Special Taxes and Public Finance

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Abstract

The system of tax burden has been recently restructured in Hungary, since consumption taxes became to the focus of taxation, furthermore many special taxes have been introduced. This paper focuses on the major matters in which enacted provisions themselves might possibly be deemed as the establishment of the abuse of law occurring on the side of the legislator. Accordingly, the different arguments are presented and related proposals are made as well.

Keywords

Special Taxes, Personal Income Tax, Interest.

1 Introduction

The Hungarian tax system has been modified significantly in the last four years. Many new pieces of legislation were passed and accepted, and the public burden was restructured the way that consumption taxes became to the focus of the tax system, and extra taxes (such as taxes on interest, special income tax levied on income granted as severance payment, banks, advertisement, etc.) were lived on many sectors.

As a result of these procedures, many taxpayers tried to avoid taxation, and they even committed abusement of law. However, regarding the abuse of law and arbitrariness in public financial activities, abuse of law occurred during the legislation procedure as well, and in relation to many pieces of legislation (e.g. new acts on taxes, new types of introduced burdens).

Special taxes introduced by the government may prevent the abuse of law, or result in arbitrariness in public financial activities. For instance, on the one hand, a special tax on interest and a 98% special income tax levied on income granted as severance payment upon the termination of employment may prevent state officers from concluding abusive contracts. On the other hand, it violates human dignity, thus such provisions were repealed by the Constitutional Court in Hungary with retroactive effect.

Additionally, special taxes have been introduced for different sectors of the economy, in order to make the tax system more effective and fair, upon which a significant debate has been going on. This paper analyses the different methods that have been used by the legislator regarding the special taxes from the point of view of public finance, and the behaviour of the taxpayers regarding compliance and tax avoidance as a reaction of the introduction of such taxes.

2 General remarks

Some of the abuse of law derive from the principals of the Act XCII of 2003 on the Rules of Taxation. Among these, the powers of the tax administration play an important role regarding the evaluation of the different private transactions. The revenue office may review the private law contracts, and is entitled to change the taxation consequences thereof. From this point of view, even the invalid contracts and other transactions shall be taken into account from the tax point of view, if they have or carry any economic results. Similarly, the transactions of affiliated companies may be changed from the tax point of view by the tax administration, taking into account the market price, and dismissing the possible tax avoidance measures used through transfer pricing.

Another major field of the relation between financial law and abuse of law is the matter of public-private partnerships. Such developments are commonly used in Hungary on the field of education, logistics, and health care, furthermore in recent years on the field of criminal management. The type of these investments and projects has been strongly debated, because they seem not to achieve the goals thereof. For instance, many prisons (so called private prisons) are run and operated by private companies, which do not reach the aim of providing better service and higher standard of living (for instance bigger place for the convicted felons, nicer facilities, etc). Obviously the state did not have to finance these investments totally at once, but the running service fee shall be provided in certain instalments by the annual budgets, therefore the investment can be financed from different sources and by different budgets through many years.

However, the most debated matter regarding the interaction between public financial activities and abuse is related to banking, the area of bank contracts and transactions. Many Hungarian citizens took foreign currency loans (mostly based on Swiss franc, because the interest rates on these currencies were lower than the interest rates on the Hungarian forint), the repayment of which has not happened to date, and due to the dramatic change of the exchange rates (weakening HUF), the monthly instalments of repayment increased significantly. Thus the government has taken many measures, in order to offer possible solutions for the debtors, whose burdens have increased significantly.

3 The flat personal income tax

Despite the huge criticism that is pointed out in this paper as well, the Hungarian government still believes that the flat tax personal income tax regime shall stay in force and, in order to establish a system that is stable and calculable, shall remain protected by related to qualified majority vote of the Hungarian Parliament. They stated that the new regulation achieved its goal; it provided higher budgetary income (a sum of extra 60 billion HUF together with the health care contribution), stimulated the economy, and promote employment.

However, levying a progressive tax regime may be more advantageous from the point of fulfilling state obligations. The projections of both the parliamentary opposition and the International Monetary Fund show that contrary to the governmental expectations a huge fall will be experienced in medium-term. This argument seems to be correct, if we study the amounts collected from personal income tax payments. According to the Act CXXXIII of 2011 on the Execution of the Budget of 2010, 1,767,865 million HUF was collected from personal income tax payments. In comparison, in the Act CLXIX of 2010 on the Hungarian Central Budget of 2011 a revenue plan of 1,362,977 million HUF is indicated, which is significantly less than fulfilled in 2010, and a sum of HUF 1,574,300 million is planned to be collected for the tax year of 2012 according to the Act CLXXXVIII of 2011 on the Hungarian Central Budget of 2012.

