

Development of the estate planning industry through the introduction of the trust in Hungary

Ákos Menyhei*

Abstract

Parallel with the implementation of the trust in Hungary, the complete legal environment was harmonized to conform to the trust rules. The author explains some of the misunderstandings of the continental law trust. In particular, the article describes the historical background, the beneficiary's protection with *in personam* rights, the interpretation of the general trust rules, the asset segregation, the power of appointment, and the beneficiary's position. The article concludes that the Hungarian trust meets the trust definition provided by the Hague Convention and, moreover, that it is a genuine clone of the Anglo-American trust.

trust in estate and inheritance planning. The clarification of the interpretation of the legal terminology³ provided further dynamism with regard to estate planning and protection.

One of the key factors of the trust framework's successful implementation has been that the complete legal environment was harmonized to conform to the trust rules. The legislator, with the help of legal practitioners, has designed completely new sets of acts⁴ thereby enabling the immediate use of the new legal instrument.

One of the key factors of the trust framework's successful implementation has been that the complete legal environment was harmonized to conform to the trust rules

Introduction

The new Hungarian Civil Code¹ introduced the trust framework into the Hungarian legal system in March 2014. The last two years show express proof that the lawyers and other practitioners understand the new legal vehicle and are ready to grasp the chance to use the freedom² provided by the Hungarian Civil Code. Just a few months after the introduction of the new vehicle, Hungarian practitioners started to use the

The second factor of the success is that the trust framework was not initiated and designed at a political, but at a professional level. The codification of the new Civil Code was started by the Codification Committee 20 years prior to the implementation. The Committee was composed of the most experienced law professors and scholars, with many of the legal practitioners being in daily legal practice. At an earlier time, it was a common legal solution to use

*Dr. Ákos Menyhei LL.M., TEP, Trustee and Attorney-at-Law in Budapest, Chair of Step Hungary, Primus Trust Corp., Petőfi Sándor utca 11. IV. em./18, 1052 Budapest, Hungary. Tel: +36 1 318 41 28; Fax: +36 919 12 80; Website: www.primustrust.hu

1. Act V of 2013, 'On the Civil Code of Hungary', available in English at: https://tdziegler.files.wordpress.com/2014/06/civil_code.pdf accessed 31 January 2016.

2. A Menyhei, 'Estate Planning in Hungary: Private Foundation or Trust?' (2015) 21 *Trusts & Trustees* 652.

3. *ibid* 655.

4. Act XV of 2014, 'On the Trustees and the Rules of their Activities' provides detailed rules on the professional trustee's activity and it has modified the most important acts in connection with the trust framework. The modified acts include: Corporate Income Tax Act, Personal Income Tax Act, VAT Act, Accounting Act, and several other acts in connection with property registration.

offshore vehicles or a combination of a nominee and an option contract in order to provide anonymity for certain legal transactions. These solutions create serious tax consequences with an impact on the legality of the solutions themselves. Therefore, it was crucial to find something new to satisfy the legitimate demand of business life and to meet the trend of tax transparency⁵ all together.

The third factor of the success is that STEP Hungary has played an active role to spread knowledge by organizing conferences and seminars about the international and Hungarian trusts. Moreover, practicing lawyers have summarized the framework in a comprehensive book,⁶ thereby providing a textbook to the recently launched trustee diploma programme.⁷

Despite the fact that several articles and books on the very topic have been published meanwhile,⁸ now in English as well, and that the Hungarian trust framework has been a topic in various international conferences,⁹ some of the international scholars still have not understood the core of the trust framework, denying to recognize it as a special type of trust.¹⁰ In this article, I explain and clarify those elements, which create particular uncertainty in understanding the trust framework.

Trust or fiduciary asset management contract?

Rounds and Illés conclude that although the Hungarian trust is a hybrid of the Anglo-American trust and contractual obligation at the same time, it is neither a type of the Anglo-American trust nor its

clone, but a fiduciary asset management contract which contains certain elements of the Anglo-American trust.¹¹ Their arguments are wrong; therefore, their final conclusion is wrong as well, due to the following reasons.

