage to the corporate income tax (10% / 19%), since gains proceeding from the sale of assets are treated as ordinary business income, and therefore are included in the corporate tax base, unless the participation exemption applies.

Participation exemption is valid for dividends and capital gains, under which the dividends received by a Hungarian company from any source (except from a CFC) are exempt from the CIT and withholding tax, regardless of the extent of the participation. It also applies to capital gains derived from sale or in-kind contribution of a participation, but the taxpayer must hold at least 10% of the subsidiary (not a CFC) for minimum 1 year and report the acquisition of the participation to the national tax authorities within 75 days of the acquisition.44

Since Hungary has over 80 DTCs, they provide for relief from double taxation on capital gains and real estate investment entities as well, however, the exact provision can be found only in those DTCs, which were signed by Hungary in 2005 or later. Usually the

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44 Supra 3
numbering of the Article changes, therefore it is inserted in the Article 13 as paragraph (2) or (4).

In the following the relevant articles of those treaties will be presented, which deviate from the OECD MC (because of being signed before 2005 or due to an additional provision inserted):

1. Hungary – Switzerland DTC45:

   "Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State. The provisions of the preceding sentence shall not apply to gains:

   a) from the alienation of shares quoted on a Stock Exchange in either Contracting State or any other Stock Exchange as may be agreed between the competent authorities; or

   b) from the alienation of shares in a company, the assets of which consist of more than 50 per cent of immovable property, in which the company carries on its business."

The subpart a) of this provision contains a stock exchange clause, that is, an exception is made for the income proceeding from the alienation of shares in one state, will not be taxed in the other state, despite the DTC. The OECD considers this condition as approvable due to the various benefits state give to companies.

2. Hungary – Luxembourg DTC46 and Hungary – Austria DTC47:

   "Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent

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45 Act CLXIII. of 2013, Article 13 (4)
46 Act XCV. of 1990, Article 13 (2)
47 Draft Decree 2. of 1976, Article 13 (2)
establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.”

3. Hungary – Hongkong DTC\textsuperscript{48}:

“Gains derived by a resident of a Contracting Party from the alienation of shares or comparable interests deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting Party may be taxed in that other Party. However, this paragraph does not apply to gains derived from the alienation of shares:

(a) quoted on such stock exchange as may be agreed between the Parties; or
(b) alienated or exchanged in the framework of a reorganisation of a company, a merger, a scission or a similar operation; or
(c) in a company deriving more than 50 per cent of its asset value from immovable property in which it actually carries on its business.”

This article is similar to the one in the Hungary – Switzerland DTC, since it contains a stock exchange clause and the exception to those companies, which normally operate with purchase and alienation of immovable property.

4. Hungary – Iceland DTC\textsuperscript{49}:

“Gains from the alienation of shares, rights or an interest in a company, in any other legal person or in a partnership, the assets of which consist principally of, or of rights in, immovable property situated in a Contracting State or of shares in a company the assets of which consist principally of, or of rights in, such immovable property situated in a Contracting State may be taxed in the Contracting State in which the immovable property is situated.”

This paragraph is unique in the Hungarian DTCs, since it defines the broad meaning of ‘other rights’ as rights and interest, and includes the partnership as a type of company as well.

\textsuperscript{48} Act CXXIX. of 2010, Article 13 (4)
\textsuperscript{49} Act CXLV. of 2005, Article 13 (2)
5. Hungary – Mexico DTC\textsuperscript{50}:

4. Gains derived by a resident of a Contracting State from the alienation of shares, participation or other rights in the capital of a company or other legal person that is a resident of the other Contracting State may be taxed in that other State, if the recipient of the gain, at any time, during the 12 (twelve) month period preceding such alienation, together with all persons who are related to the recipient, had a participation of at least 25 (twenty-five) per cent in the capital of that company or other legal person.

The Hungarian–Mexican treaty is unique among the other DTCs, since it establishes a minimum holding period in twelve months and also makes a concrete proportion of participation requirement.