From the point of view of public finances, the additional argument and aim was to increase the revenue deriving from consumption taxes, however, this goal has not been reached yet significantly. Whereas in 2010 an amount of HUF 2,313,582.1 million was collected from VAT payments, and HUF 856,524 million from excise tax, these amounts have not increased significantly in the year of 2011, when the VAT revenue was supposed to be 2,488,964.1 million HUF, and the excise tax is HUF 881,132.9 million. These figures show that the measures taken by the Hungarian government 'have led to less than optimal economic outcomes'. According to governmental expectations and ambitious budget though, the appropriation of 2012, 2,722,000 million HUF is to be collected from VAT, and 913,850 million HUF from excise duties, which amounts, if fulfilled within the tax year of 2012, could prove the success of the modification of the tax system. In this regard it shall be pointed out that the consumption taxes have been increased in the tax year of 2012, out of which the most important change that affects all taxpayers is the raise of the standard VAT rate from 25 to 27 percent, which, in my opinion, together with the cut in personal income tax (e.g. dismissing the tax base extension below the annual income of HUF 2,424,000) might make the tax system more just.

It is a fact that the reduction of the tax rate of individual income tax, as it can be seen from the recent experiences, does not result in a serious consumption increase (neither in 2011, when the VAT rate did not change and the wealthier taxpayers earned significantly more, since the tax burden dropped mostly for those who earned most, nor in 2012 and not due to the higher VAT rate), because income owners will save some of the money that stays with them. It is of course likely that they would spend and consume more, but their total surplus will not be spent in its entirety. The recent results show that consumption has in fact even radically decreased in the first quarter of 2012, according to Gfk Hungaria, the technical consumer goods market index fell radically. In accordance with these, the system effective of January 1, 2011 resulted in rather promoting savings and mostly low risk small or medium range investments, but did not increase the level of consumption extensively.

Unlike the previous progressive personal income tax system, this solution, i.e. the decline of tax rates and competitive taxation and tax amounts is on the one hand in harmony with the connecting international trends, albeit the introduction of flat tax rate is preferably used by East-Central European states, and hardly used in Western countries.

As professor Antal Ádám declared for both the legislator and law practitioners, the maintainable development and the social fairness shall be part of the main goals of the government.

According to the social fairness, the tax systems shall be fair, as well as each types of taxes. This means, regarding the personal income tax, that everybody shall contribute to the public expenses according to their income and wealth situation.

The earlier system of personal income tax following the progressive method was used as follows: the tax payable for revenues creating the consolidated tax base (calculated tax), if the consolidated tax base did not exceed 5 million forints, 17 per cent of the consolidated tax base; if the consolidated tax base is higher than 5 million forints, 850,000 forints plus 32 per cent of the amount over 5 million forints.

The criticism regarding the previous regulation of progressive personal income tax is that it made an obstacle to revenue and wealth accumulation and the process of getting richer. In other words, higher percentage of the income was taken from the wealthier. This raised the issue of social fairness for the group of society with higher amount of income: they took a bigger part of building the society and financing thereof, since they provided a higher amount for the public revenue both nominally and proportionally. However, they were entitled to less exemptions and/or credit and received less state transfers and government subsidies or financial support than the poorer taxpayers, therefore really they paid the costs of maintaining the society.

Taking into account these arguments, the opponents of progressive taxation stated that a flat system would be more optimal, since all the groups and taxpayers of the society take part the same rate in contributing to public funds irrespectively of their amount of income. Obviously their nominal contribution differs, and the wealthier pay more, but the same proportion, which might sound fairer than taking more proportion of their income. This could lead to a more balanced and proportionate tax payment system: the taxpayers of higher amount of income pay more anyway, taking part in contributing to public funds according to their ability to pay, and receive more indirect counter services. Furthermore, as another strong reason of the government that led to the introduction of flat tax, is that the reduction of the marginal tax rate promotes employment.

