

PREPRINT

Megjelent kötet:

Ercsey, Zsombor

Tax Reforms in Hungary

Pécs, Magyarország : Harthmedia Kft. (2015) , 149 p.

ISBN: 9789631228465

Zsombor Ercsey

Tax Reforms in Hungary

Contents

- 1. Introduction..... 5
- 2. Tax law and tax system..... 11
 - 2.1. The aim of taxation..... 11
 - 2.1.1. Tax payment obligation in theory 12
 - 2.1.2. Tax and fairness..... 12
 - 2.1.3. Tax incentives and equity 14
 - 2.1.4. Sense of taxation rightness 15
 - 2.2. Tax exemption for the minimum of subsistence..... 16
 - 2.2.1. Underprivileged groups of modern society..... 16
 - 2.2.2. History of the doctrine 16
 - 2.2.3. The minimum of subsistence level 17
 - 2.2.3.1. Measures: wealth or income..... 19
 - 2.2.4. Exemptions 20
 - 2.2.4.1. Personal exemption..... 20
 - 2.2.4.2. Other exemptions..... 22
 - 2.3. Progressivity debate: flat tax and progressive tax 25
 - 2.3.1. Theoretical approach..... 28
 - 2.3.2. The concept and types of the income 31
 - 2.4. Methods of tax reform 34
 - 2.5. Tax harmonization..... 36
 - 2.6. Environmental taxation..... 37
 - 2.7. Proposed innovative measures for tax systems..... 38
- 3. Tax regulation..... 42
 - 3.1. Some major issues of value added tax 42
 - 3.1.1. The functions of taxation and value added tax..... 42
 - 3.1.2. Equity and fairness 44
 - 3.1.3. Simplicity 46
 - 3.1.4. Efficiency 47
 - 3.1.5. Rates 49
 - 3.1.6. Exemptions 50
 - 3.1.7. VAT reform 52
 - 3.2. Personal income tax 55
 - 3.2.1. Tax rates 55

3.2.2. Deductions, exemptions and tax allowances	63
3.2.3. Burdens on interest	65
3.3. Local government units	69
3.3.1. Scope of authority of local and regional self-government units and their revenue	72
3.3.2. The revenue of local and regional self-government units	74
3.3.2.1. The Property of the local government units	75
3.3.2.2. The budget of the local governments	78
3.3.2.3. Handling the debts of the local self-government units.....	81
3.3.2.4. The financial resources of the local self-government units	82
3.3.2.5. State subsidies.....	82
3.3.2.6. Own revenues.....	83
3.3.2.7. Shared taxes	84
3.3.2.7. Concluding remarks.....	86
4. Practical issues.....	91
4.1. VAT matters.....	91
4.1.1. Deduction of input VAT	91
4.1.1.1. The right to deduct input VAT in case of an error of an invoice	91
4.1.1.2. Deduction regarding a reverse charge regime	95
4.1.2. Application for VAT refund.....	99
4.1.2.1. Application for the refund of excess value added tax.....	99
4.1.3. Concluding comments	102
4.2. Interaction of private and financial law in Hungary.....	103
4.3. The government measures to reduce retail mortgage debts	104
4.4. Practical anti-avoidance measures taken recently in Hungary	107
4.4.1. Tax planning	107
4.4.2. Procedural issues.....	110
4.4.3. Recent experience	113
4.4.4. Legal background.....	116
4.4.5. Tax control unit	117
4.4.6. The usage of the new technical devices.....	118
4.4.7. Direct control.....	119
4.4.8. Concluding remarks.....	120
5. Summary.....	122
6. Bibliography.....	140

1. Introduction

Tax fraud, tax evasion, and tax avoidance are serious problems for all tax systems.¹ Taxpayers always want to find the ways of avoiding tax payments, in order to reduce their tax liabilities. Unfortunately, from a global perspective and in an international comparison, tax avoidance is high in Hungary. Hiding the real and actual turnover is the most effective way to hide income, or even certain proportion thereof, furthermore to avoid VAT obligations as well.² Therefore one of the most common methods to avoid taxes is the business performance (providing services and/or selling goods) without an invoice.³ This activity, the failure of issuing an invoice is sanctioned by Paragraph (2) of Section 172 of the Act XCII of 2003 on the Rules of Taxation.⁴ However, in case the volume of income is followed and controlled precisely, the proportion of black market and the level of tax avoidance may be reduced significantly. Additionally, the control and monitoring of income is cheaper and easier to achieve, thus it is a much more effective way to fight against tax fraud and tax avoidance.

This paper focuses on the role of innovation in taxation and tax systems. The social aim of taxation is analyzed, and the related issues are reviewed. The different ways of tax reforms are drawn up, and proposals are made regarding what kind of innovative measures have to be taken, in order to achieve an effective tax system that makes the state and the residents thereof, as well as the economy, public administration, and the whole society possess competitive advantage. The paper explains in detail that, in our opinion and taking into account the international trends, the main goal of innovation should be to form a simple, comprehensive, transparent tax system with just a few tax rates and simple way of filing tax returns.

Regarding the interaction of private and financial law in Hungary, the burdens levied on interest are analyzed in detail as well. Accordingly, the practice and provisions of the Hungarian

¹ Prebble R.: Does Croatia need a general anti-avoidance rule? Recommended changes to Croatia's current legislative framework. *Financial Theory and Practice* 29/3, p. 211

² Krekó, J. – Kiss, G. P.: Adóelkerülés és a magyarországi adórendszer. [*Tax avoidance and the Hungarian tax system.*] MNB-tanulmányok 65. [*Essays of the Hungarian Central Bank, no. 65.*] p. 36

³ Note that especially regarding services, this is materialized in the cooperation of the seller and the buyer, which aims the avoidance of tax liability. By this behavior, both the VAT, and the income tax (e.g. personal income tax regarding private entrepreneurial, and corporate income tax of enterprises) may be avoided. Accordingly, even the personal exemption regarding VAT can be applied for, which makes this phenomenon even more harmful for the economy.

⁴ 'Taxpayers may be fined up to one million forints for any failure to meet the obligation to issue invoices, simplified invoices or receipts, or for issuing invoices, simplified invoices or receipts for an amount other than the actual consideration received. Taxpayers shall be fined up to one million forints for employing a non-registered employee currently or previously. If the taxpayer has complied with the obligation of notification of any new employment contract before the commencement of the audit in respect of the entire duration of employment, the tax authority shall proceed in accordance with what is contained in Subsection (6), or in Subsection (21).'

personal income tax system and the health care contribution are in focus. In order to provide a wider picture, the related problems of the mortgage debts are also presented together with the new applicable regulation and financial law measures taken by the government.

The regime of value added tax (hereinafter referred to as the VAT) is analyzed through some important matters, such as the functions thereof, equity and efficiency, rates and exemptions. Some ideas concerning the VAT reforms, as well as few common features and related lessons of the different VAT structures are drawn up. It is shown that the aim of increasing government revenue can be achieved on the ground of fairness, efficiency, simplicity and transparency by a carefully designed VAT.

Indirect taxation has become more and more important over recent decades and years. Accordingly, the value added tax (hereinafter referred to as the VAT) has become a revenue-producing mainstay and the main source of government finance in more than 120 countries on five continents⁵, in both the developed and developing world.

The VAT, in my opinion, is one of the most effective, fair and simple measures of increasing government revenue. Therefore, it has spread to most countries throughout the world and has become the major sources for government finances in many of them. It is generally accepted that the VAT can be even more efficient than income taxes, affects the savings decisions of the individuals, and the whole system of consumption there through. Furthermore this is the type of tax that was chosen half a century ago as the preferred consumption tax for the European Economic Community in part due to the perceived advantage thereof in dealing with cross-border sales within a single economic community.⁶ Accordingly, the European Union wanted potential new members to charge at least a minimum VAT rate as a condition of accession.⁷ Thus a neutral and transparent turnover tax system has been established and the standard VAT rate must be at least 15%, and the reduced rate⁸ at least 5%.⁹

⁵ Graetz, Michael J.: 100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System. In: Yale Law Journal 2002/11, p. 283.

⁶ Krever, Richard: Value Added Tax and Direct Taxation: Similarities and Differences. In: British Tax Review 2010/4, p. 393-394.

⁷ McGee, Robert W.: The Philosophy of Taxation and Public Finance. Kluwer Academic Publishers, Boston/Dordrecht/London, 2004 p. 105

⁸ Only for supplies of goods and services referred to in an exhaustive list.

⁹ The actual rates applied vary between Member States and between certain types of products. In addition, the Member States have retained separate rules regarding specific areas.

Additionally, for instance, in the United States ‘a new federal consumption tax, imposed at a rate of 10% to 15%, would finance the costs of eliminating more than 100 million American families--almost 90% of all filers--from the income tax rolls’.¹⁰

When any type of tax, including VAT is introduced, pros and contras are taken into account also regarding compliance matters. It is obvious that there are various taxpaying motivations, and there are different reasons why people pay their taxes. Many, taking into account the possible audits and the related fines, pay only when the cost of noncompliance¹¹ outweighs its benefits, others want to avoid feelings of guilt or shame, or want to comply with the provisions just as in all situations.¹² Tax fraud and the related corruption, however, regarding VAT and especially VAT refund is much more difficult to recognize and investigate, furthermore it is much more significant from the fiscal point of view.¹³ Besides, the effectiveness of any type of tax, including VAT, depends upon efficient administrative audit, in order to ensure compliance.¹⁴

In most tax regimes the two most important tax bases, direct taxes on income and value added taxes on consumption are simultaneously in force, although their operation differs significantly. Income tax imposes tax on income transactions, while VAT is collected on a transaction basis. Therefore, the VAT hidden for the average people, since the ultimate consumer does not know what proportion of the paid purchase price is the tax,¹⁵ and the consumer may blame the seller or service provider for charging a huge amount (even if the portion of tax is high). Additionally, many experts (e.g. Ballerini, Marc, Lehmkuhl) believe that VAT, as an indirect tax, is purely penal.¹⁶

In case higher tax burden is levied on consumption (for instance, higher VAT rates are enacted), taxation of savings might be reduced, and the taxpayers have a wider discretion opportunity for their own decisions.

¹⁰ Graetz, Michael J. op. cit. 286.

¹¹ The cost of tax compliance, on the other hand, includes the costs of tax record keeping, reporting, filing the tax return, and planning along with other costs.

¹² Raskolnikov, Alex: Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement. In: Columbia Law Review 2009/5. p. 689.

¹³ Szilovics, Csaba: Csalás és jogkövetés az adójogban. Gondolat Kiadó, Budapest, 2003 pp. 185-187.

¹⁴ Schenk, Alan – Oldman, Oliver: Value Added Tax: A Comparative Approach. Cambridge University Press, New York, 2007 p. 17.

¹⁵ McGee, Robert W. op. cit. p. 180. and 192.

¹⁶ Crowe, Martin T.: The Moral Obligation of Paying Just Taxes. The Catholic University of America Press, Washington, D.C., 1944 pp. 72-77.

The VAT in the European Union is a general, broadly based consumption tax¹⁷ assessed on the value added to goods and services¹⁸. It applies more or less to all goods and services that are bought and sold for use or consumption in the European Community.

Regarding the introduction of VAT regimes, certain major issues arise, such as the VAT refund and the related conditions concerning the application for that, furthermore the right to deduct input VAT. Let us review these matters as per the Hungarian regulation and the related EU perspectives.

This paper analyses the recent trends and experiences of the Hungarian personal income tax, since a flat tax regime has been introduced in order to make the system more effective by reducing the tax burden, and to simplify the taxation, especially the tax obligations, including the assessment. Accordingly, the different types of income and some of the most important related matters (e.g. tax base, tax rates, and credit) are reviewed basically, mainly from the point of view of fairness and efficiency. The issue of the just taxation and a just tax system is very complex, should be examined by taking into account all types of taxes and the fiscal consequences, which obviously can not be dealt with in detail by this paper, due to lengths limits. Therefore it focuses on the matter of a personal income tax regime that may achieve a higher level of fairness, evaluates the arguments and practice of the currently effective individual income tax regulation, and points out the interconnected matters thereof. Just taxation and an appropriate personal income tax regulation is based on the ability to pay principle and proportionality, both of which are set forth by the Hungarian tax system as well. The key issue regarding this approach as per the Hungarian provisions in force is the difference of the progressive and flat tax regime, upon which the ongoing debate is still heavy, due to budgetary issues and functional matters. Therefore, the paper scrutinizes the advantages and disadvantages of the operation of the new system, highlighting the impact thereof on public revenues and tax complying matters.

In my short paper I wish to analyze the theory of tax exemption for subsistence level and the related major issues, such as the conditions of the individual taxpayer as legal grounds for certain further exemptions. My analysis will cover fairness and other characteristics of the different types of tax systems, focusing in general mainly on two major issues: flat and progressive regimes.

¹⁷ It is borne ultimately by the final consumer, and not charged on the enterprises.

¹⁸ Accordingly, charged as a percentage of price.

According to some views, any tax that achieves the desired and anticipated economic impact may be considered fair. The Hungarian positive tax system, similarly to others, is justified by the Constitution which states that everyone must participate in the settlement of public expenses in accordance with their capabilities. Accordingly, the tax system is based on the principles of fairness and equality, therefore taxation should be the least property limitation. Tax on personal income is the instrument of tax policy that with its inevitable fiscal objective has a much more important objective of a social nature-alleviate regressivity of VAT. Most financial scholars, lawyers or economists, agree that the principle of fairness is tried to be put into practice just by applying progressive tax rates on income. In Hungary, though, a flat personal income tax system has been introduced, also in order to increase the level of fairness. Thus this paper analyses the new Hungarian personal income tax system, by focusing on the different types of income, tax base, and tax credits, and also comparing that to the Croatian approach. The other issue of taxation that is scrutinized is the formation of an optimal tax burden, which means a continuous balance searching. This procedure and the related arguments are presented in this paper.

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,¹⁹ 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.

This paper analyses a few cases decided by and pending in front of the Court of Justice of the European Union regarding the Hungarian VAT scheme. Accordingly, the most problematic matters are examined in this regard, such as the deduction of the input VAT and the conditions of tax refund.

The right to deduct input VAT in case of an error of an invoice and regarding a reverse charge regime, furthermore the application for refund as per the corresponding Hungarian law and according to Council Directive 2006/112/EC are discussed in detail regarding two most recent related judgements of the Court of Justice and an application filed by the European Commission.

The decisions and arguments of the referred cases declared that the right to deduct shall not be limited, and despite certain discretion is provided for the member states to decide whether the excess VAT shall be carried forward to the following tax year or shall be refunded instead, the principles of the common system of VAT and in particular the principle of tax neutrality shall be taken into account when the applicable national rules are determined. The withholding of the VAT excess shall not cause serious liquidity problems and financial risk for the taxpayer, therefore shall be refunded within the next fiscal year.

Taking into account the cases and their consequences, in the opinion of the author, the Hungarian VAT regime and the provisions thereof shall be reviewed, reconsidered, and, if necessary, amended.

¹⁹ Regarding the special obligations for taxpayers owning land and or other agricultural property, see Ercsey, Zs. – Ercsey, Zs.: Some aspects of the Hungarian regulation on ragweed. Being published. Masaryk University, Brno, Czech Republic.

2. Tax law and tax system

2.1. The aim of taxation

In order to determine the aim of the tax, taxation, and tax system, the definition thereof should be drawn up first. A tax is “a rate or sum of money assessed on a person or property for the support of the government, [...] and commonly levied upon assets or real property (property tax), or income derived from wages, etc. (income tax), or upon the sale or purchase of goods (sales tax).”²⁰ According to Black's Law Dictionary, »a tax may be defined as a "pecuniary burden laid upon individuals or property owners to support the government [...] a payment exacted by legislative authority." A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority" and is "any contribution imposed by government [...] whether under the name of toll, tribute, tallage, gabel, impost, duty, custom, excise, subsidy, aid, supply, or other name."«²¹

According to many tax theorists, tax payment is not an obligation related to citizenship, but rather a limit to ownership.²² It can easily be denied that tax payment obligation would be related to citizenship, thus taxation can not be considered simply as an obligation for citizens, since foreign citizens and legal entities (e.g. enterprises, undertakings, organizations, institutions, etc.) are obliged to pay tax as well. Furthermore the double tax treaties do not base the regulations on citizenship, but rather on place of residence. Finally, citizens at, below or under certain financial circumstances (such as poverty line, subsistence level of income, etc.) are not obliged to pay tax, but are exempt from tax instead.

In our opinion, focusing on the topic of this paper, tax is basically the main measure of central redistribution, the legal limit of private property, such one time or continuous financial service, which is determined by the correspondent provisions; an income deduction related to the business activity and or the income-wealth position of the individual or enterprise, which may be forced, generally without direct counterservice, by the state or the authorized body thereof from all the persons (be either natural or legal ones) to whom it is levied, in order to secure the funds for the public tasks, functions, and for the fulfilment of public needs.

²⁰ Gifis, Steven H.: Law Dictionary (Barron's Legal Guides). Barron's Educational Series, Inc., 1996. p. 503.

²¹ Black's Law Dictionary, p. 1307 (5th ed. 1979), quoted by Wikipedia at <http://en.wikipedia.org/wiki/Tax> (downloaded on 19/05/2010)

²² Földes, Gábor. *A pénzügyi alkotmányosság*. Társadalmi Szemle, 1996. 1, pp 64-65.