The application of the exact wording of Article 13(4) OECD MC limits the possible benefits, which can be exploited by the treaty. Until there was not any proportion on the value, that is, the gains deriving minimum 50\% of their value from immovable property, foreign companies could perform transactions with real estate and receive the interests from its alienation without paying any tax. Many companies carried out these transactions through a holding company residing in Luxembourg, which is the reason why Hungary renewed its DTC with Luxembourg in 2015 and inserted the recommended provision of the article 13 (4) OECD MC. The change in DTC with Luxembourg will apply not only to any future transactions, but also to those, which were made under the DTC of 1990, in other words, it will have a retroactive effect.

In every treaty concluded by Hungary the double taxation of interests, dividends and/or royalties received by a resident of Hungary is eliminated by the provision of article (x), Elimination of double taxation. The provision states, that Hungary shall allow a deduction from the tax on the income of the resident in question an amount equal to the tax paid in the other state. The article does not distinguish between the gains from alienation of immovable property and gains from alienation of shares.

Certainly, the tax authorities will attempt to make further amendments to those treaties in force, which were not changed since 2005, due to the pressure by the EC and the propositions of the OECD on anti-tax planning.

\textsuperscript{50} Act CXLV. of 2011, Article 13 (4)
3.6. Other SAAR in tax treaty law

3.6.1. Principal purpose test (PPT)

Since the taxpayers may be tempted by the possibility of not paying taxes in one jurisdiction by exploiting the legal loopholes and creating conduit companies for that reason. In order to combat this ‘treaty shopping’, the OECD elaborated the so-called Principal Purpose Test, which is described with detail in the Action 6 of the BEPS Package. Briefly, the Action proposes a broadly drafted general purpose rule aimed at removing treaty benefits where one of the principal purposes of arrangements or transactions is to obtain treaty benefits.

Apart from the SAAR included in different national tax laws and most of the tax treaties, further rulings can be found in the tax treaties concluded by Hungary. One of these is the PPT rule, which is included in nine DTCs under the article (x) Limitation on benefits in various versions. Despite the name of the article, the provisions cite the new PPT rule, which generally states that benefits shall be denied to a resident who has as one of its (main) principal purposes the obtainment of these benefits. The difference in the wording of the paragraph may appear. The relevant paragraphs of the Limitation on benefits article will be presented below:

1. Hungary – Mexico DTC51:

“1. A resident of a Contracting State shall not be granted the benefits of this Convention if the competent authority of the other Contracting State determines that the said resident actively carries out business in the other State and that the establishment or acquisition or maintenance of such person and the conduct of its operations has as one of its principal purposes the obtaining of benefits under this Convention.

3. The provisions of this Convention shall not prevent a Contracting State from applying its provisions regarding thin capitalisation and controlled foreign corporation (in the case of Mexico, preferential tax regimes).”

51 Act CXLV. of 2011, Article 22
This treaty does not only provide for the PPT rule, but provides for an activity clause and also permits the contra-actions on thin capitalisation and CFCs, which are already included in the Hungarian Corporation Tax Act.

2. Hungary -Taiwan DTC\textsuperscript{52}:

\textit{\textquotedblleft}Notwithstanding the provisions of any other Article of this Agreement, a resident of a territory shall not receive the benefit of any reduction in or exemption from tax provided for in the Agreement by the other territory if the competent authority of the other territory determines that \textbf{the main purpose or one of the main purposes} of such resident or a person connected with such resident was to obtain the benefits of this Agreement.\textquotedblright

3. Hungary – Saudi Arabia DTC\textsuperscript{53}:

\textit{\textquotedblleft}Nothing in this Convention shall affect the application of the domestic provisions of a Contracting State to prevent tax evasion and tax avoidance if the competent authority of that Contracting State determines \textbf{that the main purpose or one of the main purposes} of a resident of the other Contracting State or a person connected with such resident was to obtain the benefits of this Convention. The Contracting States may consult each other before a resident of a Contracting State is denied relief from taxation in the other Contracting State by reason of the preceding sentence.\textquotedblright

4. Hungary-Bahrein DTC\textsuperscript{54}; Hungary – Cosovo DTC\textsuperscript{55}:

\textit{\textquotedblleft}Notwithstanding the provisions of any other Article of this Convention, a resident of a Contracting State shall not receive the benefit of any reduction in or exemption from tax provided for in this Convention by the other Contracting State if the competent authority of the other State determines that \textbf{the main purpose or one of the main purposes} of such resident or a person connected with such resident was to obtain the benefits of this Convention.\textquotedblright

\textsuperscript{52} Act CXXXIII. of 2010, Article 26
\textsuperscript{53} Act LII of 2014, Article 28
\textsuperscript{54} Act XLIX. of 2014, Article 27
\textsuperscript{55} Act CLXXXVII. of 2013, Article 27
5. Hungary – Iran DTC\textsuperscript{56}:

"1. Notwithstanding the other provisions of this Agreement, a benefit under this Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Agreement."