The flat tax provides a stronger motive for the taxpayers to realize higher amount of income, since they can achieve a higher amount after tax in case they invest more energy to make higher revenue. Thus despite their tax due is higher, still a higher amount can be used as per their sole decision.

In the progressive structure it is not worth to the taxpayer to invest more energy in obtaining higher amount of income, since the amount taken as tax is proportionally higher as well. In other words, it establishes a psychological limit to the activities out of which income is derived. For instance, there is no another additional job is taken by the taxpayers, or no other grants are taken by them if they get to a higher tax bracket accordingly, and have to pay a higher percentage therefore, and, at the end of the day, because of this deduction, they take less money home. The higher tax rate increases the level of redistribution, but decreases the employment rate, and progressive tax levies a higher rate of tax on the higher income, therefore it seems to punish the hard working taxpayers.

The theoretical base of progressive income tax is that 'increasing income is connected to declining margin of profitableness'. Progressivity obviously favours those with a medium income level albeit many think it rather enhances justice, but it undoubtedly decreases the revenue of those with a high revenue in a higher proportion. This, on the other hand can be achieved by an appropriate tax reduction system in a linear system too.

The recognition that progressive income tax has a negative effect on performance led to the practice of reducing and unifying tax rates, the relatively low and nearly proportionate income taxation. One of the most competitive practical forms of these is applying a flat tax rate.

The definition of tax amount in such a way and its codification as a legal regulation has been present in its current form in the developed world as a key element of competitiveness and eventually became a general international trend. I believe this is part of the universality and unification process that has been marked and elaborated by Antal Ádám as 'some coordinated economic actions of developed countries as well as some important and well-designed financial activities of global or regional financial management concentration stimulators deserve acknowledgement.'

The Hungarian tax system including the personal income tax system was characterized by progressivity and complexity. The first signs of the introduction of the flat tax rate were already marked by the trends of decreasing the number of tax rates, reducing the upper rates and the extension of the tax base. The legislators, observing the examples of other East-Central European countries (e.g. Slovakia, Estonia, Latvia, Romania) believed that the goal of tax payment is easier to reach by defining a wider tax base and lower tax rates, because more people will be willing or at least become readier to pay tax, thus not only the constitutional principle of tax payment, but also the basic principle of the personal income tax law will be applicable at a much higher level and government revenues may also increase significantly.

The parliamentary opposition emphasizes that the flat individual income tax is harmful for the fiscal growth and federalism, generates huge budgetary deficit, furthermore made the existence of millions of the lower classes much harder and decreased the employment rate, and basically this has been established by the International Monetary Fund as well: Hungary's design 'added to bureaucracy, and overly burdened the most vulnerable'. The flat tax rate system indeed favours the rich of society. Considering that in comparison with the previous 17 per cent lower rate the current tax rate is no real decline, but there is a significant change against the previous 32 per cent upper level rate, this statement seems to be justified. This decline produced serious tax revenue cut on the government budget side, but this was not balanced by the reduction of allowances, additionally, as the current study later states in detail, these allowances have even been extended, although the basic tax allowance has been eliminated, so 'people pay taxes from the first forint they earn'.

In this regard it is important to note the solution too that several employers have used recently. Using the advantages of lower taxation level the gross salary of employees was reduced and the company saved some of its business costs. By this method it was not personal income taxpayers who got into a more favourable situation after the amendment effective of January 1, 2011, but enterprises and market players that could take this chance. Therefore, it was not defenceless employees who enjoyed the advantages of lawmaker's goal, but due to work contracts amended by "joint agreement" it was actually employers that benefited, although they would not have been preferred by the legal regulation. Naturally the business effect of the personal income tax decline is undoubtedly positive even by this solution, also considering that the increase of employment and the decrease of unemployment under the EU average are only feasible by the reduction of tax and contribution levels. These practical solutions show a good example of the two options used in the European Union: high personal income tax and low contribution level (see e.g. Danish model) or lower personal income tax rate for employees and high contribution burden for employers (e.g. in Germany and France).

Based on the above mentioned facts it is obvious that the amount of personal income tax paid by Hungarians in the same economic position may greatly differ. The tax base of contracted revenues must be defined by tax base extension (by adding 27 per cent of the revenue to it, i.e. creating a gross revenue or as people say in Hungary a "supergross" revenue for the annual income exceeding the sum of HUF 2,424,000). Thus, the real tax payment level is 20.32 per cent for revenues in the consolidated tax base, not respecting whether those arise from independent or non-independent activities or other sources. Revenues taxed separately, but are not taxed under this tax base extension; the real calculated tax of such revenues is 16 per cent of the income.