According to the essence of tax as described above²³, the main aim of taxation is to provide the proper tax revenue for fulfilling the state obligations and cover the related state expenditures. In order to increase the foreign direct investment and the amount of incoming capital, attractive business circumstances are needed,²⁴ of which an effective and widely acceptable tax system should be a relevant part.

2.1.1. Tax payment obligation in theory

According to many tax theorists, tax payment is not an obligation related to citizenship, but rather a limit to ownership.²⁵ It can easily be denied that tax payment obligation would be related to citizenship, thus taxation can not be considered simply as an obligation for citizens, since foreign citizens and legal entities (e.g. enterprises, undertakings, organizations, institutions, etc.) are obliged to pay tax as well. Furthermore the double tax treaties do not base the regulations on citizenship, but rather on place of residence. Finally, citizens at, below or under certain financial circumstances (such as poverty line, subsistence level of income, etc.) are not obliged to pay tax, but are exempt from tax instead.

The doctrine that a minimum of subsistence should be exempt from taxation provides a certain safeguard for all these underprivileged groups, families, and individuals. This principle, as a limit to the whole tax system, establishes a subjective right, providing the security of existence²⁶, or a guarantee for the financial security of the individual²⁷.

2.1.2. Tax and fairness

Fairness is a multiple-meaning category that may be achieved in various ways and always refers to the right social, political, and legal system as well. However, it is always a question whether a tax system is fair or virtuous, and if yes, on what ground. Furthermore, whether political virtue or economic virtue shall be considered, and what is meant by fairness and virtue at all?

Generally speaking it must be admitted that supranational consensus can be found only regarding a few legal principles. Therefore it is understandable that it is hard to achieve international unity on the field of tax law and taxation systems or certain provisions thereof.

²³ Please note that many other views exist regarding the definition or even essence of tax, for example, an interesting view says that tax is theft, the state steals money from the individual.

²⁴ Cf. Ercsey, Zs.: Üzleti folyamatok támogatása a felhőben. Pollack Press, Pécs, 2014, p. 18

²⁵ Földes, Gábor: A pénzügyi alkotmányosság. In: Társadalmi Szemle (1996) No. 1, pp 64-65.

²⁶ Ibid, 65.

²⁷ Szilovics, Csaba: Csalás és jogkövetés az adójogban. Gondolat Kiadó, Budapest 2003, p. 103.

Even regarding subsistence level tax exemption, national interests make the more general and moral approach impossible. However, the taxation principle of tax exemption for poverty line (i.e. subsistence minimum) is a limit to tax, which was established as a result of the social consensus regarding fairness.

It is also questionable what theoretical ground is the basis of taxation, and what tax system suits most²⁸. One important principle of the right and fair taxation is the righteous and proportionate bearing of tax burden, therefore the endurance ability of the taxpayers. Accordingly, the tax burden shall be borne by the members of the society, taking into account their ability to fulfil the so established obligations; in accordance with the ability-to-pay principle. According to Kurt *Miehler*, tax laws, based on fairness, rightness, and equity, shall be established according to the payment ability of the taxpayers, and not to the needs of the administration. The taxpayer will be ready to fulfil its obligation, if it is believed thereby that the required amount is fair enough.

According to the ability to pay principle, taxes should vary according to an individual's level of wealth or income. This principle is well used regarding income taxes. The application thereof is a progressive tax system. This principle as a canon of just taxation is notorious for its ambiguity, since many experts consider it to be characteristic of a socialist sentiment. Many hard-line classical economists like Adam Smith believed any elements of socialism would destroy the initiative of the population within a free market economy.

The other, so-called difference principle says that the social and economic inequalities attached to offices and positions are to be adjusted so that, whatever the level of those inequalities, whether great or small, they are to the greatest benefit of the least advantaged members of society. The intuitive idea is that those who have gained more than others are to do so on terms that improve the situation of those who have gained less. Accordingly, the difference principle permits inequalities in the distribution of goods only if those inequalities benefit the worst-off members of society. According to Rawls, each member of society has an equal claim on their society's goods, which claim shall not be effected by natural attributes, so the basic right of any individual, before further considerations are taken into account, must be to an equal share in material wealth. Thus, inequality is acceptable only if it is to the advantage of those, who are worst-off, otherwise unequal (re)distribution is unacceptable.

²⁸ It is not the goal of this paper to either list or analyze the existing theories, that would exceed the latitude thereof. Accordingly, just a few principles are pointed out, in order to draw up the most relevant basic ideas.

Generally speaking it must be admitted that supranational consensus can be found only regarding a few legal principles.²⁹ Therefore it is understandable that it is hard to achieve international unity on the field of tax law and taxation systems or certain provisions thereof.

Even regarding subsistence level tax exemption, national interests make the more general and moral approach impossible. However, the taxation principle of tax exemption for poverty line (i.e. subsistence minimum) is a limit to tax, which was established as a result of the social consensus regarding fairness.³⁰

One important principle of the right and fair taxation is the righteous and proportionate bearing of tax burden, therefore the endurance ability of the taxpayers. Accordingly, the tax burden shall be borne by the members of the society, taking into account their ability to fulfill the so established obligations; in accordance with the ability-to-pay principle. According to Kurt *Miehler*, tax laws, based on fairness, rightness, and equity, shall be established according to the payment ability of the taxpayers, and not to the needs of the administration. The taxpayer will be ready to fulfill its obligation, if it is believed thereby that the required amount is fair enough.³¹

The different economic situations of the states, and the aims of the economic policy thereof resulted in different tax systems and tax burdens. There is no general consensus regarding the definition of subsistence or other taxation conditions. Neither national laws, nor international law have established the generally accepted limits of tax law, due to the related autonomy and sovereignty of the states.³²

It is of high importance to declare and proclaim that the state is for the taxpayers thereof and not the other way around, and that tax laws establishing tax systems shall be made accordingly, in order to reflect this essential principle. Therefore, usually besides efficiency, equity is regarded as the main objectives of tax policy.

2.1.3. Tax incentives and equity

Even though indirect taxation has become more and more important over recent years, the income tax remains significant for many reasons. It is still a major source of state revenue and is best suited to being adjusted according to an individual's ability to pay. One reason for this

²⁹ Ibid, 67.

³⁰ Ibid, 103.

³¹ Ibid, 105.

³² Ibid, 108.

is that as income or wealth increases, its marginal utility (its real value to its owner) decreases so that higher rates of tax can be levied on the higher slices.

Furthermore, tax incentives raise equity concerns. The use of tax incentives as a policy instrument clearly affects the distribution of income and wealth. Since several tax avoidance possibilities are available, they allow to bypass the progressivity of the income tax system. The effect seems to be a redistribution of income and wealth from the relatively poor to the relatively wealthy.

Indeed, tax incentives generate an inverted subsidy effect. Due to the nature of the progressive rate structure of income tax system, tax incentives disproportionately benefit the wealthy. A result of the progressive rate structure is that incremental reductions of the tax base increase in value as the taxpayer's marginal rate increases. Thus tax provisions reducing the tax base are worth more to the rich and less to the poor. Therefore issues of complexity, compliance and effectiveness are closely connected to the changes in the role of income taxation in society.

2.1.4. Sense of taxation rightness

It is the general view that the taxpayer does not acquire certain rights directly for certain services in return for the tax payment thereof, and is not entitled to extra rights such as different privileges or subsidies just because of paying higher amount of tax. Furthermore, the persons paying less in taxes can not be discriminated against, either.³³

This concept, especially the fact that the individual taxpayer has to accept that certain rights for certain services are not acquired directly in return for tax payment, is one of the problems regarding the sense of taxation rightness. The counterservice of the state is indirect, and appears later in time, furthermore common goods might not be received by all taxpayers in the same manner, although the tax payment obligation is realized and recognized immediately and totally.³⁴ It must be admitted that, as proven by much researches, a significant percentage of the society could not even tell what counterservices are provided by the state in return for the paid taxes, and many taxpayers do not even consider infrastructure, supported education, public administration, etc. as counerservices financed by the state from the collected taxes. However, many researches show that the individual taxpayer is able to consider the bigger taxation coherences as well, and to take into account the whole tax system, including the rightness

³³ Földes, Gábor endnote 2, 65.

³⁴ Szilovics, Csaba endnote 4, 103.

thereof and the related activity of the government.³⁵ This enables them to obtain a more complex view regarding taxation.

2.2. Tax exemption for the minimum of subsistence

2.2.1. Underprivileged groups of modern society

One of the main characteristics of modern society is that it pays attention to and also handles social issues, taking care of the subsistence of the underprivileged groups and families. The reasons for underprivileged status include the low level of income per capita, disadvantageously high rate of dependents, unemployment, poor quality of accommodation, illness, underqualification, etc. The low level of income per capita plays a very important role in the underprivileged status, especially if it only provides such a low level of consumption that it cannot satisfy the generally accepted needs.³⁶ Therefore this underprivileged status shall be compensated by the state by providing certain benefits and reasonable financial support to those who are below the commonly accepted minimum level.

2.2.2. History of the doctrine

The theory appeared more than two centuries ago. Like many other tax theories, request for tax exemption at the level of subsistence and granting of basic allowance have also been influenced by Natural Law up to date. The Natural Law tax theory, between the mid 1600s to the early 1800s based tax exemption for subsistence level on the right to live, the individualistic state contract theory, and last but not least, on the ability-to-pay principle. The latter as a basis for taxation was already contained in British Natural Law and occurred, for instance, in older German traditions as well.³⁷

The doctrine may be deduced also from the prohibition of over-taxation; as Csaba *Szilovics* states, the negative definition of over-taxation prohibition means a subsistence level tax exemption from the positive approach.³⁸

This principle itself has been accepted by many economists in various forms and on different grounds, but many economists and lawyers have ignored or even rejected it. However, this is only one of the reasons why there is no definitive decision on what the subsistence level or its minimum shall include, or what taxes shall the exemption be applied for.

³⁵ Ibid, 104.

³⁶ Létminimum és társadalmi minimum. Esély. Társadalom- és szociálpolitikai folyóirat (1991) No. 6, 84.

³⁷ Corinna Treisch, *Taxable treatment of the subsistence level of income in German Natural Law*, [Accounting, Business and Financial History](#) (2005) No. 3, 255.

³⁸ Szilovics, Csaba endnote 4, 193.

2.2.3. The minimum of subsistence level

Neither the level of subsistence, nor the poverty threshold is an objective category. As Júlia Szalai points out, “Its extent, its content and its philosophic base are shaped by the historical traditions, the culture, and the generally accepted values of the given society and more directly by the compromises arising from the clashes of political forces”.³⁹

Accordingly, subsistence-level standard of living involves a number of concepts: it calls for consideration of such things as the minimum income that the particular government guarantees (such as the minimum income provided by welfare) or below which is no taxation (for example, the standard deduction and personal exemptions under US federal income tax law). No uniform or generally accepted minimum exists for subsistence level, due to the relative factors that shall be taken into account, but it is clear that this idea is somehow related to the basic necessary costs of maintaining population.⁴⁰ In other words, the minimum of subsistence contains the necessary cost of population, and subsistence level is “a standard of living in which the income is so low that only the bare necessities can be afforded”⁴¹, or even keeping it more simple: “living in a way that means you only have enough food to keep you alive”⁴².

However, the measurement of subsistence level may differ according to cultural, geographical and economic features of the country and therefore the consumer price level thereof, and furthermore according to the conditions and situation of each individual (such as talents, abilities, marital status, family size, age, etc.). Therefore the content of the category, as well as the socially acceptable level of wealth, assets and wage, differ by country and across time.⁴³ Also, if subsistence includes more than just material to survive with, then it is a social construct, not a fact of nature.

This is another ground to make distinction between subsistence minimum (or survival minimum) and social minimum. The survival minimum is an income that only allows the fulfillment of the basic necessities of the human individual. This only includes a very modest consumption level, and enables one to satisfy only the very basic necessities. In that case a smaller extraordinary expenditure or earning gap (loss of income) jeopardizes the fulfillment

³⁹ Szalai, Júlia: Some thoughts on poverty and the concept of subsistence minimum. 296-304. In: SOCIAL REPORT. (Ed. by Rudolf Andorka – Tamás Kolosi – György Vukovich, Társadalomkutatási Informatikai Egyesülés, Budapest 1992), p. 297.

⁴⁰ Buehler, Alfred G.: Taxation and the Minimum of Subsistence. The American Economic Review (1933) No. 2, 234.

⁴¹ <http://www.allwords.com/word-subsistence%20level.html> (downloaded on 30 March, 2007)

⁴² <http://www.bbc.co.uk/skillswise/glossary/index.shtml?00723> (downloaded on 30 March, 2007)

⁴³ Kristensen, Nicolai – Cunningham, Wendy: Do Minimum Wages in Latin America and the Caribbean Matter? Evidence from 19 Countries. The World Bank, Washington D.C., 2006, p. 2.

of those needs. On the other hand, the wider category of the social minimum in addition to a modest consumption level and the fulfillment of the basic necessities, provides the possibility to consume such goods and services that have become a mass social demand on the particular level of economic, social, and cultural development, and allows some regrouping for extraordinary cases. The minimum of subsistence and the poverty line are not neutral measurements, but they imply, as Júlia Szalai phrased, a “whole range of socio-political values and legally granted rights, which, by virtue of their demands of expense, are in direct relation with the redistribution of tax revenues”⁴⁴. Therefore the content and the particular level of the poverty line or subsistence are continually subject to complex social and political debates and bargaining processes.

The level of subsistence minimum is also a figure that shows the minimum level of satisfying needs on the lowest level that is still acceptable for the society. It can be determined from two aspects: from the side of the particular needs, or relatively, by correlating to the average life standards of the population through consumption data. These are usually family categories, since people satisfy a great deal of their needs within their households and families. This shall be taken into account when the exemption rates are determined.⁴⁵

The minimum rates basically include the following factors. The household’s accommodation need shall be considered, therefore the costs related thereto, such as the rent, acquisition of a dwelling place, the common charge of the condominium, interest on the credit for apartment purchase and the redemption thereof, maintenance costs, heat and energy costs. These costs occur irrespectively of the number of the family (also in case of a one-member-household), however, these costs increase in relation to the number of family-members, but not proportionately.⁴⁶ Additionally, it must be pointed out, and this is also the common understanding, that these costs differ according to the cultural and living conditions of the families. For instance, living in a downtown penthouse apartment with a much higher level of services (e.g. air conditioning and garage) incurs higher costs, including higher common charges, however a small family house for example built in the 20th century is not that economical (e.g. more energy shall be used for heating a square meter, due to the worn out insulation or the old furnace).

⁴⁴ Szalai, Júlia endnote 7, 297.

⁴⁵ Létminimum és társadalmi minimum, endnote 1, 84.

⁴⁶ Ibid, 85.

Furthermore, the personal needs shall be considered as well. These, as mentioned above, depend on several factors, for instance the age. The needs of children under the age of 15 are lower than the adults', however the consumption thereof might be higher. The cost for one child is less in cases where there are more children in the household (e.g. commonly used toys and other equipment, inherited clothes), furthermore the average needs of the retired are also less than the people of working age.⁴⁷ On the other hand, it is also reasonable for subsistence-based exemption levels not to reflect decreasing expenditures on additional children, because, according to Lawrence *Zelenak*, "the bulk of the decrease comes from children receiving smaller shares of discretionary family income as the family becomes larger, rather than from economies of scale in the cost of subsistence living"⁴⁸.

Based on this level of subsistence, and the related tax exemption, it is common among tax theorists to divide society into two groups: relatively wealthy individuals who pay taxes, and poor individuals who are excluded from tax payment obligation.⁴⁹

However, in relation to tax payment obligation there is a debate regarding the fair type of tax systems.

2.2.3.1. Measures: wealth or income⁵⁰

Numerous sources declare that theorists on both sides of the particular debate over progressive taxes have come to a consensus agreeing that poor individuals, those living at or below subsistence levels of income, should not have to incur tax costs, therefore legislators and policymakers must avoid imposing tax costs, and tax laws should avoid levying a burden upon on those individuals.

It must be stressed that this type of exemption can not be extended to organizations, institutions, legal entities, undertakings, or other enterprises, since the bankruptcy proceedings and liquidation procedures shall not be avoided or stopped in the case of a business enterprise or other legal persons that do not exist in a thriving manner or even exist in a manner that causes financial loss, damages or debts to other natural or legal entities.⁵¹

There shall be certain limits to the state and governmental intervention occurring through taxation, and the tax exemption for poverty line or the level of subsistence, which effects the

⁴⁷ Ibid, 86.

⁴⁸ Zelenak, Lawrence: Children and the Income Tax. In: Tax Law Review 1994/1, pp. 407-408.

⁴⁹ Staudt, Nancy C.: The Hidden Costs of the Progressivity Debate. In: Vanderbilt Law Review 1997/5, p. 922.

⁵⁰ This paper does not discuss this important debate in detail due to the limited length.

⁵¹ Cf. Ercesey, Zs.: Üzleti folyamatok támogatása a felhőben. Pollack Press, Pécs, 2014, pp. 23-28

whole system of taxation, shall be a limit to the extent of the whole taxation system. Therefore, according to many theorists, it shall be regulated in the constitution as well, for instance, in the Hungarian constitution as the fourth principle of taxation.⁵²

Many experts declare that wealth would be a better measure of ability to pay than is income, and therefore it is suggested that a wealth tax should replace the income tax. It is easy to explain that it is not enough to take into account the income of the taxpayer, since wealthy men having for instance no personal income falling under personal income taxation shall not be considered to be at or below the level of subsistence.