6. Hungary – United Kingdom DTC\textsuperscript{57}:

“Notwithstanding any other provisions of this Convention, where an enterprise of a Contracting State derives income from the other Contracting State, and that income is attributable to a permanent establishment which that enterprise has in a third jurisdiction, the tax benefits that would otherwise apply under the other provisions of the Convention will not apply to that income if the combined tax that is actually paid with respect to such income in the first-mentioned Contracting State and in the third jurisdiction is less than 60 per cent of the tax that would have been payable in the first-mentioned State if the income were earned in that Contracting State by the enterprise and were not attributable to the permanent establishment in the third jurisdiction. Any dividends, interest or royalties to which the provisions of this paragraph apply shall be subject to tax at a rate that shall not exceed 15 per cent of the gross amount thereof. Any other income to which the provisions of this paragraph apply will be subject to tax under the provisions of the domestic law of the other Contracting State, notwithstanding any other provision of the Convention.

The provisions of this paragraph shall not apply if:

(a) in the case of royalties, the royalties are received as compensation for the use of, or the right to use, intangible property produced or developed by the permanent establishment itself; or

\textsuperscript{56} Act IV. of 2016, Article 27
\textsuperscript{57} Act CXLIV. of 2011, Article 23
(b) in the case of any other income, the income derived from the other Contracting State is derived in connection with, or is incidental to, the active conduct of a trade or business carried on by the permanent establishment in the third jurisdiction (other than the business of making, managing or simply holding investments for the enterprise’s own account, unless these activities are banking or securities activities carried on by a bank or registered securities dealer).”

The paragraph cited above can be considered as a special LOB rule, which compares the tax payable in the state of residence and amount of tax effectively paid in the state of residence of the recipient and the third state, which is the state of residence of the permanent establishment. The aim is to prevent any kind of treaty shopping through Hungary or the United Kingdom by establishing a company there.

3.6.2. Minimum holding period

The contracting states may apply a specific condition with respect to the benefits provided for the dividend payments. According to this condition, the company receiving the dividends must not only have a certain percentage of the capital of the company paying the dividends, but must comply with a certain capital-holding period, which is to be defined by the contracting parties. Nevertheless, the OECD makes a remark in the Commentary on the Article 10 (16) that to require the company to have possessed the minimum holding for a certain time could involve extensive inquiries, which could only function if the contracting states have a steady and trusted information sharing system.

In the Hungarian tax law there is no defined minimum holding period, therefore if a contracting state wishes to apply this condition, it should be inserted in the DTC. In two of the newer treaties (signed in 2011 and 2012) the Article 10 contains a holding period, which, if achieved, grants tax benefits for dividends. Below the relevant articles will be provided:

1. Hungary - Georgia DTC\(^{58}\):

   “2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if

\(^{58}\) Act XIV. of 2012, Article 10
the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) 0 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership that is not liable to tax), which has held directly at least 25 per cent of the capital of the company paying the dividends for an uninterrupted period of at least 12 months prior to the decision to distribute the dividends;

(b) 5 per cent of the gross amount of the dividends in all other cases.”

2. Hungary - Denmark DTC59:

“2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) 0 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership that is not liable to tax), which holds directly at least 10 per cent of the capital of the company paying the dividends where such holding is being owned for an uninterrupted period of no less than one year;

(b) 0 per cent of the gross amount of the dividends if the beneficial owner is a pension fund or other similar institution providing pension schemes in which individuals may participate in order to secure retirement benefits, where such pension fund or other similar institution is established and recognized for tax purposes in accordance with the laws of that other State;

(c) 15 per cent of the gross amount of the dividends in all other cases.”