Based on the above mentioned, the difference is not only the accessibility of reductions or the 4.32 per cent in figures, but also the opportunity to deduct allowances and the non-identical status of other contributions. The lawmaker taxes certain revenue types differently depending on the actual business activity and taxpayers have different chances above these to optimize tax payment.

It is essential that business players react on taxes. High and progressive taxes cut back performance and will not stimulate production. The studies show that Hungarian taxpayers unilaterally vote against tax rises especially regarding value added tax and the personal income tax. In connection with the personal income tax taxpayers have a rather narrow field of options to plan their taxes, even though many authors represent a counter opinion. Especially public sphere employees have an even narrower option to commit tax fraud.

Although the personal income tax is a central and direct type of tax, the Hungarian personal income tax system functions as an indirect tax type considering its operation mechanism. The tax to be paid, i.e. its foreseeable amount is deducted already by employer, when the salary is transferred to employee and the tax advance is paid to the tax authority. As a result, taxpayer will only receive the net salary amount reduced by its tax content together with a certificate, in which employer states how much has been paid for employee who will prepare the tax form in accordance with such data. Those who are involved in this structure have few options to commit tax fraud, because they have no chance to avoid tax payment or hide income, due to the burden of proof and documented evidences.

A single linear tax rate will stimulate taxpayers less to hide their income, or in a given case to use legal, but expensive tax evasion methods. Beyond not making the pursuing of activities appealing, high tax rates encourage taxpayers to search for legal and illegal ways of tax evasion (the back door methods, such as the long-term investment account, the calculation of cost invoices for individual entrepreneurs, or when real estate or other property is sold). I believe that tax planning is by no means harmful, but its wide option much rather promotes that taxpayers accept tax law, because taxpayer is happy to pay less tax feeling that implicitly he/she received more money or actually more stayed in his/her pocket. This will mean more revenue for the state or eventually in terms of the personal income tax for the central budget or as a final destination for the local municipalities, than as if with regard to the high tax payment obligation or by some tax fraud techniques, such as black or grey employment, no revenue would flow in or the tax base would be significantly lower due to hidden incomes.

In harmony with this, I believe that a company owner who is also employee of his enterprise, e.g. a limited liability corporation, can even morally not be condemned, if he works for a lower salary and takes the produced asset from the company as dividend. As contributions are high in a European comparison, less money is deducted from him in such a case. If the owner receives this sum as a salary, then according to the above mentioned rules of tax base extension the real tax burden is 20.32 per cent for the part of income exceeding the annual amount of HUF 2,424,000 and 16% for the sum below that, while if the sum is taken as dividend, it is taxed by the rule of separately taxed income and the addition of gross amounts will not increase the tax base and the real calculated tax will be only and purely 16 per cent of the income. Staying with this very example I claim that the taxpayer does not commit tax fraud, but reduces the calculated tax by tax planning, though I do not dispute that it is a prevalent tax evasion if only the minimum wage income is declared contrary to the real situation. For the latter case, the IMF pointed out that the minimum wage hike, introduced by the government, reduce this type of tax fraud, and therefore shall be deemed good measure.

The level of compliance with tax law may also rise, if the method of tax obligations, i.e. the declaration liability is simplified. Preparing a tax form actually means a serious challenge for the average taxpayer and the complicated preparation guidelines may even cause problems for experts, while it may be fully incomprehensible at some points for lay people.

In practice, the option of tax declaration is open from 2012, which really simplifies the preparation of a tax form. From the tax year 2011 taxpayers may fulfil their declaration obligation by this instead of submitting a proper tax form. An individual can make a tax declaration according to the personal income tax law Section 11/A, if he/she has no liability or did not take any benefits that would require the preparation of a tax statement by employer or a tax form. Besides that the law highlights three application circles with defining further conditions. The first is that in a tax year the individual's total income should come from a single employer that also stated the tax advance and the difference of the deducted tax/fax advance and the real calculated tax to be paid would not be higher than HUF 1,000 in the tax year.