In my opinion, a personal income tax system, being either a flat or a progressive one, shall additionally take into account the level of subsistence as a family category, since there are families in the society in which only one member earns significant income, and if the normal rate of tax is levied on that particular earning, the members of the family might live at or below the level of subsistence.

On the other hand, the concept of minimum wage was originated in the late 1800s, in order to provide a basic standard of living, preventing a situation defined as earnings barely sufficient to sustain existence. It is evident that the main objective of the minimum wage is to guarantee a socially acceptable wage and a decent standard of living for all taxpayers.⁵³ Therefore legislating a statutory minimum wage is an important element of anti-poverty policy in the developed and developing countries as well. However, additional measures have to be taken,⁵⁴ because subsistence level tax exemption can not be limited neither to personal income tax, nor the tax-free bracket thereof, since the financial safety of existence is a much wider concept.

2.2.4. Exemptions

2.2.4.1. Personal exemption

The above requirements can be met through personal exemption, which is a deduction that exempts a portion of each individual's gross income from his tax base. As Charles R. *O'Kelley, Jr.* writes in one of his papers, this exemption is justified in tax policy literature as “a device to shield from tax only the amount of income required for a minimally acceptable level of subsistence”⁵⁵. Therefore the aim of the taxpayer's own personal exemption, available to all

⁵² Földes, Gábor endnote 2, 65.

⁵³ Kristensen, Nicolai –Cunningham, Wendy endnote 11, 2.

⁵⁴ Murgai, Rinku – Ravallion, Martin: Is a Guaranteed Living Wage a Good Anti-Poverty Policy? The World Bank, Washington D.C., 2006, p. 23.

⁵⁵ O'Kelley, Charles R. Jr.: Tax Policy for Post-Liberal Society: a Flat-Tax-Inspired Redefinition of the Purpose and Ideal Structure of a Progressive Income Tax. In: Southern California Law Review 1985/ 3, p. 744.

taxpayers, is to protect from tax the income needed for the taxpayer's own subsistence.

The main argument for poverty-level personal exemption is based on the maxim that taxes should be levied in accordance with taxpayers' relative ability to pay tax. In my opinion, this is the main principle on which tax theorists base dividing the society into two groups, since individuals with no discretionary income should pay no tax, but every individual with discretionary income should pay at least some tax. The discretionary income, as generally accepted, is the income beyond the minimum requirements, over which the taxpayer actually exerts control by having the opportunity to choose.

Ability to pay, hence, is limited by the resources needed to support subsistence for the taxpayer and his family; because at incomes below a certain minimum, subsistence-supporting level, the taxpayer is not able to pay income tax at all.⁵⁶

Besides, since the goal of tax policy is to distribute the costs of public goods, offering an exemption to the poor might seem desirable and an policy choice. However, it must be pointed out that the poor still have responsibilities with regard to the state, and even if substantive level tax exemption is allowed and provided in regard to some types of tax, the poor still pay certain taxes, for instance sales taxes, VAT, certain duties, etc. In my opinion, this is fair, since access to rights as well as fulfillment of duties are necessary components of one's full membership in a community, and the poor still have a social duty to contribute their talents and energies to the greater social good.

In theory, the tax rate structure has to be designed to provide the retention of sufficient income to meet needs of the individual on subsistence level, plus a certain portion of the amounts in excess thereof. Therefore the state does not levy tax on the individual, due to the aspects of fairness, rightness, and equity, since the individual shall not be obliged to contribute to the public funds and government expenditures, if the subsistence thereof is jeopardized, and the state interest shall not anticipate the elemental requirements of subsistence.⁵⁷

Thus, the personal exemptions provide a zero tax rate to the income needed for subsistence.⁵⁸ This is inevitable, since individuals, as discussed above, do have the right to a subsistence level of existence, consuming the necessary resources they need. As Arthur *Cockfield* phrased: "In

⁵⁶ Please note that wealth might be a better measure of ability to pay than is income (see section III.1.), in spite of its being much more difficult to estimate.

⁵⁷ Csaba Szilovics, endnote 4, 103, and Gábor Földes, endnote 2, 65.

⁵⁸ Kahn, Jeffrey H.: Personal Deductions - a Tax "Ideal" or Just Another "Deal"? In: Law Review of Michigan State University Detroit College of Law 2002/1, pp. 27-28.

fact, most consumption tax proposals reflect a similar viewpoint, providing relief for levels of subsistence, including either household exemptions up to stipulated income levels or exemptions for food”⁵⁹. If the amount is not adequate for subsistence, other provisions, such as the earned income credit, combine with the exemptions to insulate a larger amount from taxation. Since the statutory tax rate structure can only reflect a necessarily standardized utility curve, it is appropriate to make adjustments for events that commonly occur, and result in a very different set of financial needs than those of the average taxpayer.

2.2.4.2. Other exemptions

Therefore, in addition to personal exemption, an individual may be given an exemption deduction for his/her spouse and may be allowed exemption deductions for certain dependents as well. The addition of these exemptions increases the zero bracket of the taxpayer, so a larger amount of the taxpayer's income is taxed at zero rate. These exemptions are provided because, like mentioned above, the standardized utility curve does not reflect the reality that the amount needed for subsistence for an individual who is supporting a spouse and dependents is greater, than the amount needed for an individual who does not have a spouse or dependents.

Accordingly, many experts think that these minimum rates and categories shall be considered as family categories, since most of the human needs, for instance the accommodation needs, are fulfilled on a family level, within and living in a household, not individually. This shall be taken into account when the poverty line is used as a measure for determining tax exemption.⁶⁰

Also, blind, disabled or elder people are usually provided an addition to the standard deduction, likewise taxpayers whose spouse is blind, disabled, or above a certain age. These additional deductions reflect the fact that when a person or her spouse is blind or aged, greater subsistence expenses occur than in case of a sighted or young one.

Supporting dependents is also a very important element, and it is a major issue in the context of our topic, since it has occurred from time to time that the subsistence level of the dependants shall be exempt from tax.⁶¹ The classic argument for a dependency exemption available to taxpayers regardless of income level is based on the concept of clear (or discretionary) income that is defined by Lawrence Zelenak as “income above that needed to sustain life at a

⁵⁹ Cockfield, Arthur: Income Taxes and Individual Liberty: a Lockean Perspective on Radical Consumption Tax Reform. In: South Dakota Law Review 2001, p. 52.

⁶⁰ Létminimum és társadalmi minimum, endnote 1, 92.

⁶¹ It is also a political issue and has arisen regarding the new personal tax system in Hungary. For instance see Czelnai, Éva: “Adómentes létminimumot mindenkinek!” In: Magyar Hírlap, 19 October 1992, p. 6.

subsistence level”⁶². The ability to pay derives only from that clear income, the income in excess of subsistence needs. Each taxpayer should have to pay tax only on the clear income thereof that is above the income necessary to support the taxpayer’s family at a subsistence level.⁶³ However, the minimum of subsistence is difficult to determine, besides subsistence needs might differ. For instance, a family may spend much more than the amount at subsistence level and maintain a substantially higher lifestyle. Thus, the discretionary approach is unlikely to track the actual expenditures of the family with greater than subsistence-level income, even if only necessities (e.g. food, shelter, clothing) are taken into account.⁶⁴

Considering the above, certain additional exemptions (e.g. dependency exemptions) might be provided for each family member (the larger the family, the larger the income is needed for subsistence). Furthermore, children can not be considered just as consumption, because, even if you like to simplify from the financial perspective, they are a long-term, expensive, unpredictable financial obligation and investment, and the related obligation entails a unique level of commitment and responsibility. This is well recognized by law. Children are particularly dependent, they substantiate an inalienable moral obligation in addition to social and legal ones, since they have the moral and legal right to expect a certain level of subsistence and care, and their interests have to be represented as well. They impose a unique economic burden because of this combination of factors. It is obvious that raising a child significantly differs from other consumption choices, due to the mixture of the parenting obligation and the unique nature of the related economic matters. Therefore the tax rate can depend on the age of the child, on the place of living thereof (whether being a resident in a city or in the countryside), and on the certain subsidies it receives (family allowance or scholarship).⁶⁵

Since the state is theoretically obliged to provide the minimum of subsistence to all of its citizens or even residents, it is quite common that it provides certain tax relief, allowance, credit, or exemption based on the size of the family and the number of dependants.

Accordingly, the taxpayer may be entitled to certain credits for his/her spouse and children, since the position is taken by many theorists that a person working⁶⁶ full-time even at the

⁶² Zelenak, Lawrence: Redesigning the Earned Income Tax Credit as a Family-Size Adjustment to the Minimum Wage. In: Tax Law Review 2004/1, p. 358.

⁶³ Zelenak, Lawrence: Redesigning the Earned Income Tax Credit as a Family-Size Adjustment to the Minimum Wage. In: Tax Law Review 2004/1, p. 335.

⁶⁴ Ayla A. Lari: Sharing Alike: French Family Taxation as a Model for Reform. In: Duquesne Law Review 1999/4, pp. 243-245.

⁶⁵ Éva Czelnai, endnote 41, 6.

⁶⁶ Cf. Ercsey, Zs. – Kovács, T. – Kovács, Z.: Workforce Synthesis by P-graph Method. 8th International PhD & DLA Symposium, Pécs, Hungary, October 29–30, 2012, Abstract Book, p. 51

minimum wage should be able to support his/her children and also his/her spouse at the subsistence level. In that case a minimum wage worker with an unemployed spouse and two children shall be entitled to three credits. However, the spousal credit amount might differ from the per child credit amount. Usually, in order to reflect the greater subsistence needs of an adult, the spousal credit amount is more than the per child credit amount. This system would promote the conservative favoured model of the family, reinforcing gender role stereotypes, but is contrary to increased redistribution.

In fact this solution is disputed. Legislators, policymakers, but even taxpayers may argue, also based on cultural grounds, that a full-time minimum wage worker's earning, shall or shall not be sufficient to support both the worker's children and a stay-at-home spouse. Many politicians and experts argue that an able-bodied spouse of a minimum wage worker shall be supported appropriately only with various government subsidies. Besides, if a spousal credit may be provided at all, it should apply only when the couple has dependent children, but additional distinctions might be drawn based on the children's ages, and spousal credit might be allowed for example until the age of 15 or the school age, but not thereafter.⁶⁷

The compromise might be that a spousal tax credit is only appropriate, if the society in question believes that a full-time minimum wage worker should be able to support both his/her children and a full-time caregiver married spouse.

The earned income tax credit should be designed to serve as an adjustment to the minimum wage based on the size of the family, in order to lift all families headed by full-time workers out of poverty, providing a substantially higher lifestyle than poverty line, or at least the minimum of subsistence, although the details of the ways it can be realized are still disputed (e.g. whether the credit should be designed to cover the subsistence needs of a worker's stay-at-home spouse and the worker's children). Despite these disputes and the various arguments, the credit as a minimum wage adjustment could be a significant step in the development of a more rational and more effective anti-poverty program for working families, as well as a more fair and more righteous taxation practice.

These additional exemptions are basically adjustments to the tax rate schedule, in order to reflect the difference between the utility curve for such persons who bear certain expenses in question, and the curve for those who have no such expenses. Since it is not possible to structure

⁶⁷ Zelenak, Lawrence: Redesigning the Earned Income Tax Credit as a Family-Size Adjustment to the Minimum Wage. In: Tax Law Review 2004/1, p. 343-344.

individualized utility curves for every single taxpayer, only rough adjustments are made usually for identifiable circumstances which are common occurrences.

Example

One of the well-known examples for income splitting regarding the entire economic household for tax purposes is the contemplated regulation of the French tax code. Family income splitting clearly takes into account the number of family members who share the income of the family. Although there is no explicit dependency credit to provide a shelter for subsistence-level income, the zero tax bracket functions in the same way by identifying a fixed amount of income for each member of the family, upon which no tax is levied, and which is not subject to taxation. The same rate table is applied to each share of taxable income. Thus some allowance is made by the zero tax bracket for subsistence-level needs. The system aims to provide the same standard of living for each member of the household. Hence, the French system takes a different approach than individual taxation, and taxes the whole household as one unit instead. Therefore the French approach effectively results in applying one set of graduated rates for all households, but varying the brackets to adjust for family size.⁶⁸

This system is said to be fair and effective, but a more sophisticated system is also possible. For instance, separate rate schedules could be applied for adults and children, even the age of the children may be taken into account. However, the more sophisticated the tax system is, the more difficult for the taxpayers to understand and comply with.

2.3. Progressivity debate: flat tax and progressive tax

Basically two major systems may be used: flat tax (an income tax having a single rate for all taxpayers regardless of income level and type) and progressive tax (a tax that takes a larger percentage from the income of high-income people than it does from people with low-income).

The basis of flat rate taxation, the principle that fairness requires all taxpayers to pay the same percentage of income, could be made compatible with exemptions by invoking another principle, namely that no one should be required to pay taxes until the basic subsistence needs have been met by the taxpayer and his family. Every individual shall contribute to well-being through taxes of community after meeting his own subsistence needs and that of his family. This principle implies that there is no ability to pay until subsistence needs have been met. Besides, it must be admitted additionally that demands of fairness can not be satisfied just by

⁶⁸ Ayla A. Lari, endnote 44, 248-258.

imposing the same rate on everyone, and this idea supports the claim that certain exemptions must be provided.⁶⁹ If these referred reliefs, exemptions or credits are provided (such as family allowance), the unrighteous system may be made more progressive, providing a better solution for the underprivileged social groups and for those citizens, who realize less income than average.

Therefore flat taxes, in accordance with the above principles, implemented as well as proposed, usually exempt from taxation household income below a statutorily determined level that is a function of the type and size of the household. As a result, such a flat marginal rate is consistent with a progressive average tax rate. Otherwise, all income or consumption is taxed at the same marginal rate.⁷⁰

Over the past half century, the flat-rate taxation system was supported by a significant number of other political philosophers and scientists, such as Friedrich *Hayek*, Ludwig *von Mises*, Milton *Friedman*, John *Rawls*, Richard *Epstein*, Walter *Blum*, and Harry *Kalven*.⁷¹ The exhaustive critique of progressive taxation considered that the desirability of exemptions for low-income taxpayers does not require any justification, while Juliet Rhys-Williams developed and later Milton Friedman proposed in 1962 a negative income tax for the poor, a taxation system where income subsidies are given to persons or families who are below the poverty line. This system provides financial aid to poverty-level individuals and families: after filing a tax return showing income below subsistence level, instead of paying an income tax, the taxpayer would receive a direct subsidy, called a negative income tax, in order to bring the taxpayer up to the subsistence level.

The proponents of flat taxation argue that it is simple and efficient, and that may be the key reason behind Eastern Europe's dramatic growth. Others believe it is more readily explained by a low starting base and large inward investment. Flat tax has been adopted, for example, in Estonia, Lithuania, Latvia, Russia, Serbia, Ukraine, Slovakia, Georgia, Romania, and Macedonia, furthermore Greece, Croatia, and the Czech Republic are planning to introduce flat taxes.

On the other hand, many people say that flat tax is not a fair tax, since flat taxes usually do not tax all income at the same rate. Even though only one single rate of tax could be involved as well on all income, such is not common at all. For instance, in the United States usual flat tax

⁶⁹ Coverdale, John F.: The Flat Tax Is Not a Fair Tax. In: Seton Hall Legislative Journal, 1996. p. 285-290.

⁷⁰ http://en.wikipedia.org/wiki/Flat_tax#_ref-0 (downloaded on 10 May, 2010)

⁷¹ Fried, Barbara H.: The Puzzling Case For Proportionate Taxation. In: Chapman Law Review, 1999/1, p. 157.

proposals exempt certain forms of income from tax, therefore the rate of tax on those privileged forms of income is zero percent. Additionally, income derived from capital (dividends, interest, or capital gains) might be exempted from tax at the individual level. As a result, the flat tax becomes a two rate system: zero on income from capital and nominal rate on wage income.

Introducing a flat tax system is, in our opinion, one way to address the significant matters and solve the relevant issues. This method has been used by several countries in the recent years. The proponents of flat taxation argue that it is simple and efficient, and that may be the key reason behind Eastern Europe's dramatic growth. Introducing a simple tax system might be the real solution to competition challenges, since it inspires savings that is the source of investment. This system, functioning as a consumption tax and not a one-rate income tax, ensures revenue by providing wide individual decision opportunities and reduces the level of tax avoidance.⁷² Others believe it is more readily explained by a low starting base and large inward investment. Flat tax has been adopted, for example, in Estonia, Lithuania, Latvia, Russia, Serbia, Ukraine, Slovakia, Georgia, Romania, and Macedonia, furthermore Greece, Croatia, and the Czech Republic are planning to introduce flat taxes.

The advantages of flat tax, as described above, are that it makes the tax system much more transparent, the level of tax compliance higher and tax avoidance lower, furthermore it increases the saving willingness of households.

On the other hand, many people say that flat tax is not a fair tax, since flat taxes usually do not tax all income at the same rate. Even though only one single rate of tax could be involved as well on all income, such is not common at all. For instance, in the United States usual flat tax proposals exempt certain forms of income from tax, therefore the rate of tax on those privileged forms of income is zero percent. Additionally, income derived from capital (dividends, interest, or capital gains) might be exempted from tax at the individual level. As a result, the flat tax becomes a two rate system: zero on income from capital and nominal rate on wage income.