Historical legal background

A characteristic difference between the continental and common law systems is that in the continental legal systems, the judge does not create but interprets the law. Nevertheless, the continental judicial systems continuously fill the gaps and improve the content of the law while interpreting the acts. It is like achieving the same goal in two different ways. Anglo-American readers must understand that although the continental laws are products of codifications—and therefore, the rules are not judge-made—the codification procedure does not miss the involvement of legal professionals and that it also has its historical roots. The continental legal systems are based on the tradition of Roman law and centuries of development via codifications and judicial interpretations. This results in a vibrant, but at the same time continuous development and the ability of quick correction and reaction to a changing economic environment. It is also important to emphasize that although in Hungary, the Parliament adopts the acts, the terminology of the legislator is much wider as there is a comprehensive system of different levels of lawmaking and codification available, from the scientific suggestions to the professional consultations. May anyone claim that the historical background of the one or the other legal systems is more valuable or that the concept of

5. The trust framework itself and the Hungarian Law as a whole are harmonized with the EU Directives, OECD CRS, FATCA, and FATF recommendations.

6. Szabó, Illés, Kolozs, Menyhei, Sándor, HVG-ORAC, *A Bizalmi Vagyonkezelés (The Trust)* (2014).

7. University of Szent István, <https://szie.hu/bizalmi-vagyonkezelo-szakiranyu-tovabbkepzesi-szak> accessed 2 January 2016.

8. STEP Journal: A Menyhei, 'New Ground for the Trust Concept' <http://www.step.org/new-ground-trust-concept> ; I Illés, 'Hungary and the Hague Convention' <http://www.step.org/journal/step-journal-november-2015/hungary-and-hague-convention> ; Oxford Journals: Estate planning in Hungary: private foundation or trust? Menyhei (n 2) 652–53; I Illés <<http://www.georgemasonjicl.org/issues/> <http://d18wh0wf8v71m4.cloudfront.net/docs/wp/2012/2012-05-Illes.pdf>> accessed 3 February 2016, I Sándor, 'HVG ORAC, Fiduciary Asset Management and the Trust' (2015) http://hvgorac.hu/index.php?route=product/product&product_id=336&search=s%C3%A1ndor+istv%C3%A1n.

9. STEP Hungary Conferences 2013–15; STEP Israel Conference 2014; STEP Global Conference 2014; STEP Europe Conference 2016, ITPA Conference 2016, IFA Conference Budapest 2016.

10. CE Rounds, Jr and I Illés, 'Is a Hungarian Trust a Clone of the Anglo-American Trust, or Just a Type of Contract?: Parsing the Asset-management Provisions of the New Hungarian Civil Code' 6 (2) *Journal of International Commercial Law* 153 2015 <http://www.georgemasonjicl.org/wp-content/uploads/2015/08/6_Geo_Mason_J_Intl_Com_L_153_2015-3.pdf#page=5> accessed 3 February 2016.

11. *ibid.*

bifurcation of ownership (legal and equitable) provides a better solution than the contractual solution? I do not think so.

In the continental legal systems, the judge does not create but interprets the law

The continental legal systems are based on the tradition of Roman law and centuries of development via codifications and judicial interpretations

The question of translation

Implementing the formerly unknown new legal instrument of the trust in the Hungarian legal system has created two problems. First, how to find a new technical term in Hungarian for the new solution and secondly, how to harmonize it with the existing framework. The latter was achieved swiftly as a comprehensive legal environment serves the daily implementation of the Hungarian trust. The former created translation problems. In the early days of the implementation, translators started to use a mirror translation of the Hungarian technical term instead of understanding the true nature and content of the Hungarian trust framework. The mistranslation has created a misunderstanding among foreign readers. The technical term of 'fiduciary asset management contract' does not provide an understanding of the true nature of the Hungarian trust nor of its real content. Generally, neither Anglo-American nor continental readers understand the vehicle, if we use the above translation. Only the correct use of the term 'trust' opens the way of understanding the instrument and lays the ground for the comparison of the different rules.

The technical term of 'fiduciary asset management contract' does not provide an

understanding of the true nature of the Hungarian trust nor of its real content

Sui generis or contractual

To understand the true nature of the Hungarian trust, the decisive element is not how the trust relationship is created but whether it is a *sui generis* or contractual relationship. Rounds' and Illés' arguments are controversial; they agree¹² that the Hungarian trust meets the definition of the trust as defined in the Hague Convention on the Law Applicable to Trusts and Their Recognition¹³; nevertheless, they refuse to recognize the Hungarian trust as a true trust relationship. Their main argument is as follows:

The trust is a substantive product of the coexistence of common law and equity in the Anglo-American legal tradition. That legal title to an item of property can be in X and the equitable ownership can be in Y at the same time is the juristic phenomenon that makes the A-A Trust *sui generis*. It means that a beneficial interest under a trust is more than just a collection of *in personam* rights against the trustee. This bifurcation is generally incompatible with civil law principles, as we have already noted. Thus, a civil law court is tempted to construe the interests of an A-A Trust beneficiary either as a limited property right (like the usufruct) or as a complex set of contractual rights against the trustee.¹⁴

The Hungarian trust meets the definition of the trust as defined in the Hague Convention on the Law Applicable to Trusts and Their Recognition

I believe that this argument is wrong. Although the Anglo-American legal tradition recognizes the beneficiary's interest as equitable ownership, the difference

12. *ibid.*

13. Hague Conference on Private International Law, Convention on the Law Applicable to Trusts and on Their Recognition (1985) <http://www.hcch.net/index_en.php?act=conventions.text&cid=59> accessed 31 January 2016.

14. Rounds and Illés (n 10) 161–62.

between this solution and the contractual approach is negligible in the end. In the case of a legal dispute, the beneficiary must enforce his rights in court in both systems and it does not matter whether the court provides the protection for the beneficiary's interest on the basis of equity or of a set of *in personam* rights. The difference is more theoretical than practical and it is based on form instead of content. The continental legal systems have proven that it is possible to provide the same protection for the beneficiary's interest with contractual *in personam* rights as it is done under the law of equity. The beneficiary's tracing right proves that the difference between equity rights and *in personam* rights is merely a theoretical one. In Hungary, the legislator provided tracing rights for the beneficiary in the form of an *in personam* contractual right. At the end of the day, from a pure practical perspective, both solutions result at the same level of protection for the beneficiary.

Why Hungary does not need resulting and constructive trusts

Rounds and Illés also criticize the lack of resulting and constructive trusts in the Hungarian trust framework. It is a fact that these types of trust relationships do not exist in Hungary. The reason is simple; they are unnecessary in Hungary as other types of legal instruments cover the situations where these types of trust are used in the Anglo-American system.¹⁵

No bifurcating ownership

It is true that the concept of dual ownership is incompatible with civil law principles. The Civil Code prohibits¹⁶ the differentiation between legal and equity ownership. Nevertheless, this prohibition

provides certain advantages as well. It is not a question that the legislator's aim was to clone the Anglo-American trust while at the same time having due consideration of the nature of civil law. Therefore, the only and true owner of the trust asset is the trustee. However, the beneficiary's interests are protected with very strong contractual rights. In the case of legal disputes, these rights are enforceable in court. In Hungary, the trustee is not just a legal owner of the trust asset registered in the public ownership registers,¹⁷ but the beneficial owner as well. It results therefrom that the trustee is considered as the ultimate beneficial owner by financial institutions. Despite this fact, the trustee must act for the benefit of the beneficiary. The reasoning behind the above regulation is that the trustee acts neither on behalf of the settlor, nor the beneficiary. The trustee acts on behalf of himself but for the benefit of the beneficiary. The trustee's ownership is limited in time and in powers by the trust deed and the trust law; nevertheless, within his limited powers he acts as the owner of the trust asset. This is the result of the beneficiary's interest protection method with set of *in personam* rights.

The Civil Code provides only a general guideline

The rules of the contract section of the Hungarian Civil Code are mainly dispositive; therefore, the settlor may diverge from the rules with the exception of a few obligatory rules (any deviation from these is null and void).¹⁸ The Codification Committee's general concept¹⁹ was—while creating the trust section—to provide as much freedom as possible for the settlor to create a trust. Therefore, the trust section of the Civil Code is very liberal and provides only general rules as a guideline or reference point for the parties.

15. The Civil Code provides rules of 'management without mandate' Civil Code 6:583 and 'unjust enrichment' Civil Code 6:579.

16. Civil Code 5:13 § (1).

17. Land, Company, Vessels, Vehicles, and Intellectual Property Rights' Registry.

18. Menyhei (n 2).

19. Prof Dr Attila Menyhár, Member of the Codification Committee, Professor of the Civil Law Department of Eötvös Lóránd University Faculty of Law at the STEP Hungary Conference 2015.

With the result that the Hungarian practitioners, keeping in mind the five obligatory rules,²⁰ started to clone the solutions of the Anglo-American trusts, including among others the rules of irrevocable trust, the implementation of the trust protector's office, and the right to change the governing law.