The second criterion is that in the tax year the taxpayer may only have incomes from companies that did not surpass the limit of HUF 100,000 per payment.

The third category is the combination of the first two: if in the tax year the individual received income from employer(s) that stated the tax advance in a way that the difference of the of the deducted tax/fax advance and the real calculated tax to be paid would not be higher than HUF 1,000 in the tax year, but besides this the individual only had incomes from other companies that did not surpass the limit of HUF 100,000 per payment.

4 Reducing retail mortgage debts as abuse of law

Most of the loans for housing (e.g. loans to finance purchase of real estate) were taken in foreign currency, and due to the significant and dramatic change of the exchange rates, many debtors are not able to pay the increased monthly instalments. This huge amount of debt is a clear obstacle for state growth, what is more, parallel the state debt has increased considerably as well in the last eight years. The Hungarian government, taking into account that the high proportion of foreign-currency-denominated home loans of the Hungarian population is one of the most serious economic, financial and social problem of the state, has been constantly searching for the solution of this matter, and therefore different measures were taken in the last three years, affecting civil law relationships with financial law measures.

A new set of provisions entered into force on 27 November 2010, in order to provide aid for the debtors. Accordingly, the middle rate or the official rate of exchange determined by the Hungarian National Bank shall be applied by the credit institutions for loan repayments, the opportunity shall be provided for advance repayment for a small commission only, and the term of the loan can be prolonged once with an additional five-year-term in case the debtor is in at least in ninety days of delay in payment. The credit institutions furthermore may increase the rate of interest by unilateral decision in compliance with strict rules, and no further modification of contract may be enforced unilaterally either.

In order to reduce the amount of debts of the population, and to make the debtors able to get rid of their foreign currency loans for a reasonable amount, the government enacted the possibility of repayment on a fixed exchange rate. Therefore the main measure was firstly to fix the exchange rates between the different currencies, in order to stabilize and make the position of the debtors more calculable. Hence the loans taken in CHF could be paid back on fixed exchange rate of HUF 180, the EUR based loans on the fixed exchange rate of HUF 250, and the JPY on HUF 2.5 for a temporary period of maximum sixty month.

Additionally, the opportunity for an entire repayment was provided as well. The final repayment opportunity was open for the entire sum of loans in a single instalment at a fixed exchange rate without any extra commission from 29 September 2011. From that date the debtors could apply for a final repayment based on the fixed exchange rates. The declaration had to be submitted until 31 December 2011, the existence of the related assets had to be proved until 30 January 2012, and the total repayment had to be made until 29 February 2012. The fix exchange rate in that regard was HUF 180/CHF, HUF 250/EUR, HUF 2/JPY. The employers could even provide financial aid to their employees for the maximum amount of HUF 7.5 million, for which tax exemption was provided. According to the data of the Hungarian Financial Supervisory Authority, 169, 256 debtors repaid their forint currency loans of the total amount of 1,354 billion HUF on the fixed exchange rate, thus the total forint currency loan amount was reduced with about the quarter thereof.

Since many of the debtors could not use this opportunity to repay their debts in a reduced amount in one instalment, the deadline was prolonged to request the fixed exchange rate applied for each monthly instalment until 30 June 2017 latest. The essence of the method is that the difference of the effective and fixed exchange rate is financed by a HUF based loan, the guaranty of which is the same real property that serves as the guaranty of the basic loan. The state undertook joint and several liabilities for the difference. Accordingly the capital should be paid at the market exchange rate, but the interest only on this fixed rate, and the difference is put on this extra separated account functioning as a HUF based loan. The amount loaned on this extra account should be paid back without any interest, since the interest is born equally by the state and the banks. Above a certain market exchange rate the difference is paid by the central budget. The debtor is entitled to offer a higher monthly installment, and encouraged by the state to find the best solution according to a mutual agreement by the credit institution. Further advantages are provided for public servants.

The latest legal step in this regard was that the National Assembly accepted the act on amending the related legal provisions in order to provide further aid to the foreign currency loan debtors, which makes the participation in the fixed exchange-rate program possible to those clients who are in more than 90 days of delay regarding the repayment of any instalments.