Furthermore, simply applied flat tax is not a fair tax even if the different types of income are taxed at the same rate, since social fairness would order that less tax should be levied on income derived from employment, and tax on capital should be increased.⁷³

⁷² Erős, Adrienn – Ivicz, Mihály: Egykulcsos adórendszer. A bölcsek köve, avagy egy lehetséges megoldás a sok közül? In: *Dissertationes, Iustum Aequum Salutare*, II. 2006. 1–2. p. 205.

⁷³ For instance, the tax on employment is the highest in Hungary within the European Union, and this is one of the biggest problem regarding Hungarian tax system.

Therefore, disadvantages of flat tax are that the social fairness does not prevail totally as specified above, and it might be favourable for only a relatively smaller group of the society.

Therefore, it is said by many tax theorists that flat taxes shall not be used in advanced economies, but a progressive tax system with graduated tax shall be adopted instead on household incomes and corporate profits.

A progressive tax is levied so that the tax rate increases as the amount to which the rate is applied increases. Progressive taxation can be applied to any type of tax, but it is applied mostly to income taxes, where people with a higher level of income pay a higher percentage of their income in tax than those taxpayers, who earn less income.

Theorists in almost every discipline have entered the progressivity debate, proposing a variety of different tax rates in order to disburse the costs of public goods and services.⁷⁴ There is no generally accepted standpoint among the experts regarding which type of taxation is fairer and/or more efficient, and therefore which has to be adopted.

Although the debate over progressivity has lasted for more than a century, traditional tax theorists have focused basically on the negative rights of the poor only and have not explore fully any positive rights the poor might have. Traditional tax theorists have never investigated the question in detail, of whether poor individuals have a right to certain basic needs and economic security simply because of their citizenship.⁷⁵

2.3.1. Theoretical approach

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.⁷⁶

According to the social fairness, the tax systems shall be fair, as well as each types of taxes. This means, regarding the personal income tax⁷⁷, that everybody shall contribute to the public expenses according to their income and wealth situation.⁷⁸

⁷⁴ Staudt, Nancy C.: The Hidden Costs of the Progressivity Debate. In: Vanderbilt Law Review, 1997/5, p. 920.

⁷⁵ Ibid, 922 p.

⁷⁶ Ádám, Antal: Észrevételek a magyar alkotmányozáshoz. In: Jura 2011/1. p. 194.

⁷⁷ See Section 1(2) of the Act CXVII of 1995 on Personal Income Tax, stating that the purpose of the act is to secure -- in due observation of the principles of proportionality and equity -- the tax revenues necessary for the fulfillment of State responsibilities, and in special cases, to promote the implementation of certain social and economic goals.

⁷⁸ Musgrave, Richard A. – Musgrave, Peggy B.: Public Finance in Theory and in Practice. McGraw-Hill Book Company, New York, 1989. p. 227.

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.⁷⁹

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 did not receive less state transfers and government subsidies or financial support as 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 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.⁸⁰

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.

⁷⁹ See Section 30 of the Act on Personal Income Tax in effect until December 31, 2010.

⁸⁰ Statement by Willy Kiekens, Executive Director for Hungary and Szilard Benk, Senior Advisor to the Executive Director January 18, 2012 pp. 3-4 Online: <http://www.imf.org/external/pubs/ft/scr/2012/cr1213.pdf> [2012.02.25.]

For instance, there is no another additional job is taken by the taxpayers, or no other grants are taken by them⁸¹ 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. As JOHN STUART MILL stated in 1848: the progressive tax levies a higher rate of tax on the higher income, therefore it definitely punishes the hard working taxpayers.⁸²

The theoretical base of progressive income tax is that “increasing income is connected to declining margin of profitableness”⁸³. Progressivity obviously favours those with a medium income level albeit many think it rather enhances justice⁸⁴, 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 unification⁸⁵ 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-

⁸¹ Contributions paid to citizens without tax burden have been stopped as of January 1, 2011. This used to be a revenue type belonging under the contracted tax base that also arising from its category had to be considered, when the total revenue was calculated or when the tax base and the calculated tax were defined. According to these it was deemed as tax paying revenue with the exception that its tax did not have to be paid – the text of the personal income tax law Section 34 valid until December 31, 2010 (which has been outdated by law no. 123 Section 32(14) on January 1, 2011) said that calculated sum based on regulation on tax amount referring to the total sum of contributions that were not taxed would decline the calculated tax – but it could shift taxpayer’s total revenue to a higher level in a progressive structure and thus the tax payment liability also increased. After the change, however, such revenues became perfectly and fully tax free (except for student labor fee, which is a taxable revenue of taxpayer as a revenue from non-independent activity and it is also part of the contracted tax base, thus it also enables taxpayer to gain the right to tax reduction, other reductions and social security contributions as well as counting as work status).

⁸² Mill, John Stuart: Principles of Political Economy. Longmans, Green and Co., London, 1848 p. 78.

⁸³ Streissler, Erich: Gazdaságelméleti kétségek a progresszív jövedelemadó ésszerűségét illetően. In: Közgazdasági Szemle 1990/1. p. 79.

⁸⁴ Cf. Heady, Christopher: The Conflict Between Equity and Efficiency in Designing Personal Income Tax Systems. In: The Role of Tax Reform in Central and Eastren European Economies. OECD, Paris, 1991 pp. 87-96.

⁸⁵ Cf. Ádám, Antal: A posztmodernitás jogi sajátosságairól. In: Társadalmi Szemle 1996/4. p. 19.

designed financial activities of global⁸⁶ or regional financial management concentration stimulators deserve acknowledgement.”⁸⁷

The Hungarian tax system including the personal income tax system was characterized by progressivity and complexity.⁸⁸ The first signs of the introduction of the flat tax rate were already marked by the trends of 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 constitutional⁸⁹ principle of tax payment, but also the basic principle of the personal income tax law⁹⁰ will be applicable at a much higher level and government revenues may also increase significantly.

2.3.2. The concept and types of the income

The Hungarian legislator distinguishes between the different types of income according to the basic definition of the income itself.⁹¹ Two major categories of income are specified by the Act on Personal Income Tax: income that belongs to the consolidated tax base and therefore has to be added, and types of income that are taxed separately. The first category is specified as income from self-employment activities, income from activities other than self-employment, and other income; whereas the separately taxed income is subdivided into business entrepreneurial income,⁹² income from the transfer of assets (movable and immovable property), income from capital investments, in-kind and other benefits, and miscellaneous income.

⁸⁶ For global perspectives of solving problems a detailed study was presented by the lecture of Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: New Method to Determine the Globally Optimum Solution of SNS Problems with NLP Model. Presented at Veszprém Optimization Conference: Advanced Algorithms (VOCAL 2006). Veszprém, Hungary, December 13-15, 2006.

⁸⁷ Ádám, Antal: Bölcsélet, vallás, állami egyházjog. Dialóg Campus Kiadó, Budapest-Pécs, 2007 p. 79.

⁸⁸ Cf. Hauwe, Ludwig van den: German income tax policy between equity and efficiency. In: European Journal of Law & Economics 1998/5. pp. 267-268.

⁸⁹ See Section 70/I.(1) of Act XX of 1949 (former Hungarian Constitution).

⁹⁰ See Section 1(1) of the act on personal income tax.

⁹¹ The Personal Income Tax defines the concept of revenue in three ways depending on revenue. Section 4 (1) of the law says that all taxable revenue received by a private individual from others shall be considered income, or the portion of such income with the fixed-amount expenses recognized in this Act deducted, or a given proportion thereof as set forth in this Act.

⁹² The amount of business income, and the sum paid for costs is determined by the technical background of the enterprise. Thus it is of high importance to provide a cost effective IT equipment and facilities, and the cloud document management is an appropriate solution in that regard. Cf. Ercsey, Zs.: Üzleti folyamatok támogatása a felhőben. Pollack Press, Pécs, 2014, pp. 5-46

According to this referred provision, there are some types of revenue, in connection with which the related costs may be deducted.⁹³ The tax base of these types of revenue is deductible with the costs occurred directly in relation to the activity out of which the income derived. These costs can be proven either individually or can be set off by a lump sum cost amount.⁹⁴ In other cases only a certain proportion of the revenue shall be considered as income, therefore the tax base is narrower than the income. This is the case for instance regarding the income derived from the sale and purchase of the real property. This later type of income is taxed separately, and the tax base, as well as the amount of tax due, shall be determined by a decreasing tax base structure according to the years passed between the acquisition and the sale.⁹⁵

This is completely contrary to the horizontal fairness, according to which taxpayers⁹⁶ with the same income and the source of income have to be handled equally. Thus, the salaries and other types of income – in accordance with the Hungarian regulation on Personal Income Tax contracted and separately taxed revenues – have to be taxed in the same quantity, measure, and way. Nonetheless, several contemporary Anglo-American authors reckon that due to its nature, personal income tax basically distinguishes between the taxpayers⁹⁷. The standpoint, which takes into account the double taxation in legal sense is somewhat contradictory to this consideration, for example: taxation of an income, which was once already taxed as salary and produced by it, is not only unfair, but most likely it would be economically harmful. According to the Hungarian personal income tax under the principle of the ability to pay tax, taxpayers with the same paying capacity are forced to pay the same, the higher-income taxpayers have to pay higher amounts.

Whether a tax regime of a country is fair or effective, depends on the applicability of the principles, proportionality, progressivity, and the exemptions provided.⁹⁸ Based on the ability

⁹³ The system of personal income tax in Hungary traditionally separates income that is to be contracted and income that is taxed individually. These income types and their subtypes can be well separated also based on the three income groups defined by law.

⁹⁴ Any cost can be considered only once, on one occasion and with some exceptions to the maximum of income. Cost acknowledged without certificate instead of really spent and justified expenses can be calculated up to the extent defined by law and such cost shall be deemed as fully acknowledged in such as case. If a revenue/cost is defined as a flat fee or as a certain percentage of the income, the revenue cannot be reduced by any other cost.

⁹⁵ See Sections 62(4) and (6) of Act on Personal Income Tax.

⁹⁶ Cf. I. Gy. Tóth, 'Gyermekek és eltartottak figyelembevétel a jövedelemadózáásban' [Taking into Account Children and Dependants regarding Taxation]. In: Semjén, A. (ed.): *Adózás, adórendszerek, adóreformok*. Szociálpolitikai Értesítő – Különszám 1993/1-2 MTA Szociológiai Intézet, Budapest, 1993. p. 264.

⁹⁷ Cf. R. Vosslander: 'How Much? Taxation on New Zealanders' Employment Income 1893-1984'. *New Zealand Journal of Taxation Law and Policy* 2009/12. p. 302.

⁹⁸ Deák, Dániel: *Igazságos-e a magyar adórendszer? (Egy törvényhozási csapdahelyzet elemzése)*. In: *Jogtudományi közlöny* 1997/7-8. p. 317.

to pay principle, thus higher tax is levied on the taxpayers realizing higher income, and the same amount shall be paid by the taxpayers of similar payment abilities.

As it is visible from the above classification, the Hungarian regime makes a strong distinction between certain types of income, whereas such significant difference is not set forth by the Croatian provisions, in which all types of revenues regulated by the individual income tax regime are handled uniformly. This element makes the Croatian system more uniform. However, the Croatian provisions contain some relevant distinctions as well, which reads similar to the Hungarian provisions the way that the different types of income are grouped into certain categories. The main difference is that although both regimes handle these types of income the same way regarding the sources thereof and the activity from which the related income is derived, in Croatia all these groups shall be added in order to have the tax base established, whereas in Hungary separate provisions are applicable for, among others, independent personal services income, income from property, and investment income. This means that despite the classification of revenue types are very alike, the two systems handle them differently.

It is an essential difference that the consolidated tax base in Hungary generally cannot be deducted with the costs occurred in relation to the obtainment of the revenue deducted from the independent activity, whereas in Croatia the cost of the taxable tax year and certain insurances fees (life insurance of domestic individuals, private life insurance, voluntary life and private insurance not exceeding the amount of HRK 6,000, on condition that the paid insurances fees are not deducted from the income derived from other sources) maybe decline while establishing the tax to be paid upon the independent personal activities. The Hungarian taxpayer, who performs independent activities, shall fulfil the tax obligation thereof according to corresponding provisions of the act on personal income tax (the only exception to be pointed out is the private entrepreneur, who, regarding his independently provided services, is entitled to switch to simplified entrepreneurial tax payment according to his soul decision on condition that he totally meets the related legal requirements). Such enterprises in Croatia may generally choose to pay corporate income tax instead of personal income tax.

The separate tax types of income in Hungary maybe compare to the Croatian solution of the other, so called second income regarding deductible cost. The latter category albeit contains mainly such activities, which belong to either the income derive from independent activities (for instance the revenue of the members of parliament) or to the dependent activities (e.g. activity of the members of the audit and control committee of enterprises).

2.4. Methods of tax reform

In our interpretation, reform is a positive progress, a move towards a more positive situation from a negative position. Reform for its own sake is never fruitful. A nineteenth century judge said: “Reform? Don't talk to me about reform. Things are bad enough already”⁹⁹. It is always a question whether the reform would solve the current questionable matters and/or starts a positive progress.

In Hungary, people and, naturally, experts, also found during the last 60 years that we have been experiencing reforms permanently along with continuous belt-tightening. They have learned that the provisions of the law are often volatile, not binding to everyone, and change so quickly and unfollowably that it is not worth learning them. This is especially true to tax regulations. A lot of empirical research has proved that 4-5 of 100 Hungarian citizens can not name even one type of public revenues and the referred research project of Dr. Szilovics, within which more than 2,500 people were asked detailed questions, has revealed that according to the majority¹⁰⁰ of the respondents in Hungary there is no consequence of tax fraud, and tax payment can be avoided by using connections. This is even more or less understandable for a significant proportion of the population, since the personal income is unbelievably low, but 80% of the taxpayers pay taxes according to the highest tax rate in the personal income tax system. It is clear that the Hungarian legal system is not consistent either in legislation or in judgement. The opinion of Tamás Fricz, according to which this is “a country without consequences”, is hardly disputable.

In this case the politicians should give an example of righteousness, so the citizens could follow this, pay taxes, and at the macro level feel the balance of service and remuneration. Ordinary people also understand the messages of politics in connection with public funds, realize these processes, and approach ambivalently that the state wishes to collect every forint from them, spares on the state services, while on other areas extravagance is seen. We think it is a great problem, that there is a great means of interoperability between the players of politics and economy. Already in 900BC in Theba it was forbidden for anybody to be once a politician and once a businessman within a short period of time. In a normal state it could not occur that in a

⁹⁹ Tiley, John: Away from a virtuous tax system? In: British Tax Review, 1998/4, p. 346, referring to Economist, October 25, 1997., p. 42.

¹⁰⁰ The research was done between 2002 and 2007. During the five years, approximately 2,500 pieces of eight-page-questionnaire was filled in many cities and several villages all over Hungary. For more details, see Szilovics, Csaba: Adózási ismeretek és adózói vélemények Magyarországon (2002-2007). G & G Nyomda Korlátolt Felelősségű Társaság, Pécs, 2009.

court case between a private company and the state one public actor represents once the defendant and after a short time the plaintiff. The level of state redistribution should be decreased radically.

The simplest way of increasing revenue would obviously be to increase the rates of existing taxes¹⁰¹, if, among ideal conditions, taxpayers and undertakings would simply pay the higher amount. Little new legislation is needed and the administration is already in place. However, politically this is the most sensible way of realizing this aim. Tax increase is well used regarding personal and corporate income tax, VAT, road fuel, tobacco, etc.

According to a recent research conducted by Dr. Csaba Szilovics¹⁰², Hungarian citizens are against tax rate increase, especially of VAT and personal income tax. Taxpayers and all other citizens, the whole population feels exactly and directly the raise of VAT rates, since it occurs immediately in consumer prices. The high VAT rates are not known exactly among the people, but they feel the difference comparing to the prices abroad, therefore they can realize that the domestic tax is relatively very high. Furthermore only 17% of the answering citizens support increase of personal income tax, but it is more acceptable among those, who are not affected (e.g. inactive citizens, and citizens, who are older than 60 years).

The main difference between increasing VAT and personal income tax rates is that on one hand the higher VAT rates affect all consuming citizens (including unemployed and retired citizens), and, on the other hand, higher personal income tax rates affect only active citizens, who, support 2,5 inactive ones in Hungary. Accordingly, 16% of the active citizens reject the raise of income tax rates, and 26% of the inactive citizens support it, furthermore it is supported by 17% of the ones of age between 35 and 54, and 25% of the ones above 60 years.

Contrary, increasing excises seemed to be acceptable of a higher proportion of the society. It would be supported by all groups of the society. However, for instance, raising the rates of local taxes is rejected by these groups, despite the people do not like paying local taxes more than central ones.

Another simple and clean method of tax reform is abolition, but it might not be a perfect one. As Denis Healey said: "Another lesson was that you should never commit yourself in

¹⁰¹ Please note that in relation to some types of taxes, it is not the sole and exclusive decision of a state to change the tax rate without a limit. For instance, increases in the scope of VAT have been constrained by E.C. Directives regarding EU member states.

¹⁰² For a detailed study see For more details, see Szilovics, Csaba: Adózási ismeretek és adózási vélemények Magyarországon (2002-2007). G & G Nyomda Korlátolt Felelősségű Társaság, Pécs, 2009.