It can be seen, that the minimum holding period is established in one year, which should be continuous, otherwise the benefits will not be granted.

59 Act LXXXIII. of 2011, Article 10
4. IMPACT OF BEPS ON TREATY POLICY

As it can be seen from the recent DTCs and changes in the national procedural tax law, Hungary has attempted to conform to the recommendations of OECD regarding BEPS since the work on the project has begun. The introduction of the LOB and PPT rules, the subject-to-tax rule demonstrate that Hungary actively considers the proposed anti-tax avoidance measures. The article on the exchange of information on taxes between OECD member states is also being inserted in the Hungarian treaties and procedural tax law\(^{60}\), thus permitting a more transparent and secure cooperation and cross-border taxation.

As it is widely known, the European Commission has elaborated its own anti-BEPS project, the Anti Tax Avoidance Package (ATAP), which contains similar provisions, recommendations and several legally binding requirement for Member States to the BEPS Actions and the US Model Treaty (see: Limitation-on-benefits part).

Based on the latest news on BEPS and the ATAP developments, the new treaties between Hungary and other states will certainly be affected by both, due to the fact that more and more countries request the inclusion of the aforementioned anti-abuse rules in the DTCs, as it could be seen in the DTC with UK, Liechtenstein or Germany.

5. EU LAW

As it was already mentioned in the introductory part, Hungary does not have to implement every recommendation and opinion proposed by the European Union regarding the tax law. Therefore, the recent ATAP initiative will not have any effect on the national procedural tax law unless the EU will issue an obligatory directive.

If we look at the national opinion in the field of BEPS and ATAP, it is important to emphasize, that the Hungarian Minister of Finances, Mihaly Varga has taken part in the meeting of Ecofin on 12\(^{th}\) of February, 2016, after which he announced, that the main topic of the meeting was the ATAP. According to his words, the Hungarian government agrees with the basic aim of the recommendations, which is the fight against the tax avoidance and aggressive tax planning techniques, but calls for caution with regard to the details. In his opinion, it is important to maintain the healthy European tax competition, but

\(^{60}\) Act XLII of 2014, Convention on mutual administrative assistance in tax matters
the European Commission has to take under consideration the national practice of the Member states in connection with the DTCs and not enforce the practices, which were not proved universally beneficial. Based on this, the Hungarian government proposed further examinations in this matter.

The biggest tax-consulting firms located in Hungary as Ernst&Young, Deloitte, KPMG, PricewaterhouseCoopers, BDO and others have published several articles on the potential effect of BEPS on countries all around the world, but nothing specific on the implementation of BEPS or ATAP in Hungary.

To conclude this study I would like to bring a statement from publications by EY from 2014 regarding the potential changes made by the BEPS:

“It will be a challenge for companies to stay up-to-date with tax changes around the globe in 2014. All countries are trying to both expand and protect their tax base. Many are either taking or planning wholesale tax reform. And at the supranational level, not only will the OECD BEPS project undoubtedly drive change, but similar activity by the European Commission will require close attention, too.”

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6. SUMMARY

The purpose of this study was to examine the Hungarian tax law in relation with the global changes, which were experienced by countries and companies all around the world, and assess the current specific anti-abuse rules present in the national tax laws and tax treaties.

In the introductory part the Hungarian OECD and EU membership was discussed together with the proceeding obligations.

In the second part, the study examined the specific anti-abuse rules introduced to the national tax law and their application to the companies, whereas the third part referred to the specific anti-abuse rules present in the Hungarian tax treaties. It could be said that Hungary has quite many anti-avoidance rulings, which, however, were not tested enough until now.

In the fourth and fifth parts, the effect of BEPS and the changes in EU law on national tax law were examined, with the conclusion that due to the Hungary has not participated actively in the BEPS or ATAP discussion, but has implemented the recommended action points in its newest tax treaties and tax laws, where necessary. Without a doubt, Hungarian tax law and double tax conventions comply with the proposed Model Convention and the recommendations placed in the Commentary on the Model Convention regarding the specific anti-avoidance rules, but new amendments are not expected to be introduced and applied yet.