5 Special tax on interest

Since 1 August, 2013, a new type of tax burden is applied for interest. Above the 16% personal income tax (as analyzed above), a 6% health care contribution is levied on income deriving from interest. This amount shall be deducted from the interest to be credited on the owner's account. The Act LXVI of 1998 on Healthcare Contributions states that it was adopted by Parliament, in order to ensure financial cover for health care services provided on the basis of the principle of solidarity and, furthermore, with a view to enforcing the principle of equal tax treatment. Accordingly, it is necessary to pay the specified health care contribution, which is a tax-like payment obligation determined as a percentage, in order to supplement the funds required to finance the health care services specified in the effective regulation.

Thus the aim of the regulation is to enforce the principle of proportionate contribution to public needs, furthermore to provide the funds necessary for the health care services of those who are entitled for such services according to principle of solidarity.

Such contribution regarding interest is an extremely new piece of regulation in Hungarian law, since no financial burden was applicable in the legal system earlier for such types of income; such contribution was payable and due mainly in connection with income that is part of the consolidated tax base (e.g. 27% for wages and similar remuneration). The types of income, which do not belong to the consolidated tax base and shall be taxed separately or individually (e.g. the amount of specific defined benefits other than non-wage benefits, dividends and entrepreneurial dividend base, capital gains income, and income from real estate rental in excess of one million forints) were only burdened 14% of health care contribution until the aggregate amount of health insurance contributions in kind and in money paid and the percentage healthcare contribution paid upon these types of income reaches four hundred and fifty thousand forints for the year in question.

According to the new provisions set forth in Section 3/A of the Act LXVI of 1998 on Healthcare Contributions, the resident private individuals covered by the social security or, if the responsibility to pay income tax is delegated upon the payer under the personal income tax act, the payer shall be liable to pay 6% health care contribution on interest income (excluding interest income or interest exempted under the personal income tax act) comprising part of the tax base; furthermore on the time deposit interest defined by the personal income tax act, if the term deposit under the long-term investment contract is interrupted before the last day of the three-year term deposit.

However, exemption is provided from health care contribution for interest income, if the tax rate is zero per cent; interest income earned in connection with interest or dividend paid on debt securities issued by any EEA Member State covered by the Personal income tax act (denominated in forints, or interest income earned upon the redemption, repurchase or transfer of such securities); interest income earned in connection with interest or dividend paid on collective investment instruments, or interest income earned upon the redemption, repurchase or transfer of such collective investment instruments, if detailed conditions apply.

It is important that, in compliance with the relevant provisions, the amount paid accordingly, shall be spent only on health care services, so what is generated from these payments can not be used differently, health care contributions shall comprise the revenue of the Health Insurance Fund (hereinafter referred to as the Health Fund). Accordingly, these funds are excluded from the state budget, and the detailed regulations on the appropriation of such revenues are laid down in another act. The tax authority shall transfer payments of health care contributions to the Health Fund on a continuous basis.

Despite the new provisions take into account some of the counter arguments against flat personal income tax rates, the new regulation is still criticized heavily. The most important element of this criticism is that the new provisions might cause confusion. It is obvious that no health care contribution may be related to interest, so the new total burden should be included in the personal income tax act. In fact, the confusion is not a practical matter, it is purely and simply just a theoretical issue. Since the personal income tax and the health care contribution are deducted from the interest by the credit institutions (e.g. account keeping banks) the taxpayer has no obligation to assess neither the income, nor the amount of tax and health care contribution. When the interest is credited on the account by the credit institution, the total amount of burden is deducted automatically and simultaneously, so practically only the net amount of interest is credited on the account. The deductions are indicated on the bank statements, which serve also as proof for having paid the necessary amounts. The taxpayer does not even have to indicate the interest and the amount of paid burdens in his tax return to be filed after the tax year.

For a lay person, the new provisions would not trigger the technical background of the credit institutions. However, due to the complexity of the new regulation, the credit institutions had to modify their IT systems dramatically. Since different provisions shall be applied for the different investments (e.g. bank accounts, bonds, etc.), the credit institutions had to order additional elements for their IT systems, in order to be able to comply totally with the new rules. This resulted in huge amounts paid to IT services for developing the technical system, the testing took a lot of time and effort, and that triggered a lot of extra work for the employees as well. This expenditure of the credit institutions will be paid back indirectly by the taxpayers, since the bank fees have increased notably.