Opposition to new taxes unless you had a very good idea how they will operate in practice. We had committed ourselves to a Wealth Tax; but in five years I found it impossible to draft one which would yield enough revenue to be worth the administrative cost and the political hassle.... I suspect the Conservative Party is even more unhappy that Mrs Thatcher promised to abolish the rates without having the slightest idea what to put in their place.”¹⁰³

Furthermore, the tax burden can be reduced without abolishing taxes by reducing the tax rates or increasing allowances for existing taxes. However, recent researches show that reduced rates do not help the lower paid, do not significantly increase incentives and “have no effect on the poverty trap -- raising tax allowances was a better way of helping the poor. It is also reasoned with two major justifications: one is political -- to keep pace with inflation; the other is administrative -- to prevent a significant number of people from being drawn into the tax system by the process known as fiscal drag”.¹⁰⁴

Another method is to create new allowances and reliefs. The direct tax burden is reduced if the structure of the direct tax system is altered by providing new reliefs. These reliefs can be very effective, if they are planned carefully. With innovative ideas, the support can be provided for the aimed groups. This method is, in our opinion, politically favourable as well. For example, the state can decide whether to provide allowances for each qualifying individuals or handles the families as one person. In the latter case, certain allowances may be utilized only by one person of the couple: each of husband and wife would be entitled only to one personal allowance and the husband could not claim that which one always called the larger married man's allowance.

2.5. Tax harmonization

National tax systems shall react upon the international trends of tax reforms as well as upon international movements of capital. Traditional ways and methods of levying taxes are being reviewed all around the world.

Tax harmonization has been a major issue in the European Union both from political point of view and economic approach. However, the harmonization of the tax systems of the EU member states is a long term goal, which is hard to achieve, because the member states do not want to give up their fiscal sovereignty. The monetary policy thereof is centralized, especially for the participant states since the beginning of the 3rd phase of the European Monetary Union,

¹⁰³ Healey, Denis: Memoirs. 1989., p. 404 Quoted by John Tiley: Away from a virtuous tax system? In: British Tax Review 1998/4, p. 347

¹⁰⁴ Tiley, John: Away from a virtuous tax system? In: British Tax Review 1998/4, p. 327 and 330.

but fiscal policy remained in national competence. The decreasing level of national sovereignty applies in many areas of economic and legal areas, therefore fiscal sovereignty has become of high importance. National taxation remained one of the most significant government measures among economic policy, therefore the member states want to form their tax policies independently.

There have been some steps taken already, but mainly on the field of indirect taxes (see for instance VAT directives). The achievements regarding direct taxes is much smaller, the stricter harmonization is more difficult and have many obstacles (e.g. unanimous decision is required), despite it would be of advantage of the common market. The Commission made many proposals, among which the following are the most significant: Code of Conduct for Business Taxation, Home State Taxation for SMEs, Common Consolidated Corporate Tax Base. However, the practical solutions are still to be passed.

In our opinion the innovation that makes real steps on this field, harmonization of real and effective measures would mean real competitive advantages for the common market.

2.6. Environmental taxation

One idea of the European Community to solve the problem of ever-increasing energy emissions is to use taxes to encourage efficient use of energy sources. However, many scientists and politicians believe that any environmental tax or green tax is useless, unless similar measures are taken in the United States and the Far-East (e.g. Japan and China).¹⁰⁵

We think that every measure should be most welcome in this regard; furthermore the polluter pays principle shall be applied, even if, as nowadays, the industry is in crisis or struggling in a world recession. In order to discourage environmental damages, prices shall contain this additional cost. A complex system of environmental taxes and incentives should be designed, and green taxes shall form a significant part of the GDP revenue.

¹⁰⁵ This seems to be quite obvious since the emission of the EU is quite less than 20% of the world's total emission China leads the countries and is followed by the United States. Both have a share of more than 20% of the global emission. The top 10 countries in the world emit more than 65% of the world total. This has been the case since the late '80s: in terms of emissions, EU Member States have been producing around 13 per cent of world carbon dioxide emissions, compared with more than 20 per cent of China and the United States, 5 per cent of Japan. In terms of international competition, the EC could not afford unilaterally to incur the additional costs involved at a time of slow or no economic growth. Hence the new jargon word 'conditionality' occurred and sneaked into the Commission's vocabulary, meaning that on condition that the United States and Japan adopt similar measures. For further details please see the following websites (date of download: 19 May, 2010): http://www.worldenergyoutlook.org/docs/weo2009/fact_sheets_WEO_2009.pdf, <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1709>, <http://www.eia.doe.gov/oiaf/ieo/emissions.html>, http://en.wikipedia.org/wiki/List_of_countries_by_carbon_dioxide_emissions.

According to the general view, if there was no tax (e.g. kerosene tax and/or VAT) levied on international air traffic, it would enjoy unrighteous competition advantage comparing to other sectors of logistics. Despite, in many tax systems, mineral oils such as kerosene and fuel oil are not liable to the levy because they are subject to excise duty.

Unfortunately, the early solutions and efforts are not encouraging. For example, the consequence of introducing a tax on carbon dioxide emissions from petrol and diesel fuel, natural gas, liquefied petroleum and kerosene in Sweden at the beginning of the 90's was "that the price of heating oil increased by 20 per cent, coal by 40 per cent, natural gas by 30 per cent and gasoline by 20 per cent. A parliamentary investigation into the impact of the tax on industry estimated that there had been some 10,000 job losses and that it was costing Sweden SKr20 billion"¹⁰⁶.

However, we do believe that fossil fuel consumption and greenhouse gas emissions from the personal transportation sector promise to be key challenges facing the next generation of policy makers.

2.7. Proposed innovative measures for tax systems

The taxes, quite obviously, shall be paid by the taxpayers to whom the tax laws in question shall be applied. The system shall be designed by the government. The government is basically responsible for economic and business activity of the citizens and undertakings thereof. It is liable for the actions of the people thereof, since it has the right and authority to regulate these activities by legislation that shall be based on relevant information.¹⁰⁷ This information shall be collected and analyzed¹⁰⁸ by qualified employees of government offices and agencies.

Innovation and intellectual capital is of vital interest on this field. Sorting out the information, taking into account the different factors, and establishing a structure that addresses the relevant issues and finds solution for the major problems bring a country into a much better position among competition. (Unfortunately innovation and research development do not play an important role in the Hungarian economy. The added domestic value is low, innovative

¹⁰⁶ Murray, Angus. The carbon tax - can it work? In: International Company and Commercial Law Review, 1992/3(4). p. 148.

¹⁰⁷ Regarding the recording and storage of relevant information, see Ercsey, Zs. – Radó, J.: Android API for Licensed Pescitides in Hungary. In: Peter Ivanyi (ed.): Architectural, Engineering and Information Sciences - 9th International PhD & DLA Symposium: Abstracts Book. Konferencia helye, ideje: Pécs, Magyarország, 2013.10.21-2013.10.22. University of Pécs Pollack Mihály Faculty of Engineering, Pécs, 2013, p. 137

¹⁰⁸ Regarding information systems, a more detailed study was drawn up by the lecture of Ercsey, Zs. – Kovács, T. – Kovács, Z. – Golya, G.: Agricultural Logistics Information System. Presented at the Research Conference on Information Technology. Pécs, October 2011.

undertakings form only 17% of the economy, however, this proportion is 44% average within the European Union.¹⁰⁹⁾

The transparent and honourable state function shall be established. That is of significant importance, since the people, as well as undertakings know and are able to estimate the value of the public services. It is their basic need to receive appropriate counterservices for their paid taxes. They have to feel that their payments and tax burdens are not useless. Accordingly, the public needs and state tasks shall be determined, and if you prefer, specified very clearly. It is the main interest of the politics and the society to specify clearly the state services, and to determine the minimum thereof.

Tax burden shall be allocated a more righteous way, both horizontally and vertically. Legislation, case law and practice continually evolve and up to date information should always be used to determine tax liabilities. The optimal balance of tax mix and tax burden shall be found. The huge difference regarding the tax burden of the different groups of the society. It is unacceptable that there are mainly supported as well as just mainly taxed social groups. Accordingly, the tax burden of the employees shall be made more advantageous, however, due to the requirement of being competitive from economical aspect, the tax burden of the enterprises can not be increased either. This is a very difficult and complex question. In case the taxes levied on the income of the enterprises are increased, the system of the deductible costs shall be widened.

It is very disadvantageous that both the direct and indirect income taxes are high as individual ones and together as well. In case one or more tax rates are higher, the total amount of tax to be paid is obviously bigger. Therefore it is quite obvious that in case a tax rate is higher, the tax burden is increased, the situation of the taxpayers get worse, the remaining profit becomes less, and, as an outcome, the taxpayers who are able to choose according to which tax system they would like to pay taxes (e.g. on the territory of which tax administration they do their business activities), may move forward in order to realize profits where the tax rates are lower, and at the end of the day, the total state revenue may be less.

The different types of taxes shall be harmonized and the effects thereof shall be analyzed. Tax rates shall be valorised according to the inflation, since the lack thereof might mean tax increase in real.

¹⁰⁹ Vértés, András: Adórendszer és versenyképesség. See more at http://www.magyarorszagholnap.hu/pdf/5_versenykepesseg.pdf (downloaded on 15 May, 2010)

Realistic levels of subsistence should be defined that shall be exempt from tax, also taking into account the basic models of conditions of the taxpayer, for instance the size of the family. The doctrine that a minimum of subsistence should be exempt from taxation provides a certain safeguard for all these underprivileged groups, families, and individuals. This principle, as a limit to the whole tax system, establishes a subjective right, providing the security of existence¹¹⁰, or a guarantee for the financial security of the individual.

It should be declared that the state is established for the citizens and not the other way around. All the actions shall be taken accordingly, and the legal framework, as well as the structure of tax system shall be formed by taking account this principle.

Tax administrations shall acknowledge or even accept that the individuals and enterprises want to make decisions regarding their own money, therefore the amount of money remaining in their pocket shall be increased.

The measurement of the level of redistribution does not provide a real picture of the changes of tax burden. In order to be more competitive, the elements of tax and social policy shall be separated, since an effective tax system of a society may be able to achieve such wirement of taxes, which assures the funds of the social policy. The state, within the scope of social policy, often has to solve problems that were not issues, if the taxpayers could realize more income due to the smaller level of tax burden. It would be fruitful, if the mandatory solidarity was exchanged by selfcare; on condition the net individual income is increased.

The constitutional and legal system of conditions of taxation shall be in focus. For example, the Hungarian constitution does not contain much in this regard. Taxation is the most sensitive and continuous limit regarding citizens and undertakings, and it should be handled accordingly.

We do believe that one of the most important tasks of tax legislation is to specify the rights and obligations of the taxpayers, and, in a wider approach, the basic values of the tax system. The conditions of the relationship between the individuals and the community regarding taxation shall be incorporated in the constitution, the function of which, among others, is to defend the individuals against the state.

It is urgent to re-establish the regulation of public finance and tax laws. Tax legislation shall not follow, but conduct and prevail social changes. Taxpayers' rights shall be defined clearly; taxpayers should be in the same position as the state. One solution could be, in order to

¹¹⁰ FÖLDES, Gábor. A pénzügyi alkotmányosság. In: Társadalmi Szemle, 1996/1, p. 65.

strengthen the position of the taxpayers, to establish a kind of tax ombudsman (either with investigating powers, or even with the right to make obligatory proposals) or a government office with the same powers. For instance, similar offices with general authority operate for protecting the rights of the taxpayers in approximately 15 OECD countries. Another body with similar powers could be also within the system of tax administration, or a separated tax committee (like for instance in Belgium), or just as in other countries, a committee of the parliament may decide regarding such disputes (e.g. in Germany).

The state and science should not be negligent with taxation. This is such a failure, the exact negative results of which may be determined more or less easily, but could be corrected very hardly and only in a long term.

We believe that the tax system can have a principled structure. It should be simple, comprehensive, transparent and understandable for all taxpayers. Clear, simple worded and straight forward provisions shall be enacted and made known publicly. Administrative limits (e.g. short tax return forms, which are easy and quick to fill out) shall be introduced. Long term structure shall be introduced,¹¹¹ and only really reasonable and necessary amendments shall be made.

These conditions make the tax system in question attractive for domestic and foreign capital and investments. Ongoing changes make the taxpayers unable to plan their income, taxes and financial situation; they can not count on the system, and therefore might look for other, countable solutions.

The role of marketing is inevitable. New ideas can always make the taxpayers understand the importance and role of paying taxes. Therefore, in case the advertising is successful, the taxpayers get to know the main reasons of collecting taxes, and get acquainted with the “countervalue” they receive in return of paying taxes. This may result in a higher level of tax compliance, higher percentage of taxes paid and lower rate of tax avoidance or tax evasion.

¹¹¹ Cf. Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: Rigorous Super-Structure in Action. Keynote Lecture at the 15th International Congress of Chemical and Process Engineering, (CHISA 2002), Praha, Czech Republic, August 25-29, 2002

3. Tax regulation

3.1. Some major issues of value added tax

3.1.1. The functions of taxation and value added tax

It is always the question why people shall pay taxes, and what the functions of taxation are. This issue generates further disputes and it is hard to establish or point out certain consensus regarding particular matters. The obvious answer is that taxes are needed to raise revenue for necessary governmental tasks, in order to make the state able to fulfil the obligations thereof. Accordingly, the revenue raised by tax payments covers public goods and services. This is inevitable, despite there is an ongoing and never-ending debate regarding the obligatory tasks of the state, regarding which, in my opinion, a transparent and honourable list or catalogue should be agreed on.

Furthermore, taxation has other, perhaps less obvious functions as well, which are widely applied by modern states. It, for instance, has a redistributive function, in order to make the distribution of income and wealth (deriving from the normal operation of a market-based economy) more equal.

Taxation also has a regulatory effect, since taxes are used by the government to control the private sector activity.¹¹² However, in my opinion, this is one of the most disputable functions, since if the state is established for the citizens and not the other way around, then why shall it regulate the will of the taxpayers and influence the behaviour thereof from a financial point of view, namely by conducting the spending attitude of the taxpayers?

However, in order to determine the functions and aim of taxation precisely, the definition thereof should be drawn up as well. As Oliver Wendell Holmes defined: "Taxes are what we pay for a civilized society."¹¹³ By a more detailed approach, a tax is "a rate or sum of money assessed on a person or property for the support of the government, [...] and commonly levied upon assets or real property (property tax), or income derived from wages, etc. (income tax), or upon the sale or purchase of goods (sales tax)."¹¹⁴ According to Black's Law Dictionary, »a tax may be defined as a "pecuniary burden laid upon individuals or property owners to support the government [...] a payment exacted by legislative authority." A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority" and is "any

¹¹² Reuven S. Avi-Yonah: The Three Goals of Taxation. In: Tax Law Review 2006. pp. 3-4.

¹¹³ *Compania Gen. de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927)

¹¹⁴ Gifis, Steven H.: Law Dictionary (Barron's Legal Guides) Barron's Educational Series Inc., New York 1996, p. 503.

contribution imposed by government [...] whether under the name of toll, tribute, tallage, gabel, impost, duty, custom, excise, subsidy, aid, supply, or other name."¹¹⁵

According to many tax theorists, tax payment is not an obligation related to citizenship, but rather a limit to ownership.¹¹⁶ It can easily be denied that tax payment obligation would be related to citizenship, since „[a]most all countries ignore citizenship in creating taxing jurisdiction.”¹¹⁷ Thus taxation can not be considered simply as an obligation for citizens, since, on one hand, citizens at, below or under certain financial circumstances (such as poverty line, subsistence level of income, etc.) are not obliged to pay tax, but are exempt from tax instead, and, on the other hand, foreign citizens and legal entities (e.g. enterprises, undertakings, organizations, institutions, etc.) are obliged to pay tax as well. Furthermore the double tax treaties do not base the regulations on citizenship either, but rather on place of residence. Accordingly, most countries want to tax worldwide income of the citizens and residents thereof, even if the citizen resides outside the country in question and the income is from foreign sources. The most adequate example is the tax system of the United States, the solution and regime of which often forms part of international law courses.

Each country establishes its own tax regime in accordance with the unique needs and traditional principles thereof, its choices reflect a significant amount of convergence regarding the parameters for taxing income that arises in an international setting. For example, within the scope of the fiscal sovereignty thereof, most countries recognize and exercise the right to tax income of a foreign person, which is derived within the borders and territory of the country (so-called source-based taxation, or the principle of source in an international tax law perspective). Also, most of the countries levy tax, regardless of citizenship, on the income of its residents even if that income is derived outside of the country's borders (so-called residence-based taxation, or the principle of residence in an international tax law perspective).

On the other hand, it may hardly happen that someone, residing or even shortly staying in a country does not pay tax at all in that particular state. This situation occurs mainly due to indirect taxes, value-added tax (hereinafter referred to as VAT), and/or goods and services tax (hereinafter referred to as GST), furthermore excises.

¹¹⁵ Garner, Bryan A.: Black's Law Dictionary. West Publishing, 1979, quoted by Wikipedia at <http://en.wikipedia.org/wiki/Tax> (last visited 19/05/2010)

¹¹⁶ Földes, Gábor: A pénzügyi alkotmányosság. In: Társadalmi Szemle 1996/1, pp. 64-65.