The Codification Committee's general concept was—while creating the trust section—to provide as much freedom as possible for the settlor to create a trust

Segregation

The segregation of the trust assets is strong, as there is no nexus between the trust property and the trustee's own property or other trust assets managed by the same trustee. Despite the fact that the Civil Code prohibits a shared ownership right, other acts—dealing with the taxation and accounting of the trust relationship—are less rigid from a dogmatic perspective and accept that the trustee owns the legal title only. The trust is a separate and independent entity from an accounting and tax perspective, having its own tax reports and profit and loss statement.

The trust is a separate and independent entity from an accounting and tax perspective, having its own tax reports and profit and loss statement

The Hungarian trust is a 'non-personam' independent legal relationship

The Hungarian trust relationship exists independently of the parties to it. The death of any party or a change

in the person of the parties does not terminate the trust. This feature is fundamentally different from the mandate relationship in the civil law systems.

Charitable trust

Rounds and Illés claim that the Hungarian trust may not be created for charitable purposes.²¹ This statement is a material error. First of all the trust rules of the Hungarian Civil Code are not of mandatory application; therefore, the settlor may diverge from the rules. Moreover, the Civil Code itself provides for direct rules to create charitable trusts as the beneficiary may be described by reference to a class of beneficiaries.²²

Power of appointment

Rounds and Illés wrongly claim that the settlor may not grant the power of appointment to the trustee.²³ This is false statement as well, as the Civil Code—beyond the dispositive rules—explicitly provides that the trustee may have the right to appoint the beneficiary.²⁴

The beneficiary's position

I would like to point out some additional interpretations in connection with the beneficiary's position, which are likewise wrong in my point of view.²⁵ In the Hungarian trust relationship, the settlor's position is very strong; therefore, the settlor may provide for the right of the beneficiary to claim a distribution of trust assets before the end of the stipulated trust period. It is a quasi right of termination given to the beneficiary. The relationship between the trustee and the beneficiary is not merely contractual; some of the

20. Namely, that the trust arrangement must be in writing; that the trustee cannot be the sole beneficiary, that the trust assets must be separated from the trustee's own assets and any other trust assets under his administration, that the settlor and the beneficiary cannot instruct the trustee and the trust period cannot be longer than 50 years; cf Menyhei (n 2).

21. Rounds and Illés (n 10) 154.

22. Civil Code 3:311 § (1) and see the explanation in Menyhei (n 2) 652–53.

23. Rounds and Illés (n 10) 154.

24. Civil Code 3:311 § (1).

25. Rounds and Illés (n 10) 164.

beneficiary's rights²⁶ are a type of *in rem* right. The settlor may grant to the beneficiary the right to remove the trustee, even before the settlor's death/dissolution. Last but not least, it is possible to create a trust for unborn or unascertained beneficiaries as well. The only condition is that the trustee must be able to identify a beneficiary at the time of distribution.

In the Hungarian trust relationship, the settlor's position is very strong

In contrast to the above, the position of the Hungarian foundation beneficiary is not protected with a set of special *in personam* rights in the Civil Code. The beneficiary's rights may be described in the foundation's By-Law, but the Civil Code does not provide any special protection for the beneficiary. Due to the lack of special protection, the beneficiary can only enforce his rights under the general rules of the Civil Code. Comparing the position of a

foundation's beneficiary with the position of a trust beneficiary it seems that the legislative power has favoured the trust over the foundation in Hungary. Nevertheless, as the foundation is a legal entity its working mechanism is well developed from a legal perspective. Using the foundation form for private purposes is a new possibility in Hungary but currently it is not favoured by a tax neutral treatment; therefore, it suffers a competitive disadvantage.

Conclusion

The Hungarian trust is far beyond the civil law contractual relationship. It meets the requirements of the trust definition as provided by the Hague Convention; moreover, it has cloned most of the features of the Anglo-American trust and in practice, due to the Code's dispositive nature, the trust deeds do in most cases deviate from the general rules. The Hungarian trust is a genuine clone of the Anglo-American trust.

Dr. Ákos Menyhei, LL.M., TEP, is a Trustee and Attorney-at-Law in Budapest and Chair of STEP Hungary. He is one of the authors of 'Limits to Tax Planning' (Linde Verlag 2013) and 'The Trust' (HVG-ORAC 2014). His research interests include the implementation of trust in the civil law jurisdictions. E-mail: akos.menyhei@primustrust.hu; www.primustrust.hu

26. For example, the tracing right.