Besides, the credit institutions realized extra revenue from the transactions triggered by the new regulation. As discussed below, many long-term investment contracts were concluded and many long-term investment accounts were opened due to the new provisions, in order to avoid the payment of health care contribution. Furthermore the new transactions in connection with long-term investment accounts are necessary to be done, because entry and other kinds of securities, other managed funds and bonds cannot be simply transferred to the long-term investment account, but they have to be sold first and then bought back on the new account. This definitely generates a high amount of commission for the credit institution. The long-term investment account, in order to achieve the goal of tax exception for the year 2013 as well, had to be created until 31 July 2013 (the health care contribution shall not be applied for the accounts opened until that date, irrespectively whether they are terminated within the first three years), and the related transactions shall be made until 31 December 2013.

Another consequence of the new set of rules is that the bank contracts and the regulation thereof might be slightly changed in the new Hungarian Civil Code which is being recodified and will enter into force on 15 March 2014. For instance, the provisions on modification, termination and cancellation of the loan contracts will be bound to stricter rules.

However, as referred to above, there is a chance and opportunity for tax planning. The provisions provide exceptions for the interest credited upon contracts concluded before 1 September 2006. Furthermore certain amount of interest are also exempted from tax, for instance the interest received by a foreign resident taxpayer. Furthermore, in order to increase the proportion of the internal financing of state debt government securities and investment certificates are also totally exempt from tax.

It is important to note that both the personal income tax and the health care contribution on interest are levied on the income derived from 'interest', thus similar remuneration, which is regulated elsewhere and does not qualify as interest according to the personal income tax act is exempt from tax as well.

The long-term investment account is a kind of savings account which can be opened for investments and savings that is not effected by any transactions within three or five years after the opening year. Thus the year of opening qualifies as year no. 0, within which all the amounts should be credited (amounts transferred, securities, funds and bonds bought) until 31th December. After that the term starts and if no transaction is made for five years, total tax exemption is provided for both the personal income tax and the health care contribution.

The other deadline is related to a three-year-term, because after three years one transaction is permitted without the termination of the account, and the amount can be utilized with reduced rates of taxes: 10% personal income tax, and 0% of healthcare contribution is levied on the transaction. However, in case any transaction is made within the first three year period, the account is terminated automatically according to the law, and both the personal income tax and health care contribution shall be paid in full amount.

The other possibility to reduce the amount of tax to be paid is the controlled capital market transactions. However, this possibility may be used for the tax year of 2013, but the referred provisions will not be effective from 1 January, 2014.

6 Summary

The Hungarian personal income tax system used to be a progressive scheme since its introduction, and turned into a flat tax rate system from the tax year of 2011 in order to follow the trends of the region and primarily to keep Hungarian economy competitive. The amendment aimed to promote employment, to raise government income by decreasing the level of black market, and to generate production through extending consumption. These could imply and effect higher level of employment, as well as more state revenue deriving from additional consumption taxes and corporate income tax payments.

The set of rules result a completed tax burden, since in addition to 16% of personal income tax an additional 6% health care contribution shall be paid. The reason for the method of regulation might be that the government sticks to the flat personal income tax regime despite the huge criticism, however, due to some of the arguments and reasons of fairness, the real tax burden on capitals is increased. In other words, the flat personal income tax system remains in force, however with an additional payment obligation the different types of income are taxed differently in reality from the economic point of view.

It is understandable that every amendments of a type of tax affects the entire tax system, and therefore should be handled accordingly, furthermore that all the outcomes of such modifications can be judged properly only in a long run. At this stage it is clear, that according to the recent results and the described critiques, the goals mentioned above have not been achieved yet through the new structure. In spite of this, it is also unquestionable that some of the changes — such as the reduction of tax amount and the taxation level, as well as the simplification of due tax performance — offer many advantages for taxpayers, which can be used mainly by those who realize higher levels of income.

Therefore I do believe that further measurements and amendments are required by taking into account the other types of taxes, as well as fiscal matters. Despite the tax to be paid after labour income has dropped, with regard to the provisions of tax base extension it remained higher than the tax of capital revenues, and many taxpayers contribute more than they were obliged to. Taking into account the Hungarian characteristics and special features of personal income tax operation in Hungary, but also analysing international experiences, the system would be worth correcting, and in order to establish an optimal structure, a greater emphasis should be laid on the investigation of levels of compliance, the potential techniques of tax evasion, and primarily the operation of the entire tax system also from fiscal point of view.

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