¹¹⁷ Kirsch, Michael S.: Taxing Citizens in a Global Economy. In: New York University Law Review 2007/5, pp. 448-449.

In my opinion, focusing on the topic of this paper, tax is basically the main measure of central redistribution, the legal limit of private property, such one time or continuous financial service, which is determined by the correspondent provisions; an income deduction related to the business activity and or the income-wealth position of the individual or enterprise, which may be forced, generally without direct counterservice, by the state or the authorized body thereof from all the persons (be either natural or legal ones) to whom it is levied, in order to secure the funds for the public tasks, functions, and for the fulfilment of public needs.

According to the essence of tax as described above¹¹⁸, the main aim of taxation is to provide the proper tax revenue for fulfilling the state obligations and cover the related state expenditures. In order to increase the foreign direct investment and the amount of incoming capital, attractive business circumstances are needed, of which an effective and widely acceptable tax system should be a relevant part.

3.1.2. Equity and fairness

Fairness is a multiple-meaning category that may be achieved in various ways and always refers to the right social, political, and legal system as well. However, it is always a question whether a tax system or even a type of tax is fair or virtuous, and if yes, on what ground. Furthermore, whether political virtue or economic virtue shall be considered, and what is meant by fairness and virtue at all?

Generally speaking it must be admitted that, even concerning taxation, supranational consensus can be found only regarding a few legal principles. Therefore it is understandable that it is hard to achieve international unity on the field of tax law and taxation systems or certain provisions thereof. It is also questionable what theoretical ground is the basis of taxation, and what tax system suits most¹¹⁹.

Fairness is a questionable and hardly disputable category regarding value added tax, as well as most other forms of taxation. Since, as discussed above, it is a limit of ownership, a form of taking away one's property without his consent, fairness could only be relative: distinction may be made only between the different forms and ways of using VAT.

¹¹⁸ Please note that many other views exists regarding the definition or even essence of tax, for example, an interesting view says that tax is theft, the state steals money from the individual.

¹¹⁹ It is not the goal of this paper to either list or analyze the existing theories, that would exceed the latitude thereof. Accordingly, just a few principles are pointed out, in order to draw up the most relevant basic ideas.

The most important issue in this regard is whether to enact income tax and/or VAT, or to put it another way, whether VAT should replace or complete income tax.¹²⁰ The background of this is that on one hand income tax discourages production and encourages consumption, and on the other hand VAT encourages savings and enterprise. This role of VAT is in connection with the regulatory function of taxation; it affects certain activities and behaviours of the taxpayers, and certainly supports economic growth. Furthermore, VAT, similarly to flat taxes, preserves horizontal equity.

Another important matter is that VAT is more or less a hidden tax, at least not as visible or sensible as other types of tax, since it is not well-known who pays what exactly. Accordingly, due to the lack of disclosure, it is not a fair form of taxation, furthermore the ultimate payer might blame the manufacturer or service provider for the higher market price.¹²¹ As a result, despite VAT forces taxpayers to issue invoice and operate within the formal sector, many of them decides to spare VAT instead and join the underground economy.

It is also a problem that, when tax relief is granted, it is always universal and not tailor-made, relief is provided through universal exemptions and/or multiple rates. For example, under most consumption tax regimes the rich and the poor also enjoy an exemption for certain food items, medicines, etc. Thus, according some opponents of the VAT, it could be considered as a regressive tax. Regressivity therefore has always been a problem of the consumption tax. In its traditional form it generally burdens the poor more heavily than the wealthy, because the poor consume basically all of their income, whereas the wealthy consume only a portion of it. The saved amounts are not taxed, and only the wealthy can have savings.¹²²

However, the VAT has some advantages as well. For instance, revenue can be raised easier with relatively low rates, since the tax base for VAT is much wider than for income tax.¹²³

¹²⁰ This debate is of high importance in the United States. The main focus used to be on replacing the income tax with a kind of consumption tax. However, the current tax reform debate goes beyond whether to choose between having an income tax and having a consumption tax. Many experts propose to introduce some kind of federal consumption tax as a supplement for income tax, since the introduction of for example a VAT as a partial component of the federal tax system is one way to reduce the taxation of saving. They argue that the United States needs both types of tax like most countries, and therefore the correct path to tax reform is not to simply substitute a consumption tax in lieu of the income tax, but to adopt a consumption tax (especially a VAT) in addition to the income tax. Experience from all the other OECD countries has shown that more revenue can be raised from a combination of an income tax and a consumption tax than either alone.

¹²¹ VAT as an indirect tax (the taxpayer and the taxpayer distinct) is paid by the producer, but might be borne by the consumers because of the higher prices. The ultimate payer is often not aware of the type of his payment, e.g. paying the VAT.

¹²² Ainsworth, Richard Thompson: Biometrics: Solving the Regressivity of Vats and Rsts with "Smart Card" Technology. In: Florida Tax Review 2006, p. 709.

¹²³ McGee, Robert W.: The Philosophy of Taxation and Public Finance. Kluwer Academic Publishers, Boston-Dordrecht-London, 2004, p. 220.

Furthermore, there is no penalty on higher production, since VAT is not progressive, so a higher volume of production does not result in higher tax rate and bigger payable amount.

Additionally, the VAT is said to be neutral from the point of view of the competition, the product and the sector as well, since the same rate is levied over the whole tax base, so the total amount of consumption, irrespectively to any other factors.¹²⁴

Last, but not least, it is obvious that with the method of any consumption tax, the taxpayer has a wider spectrum of decisions regarding the allocation of the income thereof. In other words, when consumption tax (e.g. value added tax) is levied, the taxpayer may have more freedom to decide how to use the income, whether to save or consume more, and the amount of tax to be paid differs accordingly. Whereas, in case of income tax, the taxpayer does not have such power and opportunity to make a decision regarding the total income and the related tax amount thereof.

3.1.3. Simplicity

Simplicity has always been a goal of tax policy, and is on the agenda on most tax reforms with innovative measures. A complicated tax system, which is not understandable or even hardly understandable for the taxpayers, is hard to comply with. Thus a very complicated system demolishes the level of compliance, encourages negligence and tax avoidance. Administration of and compliance with complicated provisions and tax code can be costly and time consuming. In addition to the costs of compliance, and especially meaningless complexity takes away the taxpayer's respect for the tax law. Complexity can also affect horizontal equity because similarly situated taxpayers may pay different amounts of tax, due to their different ability to understand the law, or occurs in extra costs of hiring a professional tax advisor or accountant. Taxpayers may also believe that complexity is a cover for some who can enjoy the hidden advantages to pay less than others; and this could mean that taxpayers lose faith in the equity of the tax system.

It is not alone the sheer volume of the material that makes a tax system or a VAT regime complicated. The physical size of the collected tax-related legislation, regulation, and provisions is, in my opinion, important though, and might make the system much more complicated, causing difficulties to the taxpayer. However, some theorists insist that "the large volume of tax-related legal material may actually make taxes simpler", "and more complex

¹²⁴ However, as discussed later, there are certain exemptions, different rates (including zero rate) might be used within the same tax system, different types of relief may be granted for those in greatest need, etc.

provisions promote the goal of fairness by allowing the law to be tailored to fit specific family situations”.¹²⁵

A simplified and transparent VAT regime within the tax system, offering a followable structure of deductions, exclusions, exemptions, and credits could improve the efficiency of the whole system as well. However, I do believe that simplicity regarding VAT is not as important issue as it is in relation to the different types of income taxes, due to the hidden form thereof. Since because of the indirect type thereof, the ultimate payer (tax bearer) most likely is not a taxpayer, the system of VAT shall be known more or less only by the undertakings of the society.

3.1.4. Efficiency

In economic terms, the VAT is a relatively efficient revenue source. As a consumption tax, it does not tax the return to saving. This is one important advantage of consumption taxes from the point of economic growth, since savings are not penalized. Income taxes operate a different way as discussed above, therefore, “[s]ince the economic costs of income taxation rise as greater use is made of it, its relative importance must be scaled back as total revenues rise”¹²⁶, also because in case the income tax is higher, by saving and investment on the wealthy, employees would bear the indirect burden through lower wages.

Due to the opportunity of raising revenue easily and quickly by introducing the VAT, it has been successfully implemented by nearly 150 nations (every single OECD member country except the United States, and most developing countries) as a major source of revenue (on average generally accounts for about 25 percent of all tax revenues in these countries), and international trade rules allow VAT to be imposed on imports and rebated on exports. These states realized that in order to achieve the goals of raising adequate revenue in an effective way, reducing unequal distributions of wealth, making tax systems fairer and reducing the burden of personal income taxes¹²⁷, broadening of the tax base, and regulating market activity and consumption, VAT shall be enacted besides an income tax regime (thus the ideal tax system includes both income and consumption taxes).

¹²⁵ Gouvin, Eric J.: Radical Tax Reform, Municipal Finance, and the Conservative Agenda. In: Rutgers Law Review 2004/Winter, pp. 436-438.

¹²⁶ Viard, Alan D.: Comment on Leonard E. Burman, “A Blueprint for Tax Reform and Health Reform” In: Virginia Tax Review 2008/3, p. 330.

¹²⁷ For example, in New Zealand, the VAT is referred to as goods and services tax (GST) and came into effect in 1986, supplemented by a reduction of marginal tax rates. Similarly, in Australia the introduction of GST was accompanied by a personal income tax cut.

The well recognized revenue raising potential of the VAT may only be realized optimally when it is properly designed and administered¹²⁸. A well structured VAT design, coupled with effective administration, is critical for the success of the tax and achieving the policy objectives of a government at large, neither good design nor administration per se would guarantee a successful VAT system.

If both these elements are available, besides the revenue performance, the VAT becomes an efficient tax with a high rate of compliance and low administrative and compliance costs. In Western European countries, for example, the individual income tax accounted in 1996-2002 for 32% of total tax revenue, compared with 30% for the VAT.¹²⁹

The EU has twenty-seven national VAT regimes coordinated by the Sixth Directive, in which several changes have been made. All Member States must adhere to a single set of rules, occasionally with clearly defined optional methodologies, and derogations from standards require Commission approval.

The VAT/GST was first introduced in France in 1948. The global introduction and enactment of the VAT in the 1950's is definitely one of the most important tax policy developments in the second half of the twentieth century, and nowadays technology offers the possibility of fully digital consumption tax regimes. This might be the further development of designing a new breed of consumption tax similar to the regime of the VAT. Digitizing the VAT is and has been also an issue in Europe as well: the Lisbon Strategy should have been achieved in this regard by a broad effort to utilize the efficiencies of an information society, in order to make the EU a more competitive, dynamic knowledge-based economy, with improved employment and social cohesion.

In Hungary, research and development is well below the average level of the European Union. There is currently no central e-ID infrastructure, although it has been an issue since October 2002, when a pilot project on e-signatures and e-ID cards was launched. As a developing

¹²⁸ I do believe that VAT, and consumption taxes in general, are relatively easy to administer, because the tax base can be determined easier, and the taxpayers, by mainly doing business activities of providing services and selling goods, may be aware of their obligations more than the average people paying income taxes. As Joseph Bankman and David Weisbach argued, the consumption tax is easier to administer than the income tax because it makes no attempt to tax income from capital and thus can omit many of the vexing complications that arise in this regard. For a detailed study of the standpoint of Bankman and Weisbach, please see: Bankman, Joseph – Weisbach, David A. : The Superiority of an Ideal Consumption Tax over an Ideal Income Tax. In: *Stan. L. Rev.* 1413, 1423, 1425 2006/58.

¹²⁹ Bird, Richard M. –Zolt, Eric M.: Redistribution Via Taxation: The Limited Role of the Personal Income Tax in Developing Countries. In: *UCLA Law Review* 1627 2005/52 at 1655 tbl. A., cited by Reuven S. Avi-Yonah, The Three Goals of Taxation. In: *Tax Law Review* 2006/5.

measure, an electronic Portal a transactional gateway was established on April 1, 2005, called “ügyfélkapu” (Client Gate), which allows access to transactional e-government services after a secure authentication registration. Authentications are not currently through a national e-ID yet, but can be obtained by a personal visit to the competent office of the municipality. Hungary is not keeping pace with e-solutions in other EU Member States regarding taxation either. The personal income tax forms can be downloaded from the homepage of the Hungarian revenue office (Adó- és Pénzügyi Ellenőrzési Hivatal, Hungarian Tax and Financial Control Administration, <http://www.apeh.hu/>) and tax returns can be filed electronically.¹³⁰ For the corporate income tax more functionality is available provided by the tax office. VAT forms can also be downloaded from the website, but returns are only accepted by the largest taxpayers.

Another element of the efficiency of the VAT is that in case the structure, rates, deductions and exemptions are well designed, a reduction in the activity of the underground economy may be achieved, despite some participants of the black market and the underground economy will always want to avoid taxes.

3.1.5. Rates

Establishing the VAT rate(s) is always a tough decision of the legislation, since it is difficult to determine exactly how economic behaviour will react upon certain elements of tax law. Based on the general experience, it can be stated that a single and relatively lower VAT rate might ease the burden on both administrators and taxpayers. However, this obviously depends on many other factors, e.g. on the taxpaying culture and other features of the society in question. The use of a relatively low and single rate (other than zero-rating) is viable in a well-functioning welfare system and a broad-based GST to generate a significant amount of the required revenue. However, in case of a high level of revenue needs and relatively narrow VAT bases, reducing the standard VAT rates would be bad policy.

The adoption of different rates, by using standard and reduced ones, although is in compliance with the modern principles of taxation (such as subsistence level tax exemption), might be a wrong decision where tax administrations are weak, especially in developing countries. The

¹³⁰ In relation to the different applications to be used for surveys and even for administrative law purposes, see Ercsey, Zs. – Radó, J.: Android API for Weed Surveys. In: Peter Ivanyi (ed.): Architectural, Engineering and Information Sciences - 9th International PhD & DLA Symposium: Abstracts Book. Konferencia helye, ideje: Pécs, Magyarország, 2013.10.21-2013.10.22. University of Pécs Pollack Mihály Faculty of Engineering, Pécs, 2013

related collection and administrative costs are higher, the proper compliance is more difficult, and the proportion of possible failures and errors is higher as well.

However, as discussed, in order to achieve equity, different rates might be operated with. In order to address equity matters, accordingly, sometimes more than one non-zero rate is used, and many states operate, besides exemption, with a zero rate as well. The use of the reduced rate(s) on equity targeted goods, according to many experts and theorists (e.g. Richard Bird and Eric Zolt, Pierre-Pascal Gendron) may be a much better solution than expanding the scope of exemptions. This measure is easier to administer both by the taxpayer and the tax authorities, since no distinction shall be taken into account between exempt and taxable inputs, and no pro-rating of inputs are needed, therefore the costs of such system is lower as well.

It is also of high importance to choose appropriate rate(s). High rates, despite they are only implicitly visible for individual taxpayers, obviously increase tax evasion and avoidance efforts, and reduce the level of compliance. “Experience in Europe has shown that very high VAT rates can have similar negative consequences to very high income tax rates.”¹³¹ If the rates are too high, economic activity is discouraged, furthermore black market, the proportion of illegal and underground economy grows. This results in slower growth and more wasted resources, but not necessarily higher revenues. Last, but not least, another disadvantage of relatively high tax rates is that economic inefficiencies could be created thereby.¹³²

3.1.6. Exemptions

Although a VAT system operating with one single tax rate is simple and transparent, in my opinion, due to equity reasons and fairness, certain exemptions shall be provided. Equity issues shall be pointed out and addressed properly. The exemption for households, for instance, makes the flat tax somewhat more progressive than a conventional VAT. Besides, favourably treating equity targeted goods and services under a VAT could be acceptable and fair, especially in societies of which many members live below or just above the poverty line.¹³³

The OECD identified a list of services as standard VAT exemptions, including postal services, hospital and medical care, human blood, tissues and organs, dental care, transport of sick and/or

¹³¹ Reuven S. Avi-Yonah: The Three Goals of Taxation. In: Tax Law Review 2006/8.

¹³² Gouvin, Eric J: Radical Tax Reform, Municipal Finance, and the Conservative Agenda. In: Rutgers Law Review 2004/4, p. 434.

¹³³ There is no unified or generally accepted opinion in this regard. Some experts stress that the use of direct subsidies rather than relief in the form of VAT preferential treatment. However, in my opinion, providing individual subsidies may not be fair on a common level of the society, it is based on individual discretion, and therefore it is difficult to determine uniform criteria and measures. This is not cost efficient either, since extra bureaucracy shall be maintained.

injured persons, charitable work, education, non-commercial activities of non-profit making organisations, sporting services, cultural services, insurance and reinsurance, letting of immovable property, financial services, betting, lotteries and gambling, supply of land and buildings, certain fund-raising services.¹³⁴ This checklist is obviously not mandatory, just establishes guidelines for the member states. The OECD reports on the departure from the standard VAT/GST exemptions in OECD member countries. Some countries exempt goods and services that are not among the usual items, while others tax the standard exemptions. This contrary regulation takes place for example in New Zealand, where GST is chargeable on postal services, human blood, tissues and organs, hospital and medical care, charitable work, education, etc.¹³⁵

In Hungary, for example, there are two basic sets of activities that are exempt from VAT as per Section 85 and Section 86 of the Act CXXVII of 2007 on Value Added Tax. Section 85 contains the exemptions for certain activities in the public interest, as per the OECD list detailed above. Accordingly, the following the following transactions shall be exempt: the supply of public postal services; hospital and medical care and closely related activities on certain conditions; the supply of human organs, blood (including sensitive blood fractions as laid down in specific other legislation) and milk, and the supply of services in connection with donation of the aforementioned and human organs; the supply of services by dental technicians in their professional capacity and the supply of dental prostheses by dentists and dental technicians; the supply of services and of goods closely linked to nursery care by public service bodies and/or to the protection of children and young persons by public service bodies, acting as such; the provision of children's or young people's education, kindergarten, school or university education, etc.

Other special activities shall be exempt as well according to Section 86, such as, for example, certain insurance and reinsurance services; special financial services (e.g. the granting and the negotiation of credit and other similar services, the negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit, the management of investment funds, and venture capital funds, etc.); the leasing or letting of immovable property or part thereof, etc.

¹³⁴ For a detailed study, see OECD, Consumption Tax Trends, (Paris, 2001)

¹³⁵ Wollela Abehodie Yesegat: A Comparative Analysis of VAT/GST Design in Ethiopia, Kenya and New Zealand. In: New Zealand Journal of Taxation Law and Policy 2008/9, p. 341.

Additionally, there are many other types of exemption, which should not be drawn up in detail in this paper, but taking into account the amount of which it could be pointed out that from a legal perspective, there is a wide use of VAT exemptions in Hungary.

The same could be found out regarding many developing countries, including Ethiopia (e.g. besides goods and services, in Ethiopia the revenue authority exempts humanitarian aid institutions, embassies and international organisations) and even Kenya (also including food items such as fruits in the latter state, despite institutions, including aid agencies, are zero-rated), but unlike some well developed states with high level of tax compliance and a strong, traditional taxation and taxpaying culture (also established with the help of consultative meetings and awareness creation programmes), such as New Zealand. In New Zealand, which established one of the broadest GST/VAT design in the world, there are only a very few exemptions, for example, the main GST exemption is for residential accommodations, but certain financial services are also exempt.¹³⁶

Exemption, in my opinion, is a good and effective measure. Besides, basically the same result may be achieved with zero rating or with a reduced rate. Generally exemption is used regarding services, while goods are taxed at zero rates instead. On one hand, exemptions might increase the compliance costs¹³⁷ of the taxpayer. On the other hand, zero or reduced rate may sometimes show a more explicitly progressive tax, therefore reflects equity more and may be made acceptable an easily manner. Thus exemptions are limited to such services as health and education and administratively difficult activities, addressing equity issues with a reduced rate. By using these measures and finding the balance between them, the number of refund requests and the related frauds may be reduced and the function of taxation may be achieved on a higher level.

3.1.7. VAT reform

If “reform” means “to put or change [something] into an improved form or condition,”¹³⁸ then it may seem that reform is always desirable. Development and improvement are always of great importance. All politicians advertise themselves nowadays in Hungary that they are able to pass on reforms.

¹³⁶ Wollela Abehodie Yesegat: A Comparative Analysis of VAT/GST Design in Ethiopia, Kenya and New Zealand. In: New Zealand Journal of Taxation Law and Policy 2008/9, p. 336.

¹³⁷ The cost of tax compliance includes the costs of tax record keeping, reporting, filing the tax return, and planning along with other costs.

¹³⁸ Merriam-Webster's Collegiate Dictionary 1046 (11th ed. 2003).

However, reform for its own sake is never fruitful. A nineteenth century judge said: “Reform? Don't talk to me about reform. Things are bad enough already”¹³⁹. Accordingly, reform should be a positive progress, a move towards a more positive situation from a negative position. A reform is made when the affected matters have become better. It is always a question whether the reform would solve the current questionable matters and/or start a positive progress.

There are no definitive and mandatory models, not a single one could be drawn up either. The societies obviously differ regarding their level of development; economic, legal and tax structures; experience and capacity in VAT administration; and the level of literacy.

Consequently, a design feature that works well in one country might not work in another.

As Bird points out, No-One-Size-Fits-All model applies¹⁴⁰, but certain common features can be found through comparison of the common design features of the VATs in different countries in the context of their legal, economic and tax structures. Thus similarities and common lessons can be drawn up in a much higher proportion than for instance in relation to income taxes.¹⁴¹

In order to use VAT as a revenue instrument with minimal adverse effects, it is essential to closely examine and identify the main areas in the design and administrative procedures that require revision. While both the design and administration of the VAT are important in making VAT successful, this article has focused on the design features.

The simplest, but politically the most sensible way of increasing revenue would obviously be to increase the rates of existing taxes¹⁴², if, among ideal conditions, taxpayers and undertakings would simply pay the higher amount. Little new legislation is needed and the administration is already in place. The VAT, which originally was adopted as a minor tax to finance the European Economic Community, proved to be the ideal tax for this purpose, therefore, not just in Hungary, governments like to increase VAT rates.

¹³⁹ Tiley, John: Away from a virtuous tax system? In: British Tax Review, 1998/4, p. 346, referring to Economist, October 25, 1997., 42.

¹⁴⁰ Bird, Richard M.: Value Added Taxes in Developing and Transitional Countries: Lessons and Questions. ITP Paper 0505, International Tax Program, Institute for International Business, Joseph L Rotman School of Management, University of Toronto, Toronto, Canada, 2005.

¹⁴¹ The reason for this is partly that the income structure and tax compliance re income taxes differ more due to their complexity, while the concept and system of VAT (e.g. structure of selling goods and providing services) are similar and simpler all around the world. Therefore VATs are very similar.

¹⁴² Please note that in relation to some types of taxes, it is not the sole and exclusive decision of a state to change the tax rate without a limit. For instance, increases in the scope of VAT have been constrained by E.C. Directives regarding EU member states.

According to a recent research conducted by Csaba Szilovics¹⁴³, Hungarian citizens are against tax rate increase, especially of VAT and personal income tax. Taxpayers and all other citizens, the whole population feels exactly and directly the raise of VAT rates (despite it is a hidden tax), since it occurs immediately in consumer prices. The high VAT rates are not known exactly among the people, but they feel the difference comparing to the prices abroad, therefore they can realize that the domestic tax is relatively very high. The main difference between increasing VAT and personal income tax rates is that on one hand the higher VAT rates affect all consuming citizens (including unemployed and retired citizens), and, on the other hand, higher personal income tax rates affect only active citizens, who, support 2,5 inactive ones in Hungary.

Another simple and clean method of tax reform is abolition, but it might not be a perfect one. As Denis Healey said: “Another lesson was that you should never commit yourself in Opposition to new taxes unless you had a very good idea how they will operate in practice. We had committed ourselves to a Wealth Tax; but in five years I found it impossible to draft one which would yield enough revenue to be worth the administrative cost and the political hassle.... I suspect the Conservative Party is even more unhappy that Mrs Thatcher promised to abolish the rates without having the slightest idea what to put in their place.”¹⁴⁴

Furthermore, the tax burden can be reduced without abolishing taxes by reducing the tax rates, increasing allowances or widening exemptions for existing taxes. However, recent researches show that reduced rates do not help the lower paid, do not significantly increase incentives and “have no effect on the poverty trap -- raising tax allowances was a better way of helping the poor. It is also reasoned with two major justifications: one is political -- to keep pace with inflation; the other is administrative -- to prevent a significant number of people from being drawn into the tax system by the process known as fiscal drag”.¹⁴⁵

Another method is to create new allowances, exemptions, and reliefs. The direct tax burden is reduced if the structure of the direct tax system is altered by providing new reliefs. These reliefs can be very effective, if they are planned carefully. With innovative ideas, the support can be provided for the aimed groups. This method is, in our opinion, politically favourable as well.

The regime of VAT, in order to achieve the goal thereof and as the result of any reform, should be simple, comprehensive, transparent and understandable for all taxpayers. Clear, simple

¹⁴³ For a detailed study see For more details, see Szilovics, Csaba: Adózási ismeretek és adózói vélemények Magyarországon (2002-2007). G & G Nyomda Korlátolt Felelősségű Társaság, Pécs 2009.

¹⁴⁴ Healey, Denis: *Memoirs* (1989), 404.; quoted by Tiley, John: Away from a virtuous tax system? In: *British Tax Review* 1998/4, p. 347.

¹⁴⁵ Tiley, John: Away from a virtuous tax system? In: *British Tax Review* 1998/4, pp. 327-330.

worded and straight forward provisions shall be enacted and made known publicly. Long term structure shall be introduced, and only really reasonable and necessary amendments shall be made.

3.2. Personal income tax

3.2.1. Tax rates

According to the social fairness, the tax systems shall be fair, as well as each type of taxes. This means, regarding the personal income tax¹⁴⁶, that everybody shall contribute to the public expenses according to their income and wealth situation.¹⁴⁷

The theoretical base of progressive income tax is that “increasing income is connected to declining margin of profitableness”¹⁴⁸. Progressivity obviously favours those with a medium income level albeit many think it rather enhances justice¹⁴⁹, but it undoubtedly decreases the revenue of those with 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 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 fairness¹⁵⁰ 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 as

¹⁴⁶ See Section 1(2) of the Act CXVII of 1995 on Personal Income Tax, stating that the purpose of the act is to secure -- in due observation of the principles of proportionality and equity -- the tax revenues necessary for the fulfillment of State responsibilities, and in special cases, to promote the implementation of certain social and economic goals.

¹⁴⁷ R. A. Musgrave and P. B. Musgrave: *Public Finance in Theory and in Practice*. New York, McGraw-Hill Book Company 1989, p. 227.

¹⁴⁸ E. Streissler: ‘Gazdaságméleti kétségek a progresszív jövedelemadó ésszerűségét illetően’ [Economic theory doubts in connection with the rationality of progressive income tax] In: *Közgazdasági Szemle* 1990/1, p. 79.

¹⁴⁹ Cf. C. Heady: ‘The Conflict Between Equity and Efficiency in Designing Personal Income Tax Systems’ In: *The Role of Tax Reform in Central and Eastern European Economies*. Paris, OECD, 1991, pp. 87-96.

¹⁵⁰ See A. Kecskés: *Felelős társaságirányítás [Corporate Governance]* HVG-ORAC, Budapest, 2011, p. 44.

the taxpayers realizing lower levels of income¹⁵¹; therefore they paid higher proportion of the costs of maintaining the society.¹⁵²

Hungary used to operate a progressive personal income tax system, and recently introduced the flat individual income tax regime of a unified tax rate of 16 percent, effective from 1 January, 2011, in order to make the system more righteous, and to promote employment by the reduction of the marginal tax rate.¹⁵³ The flat tax rate system indeed favours the taxpayers of society who earn more, and this is the fundamental critic thereof. Considering that in comparison with the previous 17 per cent lower rate the current tax rate is no real decline, furthermore the tax burden of those whose income is low became higher due to the provisions of supplementary tax base, though the tax rate of 16 per cent 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 for subsistence needs has been eliminated, so ‘people pay taxes from the first forint they earn’¹⁵⁴.

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

¹⁵¹ The former Hungarian constitution specified the protective care of those who need that as state responsibility. See A. Bencsik, ‘A fogyasztóvédelem alkotmányi szabályozásáról – az új Alaptörvény tükrében’ [About the constitutional regulation of consumer protection - in the aspect of the new Basic Law], in T. Drinóczi, ed., Magyarország új alkotmányossága. Pécs, PTE-ÁJK 2011, p. 31 at p. 36.

¹⁵² As Csaba Szilovics pointed out, the state is for the citizens, and the legal structure shall be established accordingly. Cf. C. Szilovics: Csalás és jogkövetés az adójogban [Fraud and compliance in tax law]. Gondolat Kiadó, Budapest, 2003, p. 191.

¹⁵³ Statement by Willy Kiekens, Executive Director for Hungary and Szilard Benk, Senior Advisor to the Executive Director January 18, 2012 pp. 3-4 Online: <http://www.imf.org/external/pubs/ft/scr/2012/cr1213.pdf> [2012.02.25.]

¹⁵⁴ IMF Survey online January 25, 2012 <http://www.imf.org/external/pubs/ft/survey/so/2012/NEW012512A.htm> (2012.01.30.)

allowances¹⁵⁵ 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.¹⁵⁶

Within the flat tax system, 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 rich 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.

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 work more and 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 for the taxpayer to invest more energy in obtaining a 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, the taxpayers do not take an additional job, or apply for other grants or subsidies¹⁵⁷ if they get to a higher tax bracket accordingly, and by paying higher amount of tax due to the applicable higher tax rate, and therefore they take less money home. The higher tax rate increases the level of redistribution, but decreases the employment rate. As JOHN STUART

¹⁵⁵ Taxpayers can deduct costs in several countries, even if the revenue was earned by non-independent activity. E.g. in Belgium the revenue can be declined by a progressive flat amount. See more in detail: O. Boeijen-Ostaszewska, ed., *European Tax Handbook* (Amsterdam, IBFD 2010) p. 127.

¹⁵⁶ The business processes may be handled with strict mathematical method for preparing the IT support. A detailed study was presented by the conference lecture of Zsolt Ercsey, the major points of which are highlighted in the related abstract book. Cf. Ercsey, Zs. – Süle, Z. – Kovács, T. – Bertok, B. – Kovács, Z.: *Business Process Synthesis with Various Resource Needs*. 9th International Conference Computational Management Science. Imperial College London, UK, 18-20 April, 2012. Book of Abstracts, 76

¹⁵⁷ Contributions paid to citizens without tax burden have been stopped as of January 1, 2011. This used to be a revenue type belonging under the contracted tax base that also arising from its category had to be considered, when the total revenue was calculated or when the tax base and the calculated tax were defined. According to these it was deemed as tax paying revenue with the exception that its tax did not have to be paid – the text of the personal income tax law Section 34 valid until December 31, 2010 (which has been outdated by law no. 123 Section 32(14) on January 1, 2011) said that calculated sum based on regulation on tax amount referring to the total sum of contributions that were not taxed would decline the calculated tax – but it could shift taxpayer's total revenue to a higher level in a progressive structure and thus the tax payment liability also increased. After the change, however, such revenues became perfectly and fully tax free (except for student labor fee, which is a taxable revenue of taxpayer as a revenue from non-independent activity and it is also part of the contracted tax base, thus it also enables taxpayer to gain the right to tax reduction, other reductions and social security contributions as well as counting as work status).

MILL¹⁵⁸ stated in 1848: the progressive tax levies a higher rate of tax on the higher income, therefore it definitely punishes the hard working taxpayers.¹⁵⁹

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 unification¹⁶⁰ 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.”¹⁶¹

The Hungarian tax system including the personal income tax system¹⁶² was characterized by progressivity and complexity.¹⁶³ The first signs of the introduction of the flat tax rate were already marked by the trends of reducing the upper rates and the extension of the tax base. The legislator, in my opinion, observing the examples of other Eastern and 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 constitutional¹⁶⁴ principle of tax payment, but also the basic principle of the personal income tax law¹⁶⁵ will be applicable at a much higher level and government revenues may also increase significantly.

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 being related to two-third majority vote of the Hungarian Parliament. They stated that the new regulation achieved

¹⁵⁸ See A. Kecskés: ‘John Austin gondolatai a jogról, a jogon kívüli tényezőkről és a szankciókról’ [The thoughts of John Austin on law, the factors beside the law, and the sanctions] In: I. L. Gál ed., *Tanulmányok Dr. Földvári József professzor 80. születésnapja tiszteletére*, Pécs, 2006, p. 114-116.

See also A. Kecskés: *John Austin félig megélt élete és félig megírt jogbölcselete* [The half lived life of John Austin and his anthropology of law written half]. In: *Jogtudományi Közlöny* 2007/61, pp. 345-346.

¹⁵⁹ Mill, J. S.: *Principles of Political Economy*. London, Longmans, Green and Co., 1848, p. 78.

¹⁶⁰ Cf. A. Ádám: *A posztmodernitás jogi sajátosságairól* [About the legal characteristics of postmodernity]. In: *Társadalmi Szemle* 1996/4, p. 19.

¹⁶¹ A. Ádám: *Bölcselet, vallás, állami egyházjog*. [Philosophy, religion, national canon law] Budapest-Pécs, Dialóg Campus Kiadó, 2007, p. 79.

¹⁶² See more in detail C. Szilovics: *Stability and Calculability Regarding the Taxation of Natural Persons in the Period of 1998-2005*. In Jakab, A. – Takács, P. – Tatham, A. F. (eds.): *The Transformation of the Hungarian Legal Order 1985-2005*. The Hague, Kluwer Law International 2007, p. 163 at p.169.

¹⁶³ Cf. L. Hauwe: *German income tax policy between equity and efficiency*. In: *European Journal of Law & Economics* 1998/5, pp. 267-268.

¹⁶⁴ See Section 70/I.(1) of Act XX of 1949 (former Hungarian Constitution).

¹⁶⁵ See Section 1(1) of the act on personal income tax.

its goal; it provided higher budgetary income (a sum of extra 60 billion HUF together with the social security contribution), stimulated the economy, and promoted employment.¹⁶⁶

However, levying a progressive tax regime may be more advantageous from the point of fulfilling state obligations¹⁶⁷. 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.¹⁶⁸ 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.¹⁶⁹ In comparison, in the Act CLXIX of 2010 on the Hungarian Central Budget of 2011¹⁷⁰ 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 2012¹⁷¹.

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 tax¹⁷², 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.¹⁷³ These figures show that the measures taken by the Hungarian government 'have led to less than optimal economic outcomes'¹⁷⁴. 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 duties¹⁷⁵, 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

¹⁶⁶ http://www.piacessprofit.hu/kkv_cegblog/penz/marad_az_egykulcsos_szja.html [2012.04.12.]c

¹⁶⁷ However, the tasks and responsibilities of the states are being transformed. See A. Bencsik: Fejezetek a fogyasztóvédelmi (köz)jog hazai történetéből [Chapters of the History of the Domestic Consumer (Public) Law] In: Jura 2011, p. 156 at p. 161.

¹⁶⁸ IMF Country Report No. 12/13, p. 31. Available online: <http://www.imf.org/external/pubs/ft/scr/2012/cr1213.pdf> [2012.03.10]c

¹⁶⁹ See Appendix 1 of the Act CXXXIII of 2011 on the Execution of the Budget of 2010.

¹⁷⁰ Please do note that the official figure of the amount collected from individual income tax in 2011 is not available yet, that will be enacted by the legislation in the annual accounts of the budget.

¹⁷¹ See Appendix 1 of Act CLXXXVIII of 2011 on the Hungarian Central Budget of 2012.

¹⁷² Appendix 1 of Act CXXXIII of 2011 on the Execution of the Budget of 2010

¹⁷³ Appendix 1 of the Act CLXIX of 2010 on the Hungarian Central Budget of 2011

¹⁷⁴ See IMF Survey online January 25, 2012 <http://www.imf.org/external/pubs/ft/survey/so/2012/NEW012512A.htm> [2012.01.30.]

¹⁷⁵ Appendix 1 of the Act CLXXXVIII of 2011 on the Hungarian Central Budget of 2012

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 most¹⁷⁶, 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.¹⁷⁷ 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.¹⁷⁸ 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 amounts¹⁷⁹ 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.

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,¹⁸⁰ and

¹⁷⁶ Budgetary concept of LMP (the Hungarian Green Party, Politics Can Be Different). <http://lehetmas.hu/wp-content/uploads/2011/09/Az-LMP-2012.-%C3%A9vre-sz%C3%B3l%C3%B3k%C3%B6lts%C3%A9gvet%C3%A9si-javaslat.pdf> [2012.03.04.] p. 17.

¹⁷⁷ As Dr. György Surányi highlighted in his presentation on May 19, 2011 at 6 pm at CIB Bank Zrt. headquarters, the rich also have one dinner, therefore it doesn't matter if more money stays with them after tax payment, if they don't spend it.

¹⁷⁸ For more details see latest Gfk survey http://www.gfk.hu/imperia/md/content/gfk_hungaria/pdf/press_2012/press_eng/press_2012_03_16_eng.pdf [2012.04.05.]

¹⁷⁹ These government moves have been urged by several market players and analysts for many years.

See e.g. B. Layman: Az offshore halála [The death of offshore] Budapest, HVG Kiadó Zrt. 2010, pp. 272-274.

¹⁸⁰ See for example <http://www.nepszava.hu/articles/article.php?id=464441> and http://adozona.hu/szja_ekho_kulonado/LMP_tobbkulcsos_adora_van_szukseg_UPU7YH [2012.04.10.]

basically this has been established by the International Monetary Fund as well: Hungary's design 'added to bureaucracy, and overly burdened the most vulnerable'¹⁸¹.

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.¹⁸² 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.¹⁸³ 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).¹⁸⁴

The essential issue is how business players react on taxes. High and progressive taxes cut back performance and will not stimulate production.¹⁸⁵ 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 permanent investment account¹⁸⁶, the calculation of cost invoices for individual entrepreneurs, or when real estate or other property is sold¹⁸⁷). I believe that tax planning performed by the taxpayer in such ways is by no means harmful, but its wide option much rather promotes that taxpayers accept tax law, because the taxpayer is happy to pay less tax feeling that implicitly he/she received more money or actually more stayed in

¹⁸¹ IMF Survey online January 25, 2012 <http://www.imf.org/external/pubs/ft/survey/so/2012/NEW012512A.htm> [2012.01.30.]

¹⁸² Some of the business costs may be saved via developed IT support. Cf. Ercsey, Zs.: Üzleti folyamatok támogatása a felhőben. Pollack Press, Pécs, 2014, pp. 48-50

¹⁸³ The average unemployment rate of the Euro zone was 10 per cent by surveys in December 2010, while the EU average was 9.6%. This figure in Hungary has been on the rise since December 2009 and it reached 11.7% by the December 2010 official survey. (See more in detail: Eurostat Newsrelease, 2011/18)

¹⁸⁴ Lykkesoft, M.: The Danish Model. A European success story In: Internationale Politikanalyse 2009/12, p. 5.

¹⁸⁵ Streissler, E.: Gazdaságelméleti kétségek a progresszív jövedelemadó ésszerűségét illetően [Theoretical economic doubts regarding the rationality of progressive income tax] In: Közgazdasági Szemle 1990/1, p. 79.

¹⁸⁶ See Section 67/B. of the Act on Personal Income Tax.

¹⁸⁷ The effective regulation has retained taxpayers' opportunity to deduct three types of cost: the amount of income shall be established by deducting the expenditure related to the acquisition, the costs of value-added investments, and the costs in connection with the transfer can be deducted from the revenue.

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 municipalities¹⁸⁸, 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.

The study of CSABA SZILOVICS¹⁸⁹ shows that Hungarian taxpayers unilaterally vote against tax rises, especially that of the value added tax and the personal income tax (only 17 per cent of the interviewed would support the increase of personal income tax rates). In connection with the personal income tax taxpayers have a rather narrow field of options to plan their taxes (especially public sphere employees have an even narrower option to commit tax fraud), even though many authors represent a counter opinion¹⁹⁰..

The Hungarian tax system operates legally with a single flat tax rate, but practically with two levels of tax burdens. A progressive individual tax system is used in the Republic of Croatia, with three tax brackets and three different tax rates. The Croatian provisions in force, similarly to the former Hungarian ones¹⁹¹, indicate that the legislator believes that just taxation can be applied in a more effective way if the wealthier pay more not only regarding the volume of tax, but also proportionally. This approach is doubted by the current Hungarian government that has received huge criticism in this regard both from the opposition thereof, and the International Monetary Fund.

¹⁸⁸ Based on the 2011 budget of the Republic of Hungary, i.e. Act no. CLXIX of 2010, Section 38, (1) local municipalities in total are entitled to 40 per cent of the personal income tax declared for the year 2009 according to taxpayers' permanent addresses. 8 per cent of this sum based on administrative areas is actually going to the local municipality.

¹⁸⁹ See more in detail Cs. Szilovics: Adózási ismeretek és adózási vélemények Magyarországon (2002-2007)[The knowledge and opinion of taxpayers on taxation in Hungary (2002-2007)] Pécs, G & G Nyomda Korlátolt Felelősségű Társaság, 2009.

¹⁹⁰ Brother Layman says for example that today only 10 per cent is really paid for personal income tax, and large personal revenues have long been tax free due to offshore or domestic non-existing accounts, because the actual revenue, after which personal income tax should be paid, is extracted from companies that way. (B. Layman, op. cit., n. 40, at p. 331.

¹⁹¹ 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 (See Section 30 of the Act on Personal Income Tax in effect until December 31, 2010).

3.2.2. Deductions, exemptions and tax allowances¹⁹²

Some countries consider taxpayer's family composition, when personal income tax is calculated.¹⁹³ Thus besides personal taxation (where taxpayers are individual income earners) the opportunity of common tax payment is given as part of the fiscal sovereignty in several states (where taxpayer is a family unit). The majority of countries provide some kind of personal income tax reduction for families with children, because the lawmaker respects the social necessity and advantages of children as well as the burdens they mean for families.¹⁹⁴

Although there are various methods and countries to choose different policies, families with children are usually wholly or partly subsidized financially through the tax system.¹⁹⁵ I believe that this is an important subsidy method, although not satisfactory enough, because taxpayers will not have more children in order to get more tax reduction and tax or tax base reductions will not stimulate couples to get more children, but it is indeed an effective method of financial support. It is easy to understand that generally these reductions cannot be used by lower income realizing layers of society, because their income does not reach the taxed level, it is around the minimum wage or hardly reaches the minimum of subsistence or social minimum.

The Hungarian regulation also works like this. Those with higher revenue can apply more allowances and get greater advantage to use the subsidy opportunities offered by laws. The Hungarian system in force also received the name "family taxation", because the new provisions brought new features in terms of family allowances.¹⁹⁶ I believe it is a positive initiative of the legislator that for the first time since the introduction of family allowance in

¹⁹² On the tax free status of minimum of subsistence and minimum wage see in detail Zs. Ercsey: Tax Exemption for the Minimum of Subsistence. In: A. Ádám (ed.): PhD tanulmányok 6. [PhD studies 6]. Pécs, PTE ÁJK Doktori Iskola 2007, pp. 169-184.

¹⁹³ Some countries treat children and spouse separately (e.g. Austria, where children and spouse are taxed separately), other countries may pay special attention to children and spouse in a combined way. In France, for example, which I believe is one of the best examples of family taxation, the personal income tax is levied on households and not on husband and wife individually. Married taxpayers get the chance to submit separate forms only in special cases determined by law. (See O. Boeijen-Ostaszewska, ed., op. cit. n. 17, at p. 273)

¹⁹⁴ As the number of children grows, the allowances grow in Belgium, Greece and Italy. The contrarian solution is, when the incomes of children are wholly or partly added to parents' tax base (see in detail e.g. the Netherlands; H. Vording - O. Ydema: The rise and fall of progressive income taxation in the Netherlands (1795-2001) In: British Tax Review 2007/3, pp. 255-279.) In the majority of countries (e.g. Belgium, France) children living in the same household are also differentiated by marital status. If the child in question has already got married, a smaller allowance can be applied after him/her, e.g. regarding the limit of allowance the total contracted income maximum is relevant for the married child (a vital difference is that Hungarian law connects this issue to the point of getting capacity to exercise rights).

¹⁹⁵ Bencsik, A.: A gazdaság igazgatása. In: Fábrián, A. – Rózsás, E. (ed.): Közigazgatási jog különös rész [Administrative law special part] Pécs, PTE ÁJK, 2011, pp. 134-135.

¹⁹⁶ Since its introduction in 1988 the Hungarian personal income tax system went through serious amendment and development also in this respect. That time such reductions were available to a very limited extent only. Taxpayer had to have min. three children under 14 (or under 25, if that child was a regular higher education student) and the tax base reduction was HUF 12,000 per year per child.

1988 now it can be applied after a single child too and regardless of income amount. This tax base allowance (instead of the previous tax allowance) can be used by married couples that are entitled to family benefit together as well, if they both earn an income. The family allowance – depending on the number of children in the family – will be HUF 62,500 per child and month, if the family has one or two children and HUF 206,250, if it has three or more children.¹⁹⁷

The amount of allowance, I think, is to be criticized, because the principle of economies of scale¹⁹⁸ is valid for families too, therefore the much higher amount implicit contribution to families with three or more children will not reach the goal of the legislator had in mind due to all conditions; furthermore the higher allowance for the third child cannot be applied for families realizing lower level income. It is to be welcomed in the new regulation, though, that taxpayers who receive a disabledness contribution can also use the tax base allowance after themselves as subjects preferred by the law.

Excluded from the taxation is the part of the income that is necessary for taxpayer to fulfil his existential needs. This part of income is usually called existential minimum (poverty line). The term *non-taxable part of the income* is used in tax terminology, and in Croatian Income Tax Law the term *personal allowance* is used. Article 36 of the Income Tax Law prescribes that the full amount of realised income should be reduced for personal allowance in the amount of HRK 1,800 for each month of the taxable period. This amount of personal allowance is enlarged for dependent members of family and children. Income Tax Law presumes that the amount of HRK 1,800 is enough for a taxpayer to cover his basic existential needs.¹⁹⁹

There is no allowance, relief, or credit provided for taxpayers in Hungary due to their low level of income, not even the minimum wage is exempt from tax. In other words, every single Forint of revenue is taxed irrespectively of the level of subsistence²⁰⁰ of the taxpayer -- the only relief is that the provisions of the supplementary tax base shall not applicable for certain annual revenues. This is contradictory to the modern principles of taxation, and makes the tax system less fair. The Croatian system, however, takes into account a minimum amount earned by the

¹⁹⁷ See personal income tax law Section 29/A. § (2).

¹⁹⁸ Mieszkowski, P. M. – Pechmann, J. A. - Tobin, J. : Is a Negative Income Tax Practical? In: Yale Law Journal 1967/1, p. 8.

¹⁹⁹ Sindičić, P.: Načelo pravednosti u poreznom sustavu RH' [The principle of fairness in the tax system in Croatia], Znanstveni skup Uloga države u socio-ekonomskom razvoju nacionalnog gospodarstva, Zbornik radova u povodu 80. godišnjice života prof. emeritusa Božidara Jelčića [Scientific conference on the role of the state of socio-economic development of the national economy, Proceedings of the occasion of the 80th Anniversary of Prof. life. Emeritus Bozidar Jelčić] Zagreb, Visoka poslovna škola Libertas Zagreb [Libertas Business College] 2010, p. 345.

²⁰⁰ The tax exemption for subsistence level is the guarantee for the financial security of the individual. See C. Szilovics, op. cit. n. 14, at p. 103.

taxpayer, which is, in our opinion, a more just solution, the introduction of such personal allowance might be of value in the Hungarian structure as well.

Both countries use family allowance that can be applied irrespectively of the volume of income derived, which strengthens the level of fairness. The Croatian method, as a tax allowance, takes into account all dependent members of the family (e.g. spouses, parents of spouses, grandchildren, grandparents), and regulates in detail the personal allowance for children: the factor of personal allowance is specified from the first child with an increasing factor. However, Hungary offers a small tax-base deduction for the first and the second child, and a much higher volume for the third and ongoing children, but does not consider other dependants. Furthermore the additional amount for the third child is significantly higher, and this, as well as the applicability of the allowance for taxpayers earning less, raises doubtful matters.

The Hungarian personal income tax does not take into account the necessity of the fulfilment of the basic existential needs of the taxpayer, thus subsistence level tax exemption as the modern basic principle of taxation is not applied. Contrary tax allowances can be applied regarding the monthly salary in Croatia: according to the principle of tax exemption for subsistence level, HRK 1,800 of each taxpayers income (annual amount of HRK 21,600) is fully exempt from tax and forms a non-taxable part of the income. This can be observed regarding the pensioners as well for the monthly amount of HRK 3,200 and the annual sum of HRK 38,400.

Both states take into consideration the number of children of the household, but whereas the Hungarian regulation only establishes a tax base allowance for the children number one, two three, which is radically increased in case of the third child, the Croatian legislature handles the dependants the same way as children and a proportionately growing allowance is applied for each child precisely indicated until the fifth one.

We do believe that the allowance for disability, provided by both states, is an important measure of taxation, and shall remain enacted in the future as well.

3.2.3. Burdens 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 Contributions²⁰¹ states that it was adopted by

²⁰¹ By this act a new element of financing health care occurred in the Hungarian system, which used to be financed mostly from the central budget. It is an interesting phenomenon that the act, which aimed to be part of the reform

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 contribution²⁰² 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).²⁰³ 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.²⁰⁴

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,²⁰⁵ if

or transformation of the health care and social security system, entered into force on 1 January 1999, when similar measures from the financial point of view were taken is Poland. Cf. Pieprzyk, P.: The Polish Health Care System's Endless Journey to Perfection – A Never Ending Story, in: *Social Transformations in Contemporary Society*, 2013/1, ISSN 2345-0126, p. 39. Available at <http://stics.mruni.eu/wp-content/uploads/2013/06/34-44.pdf> (5 December, 2013)

²⁰² The percentage health care contribution as defined in Act XCII of 2003 on the Rules of Taxation is paid by the employers or payers (together hereinafter referred to as the payer) on the income paid to resident private individuals as defined under Act LXXX of 1997 on the Eligibility for Social Security Benefits and Private Pension and on Funding Such Services.

²⁰³ According to Paragraph (1) of Article 3 of the Act LXVI of 1998 on Healthcare Contributions.

²⁰⁴ According to Paragraph (3) of Article 3 of the Act LXVI of 1998 on Healthcare Contributions.

²⁰⁵ As per Section 67/B of the Act CXVII of 1995 on Personal Income Tax.

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;²⁰⁶ 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.²⁰⁷

It is important that, in compliance with the relevant provisions,²⁰⁸ 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,²⁰⁹ 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

²⁰⁶ In accordance with Section 84/G of the personal income tax act.

²⁰⁷ See Point c) of Paragraph (2) of Article 3/A of the Act LXVI of 1998 on Healthcare Contributions.

²⁰⁸ According to Paragraph (3) of Section 12 of Act LXVI of 1998 on Healthcare Contributions,

²⁰⁹ Similar approach is taken in that regard in many other countries, for instance in Poland. Cf. Pieprzyk, P.: The Polish Health Care System's Endless Journey to Perfection – A Never Ending Story, in: Social Transformations in Contemporary Society, 2013/1, ISSN 2345-0126, p. 39. Available at <http://stics.mruni.eu/wp-content/uploads/2013/06/34-44.pdf> (5 December 2013)

not even have to indicate the interest and the amount of paid burdens in his tax return to be filed after the tax year.²¹⁰

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 re-codified 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.

²¹⁰ The Hungarian personal income tax system, similarly to other countries, operate as an indirect tax, since the employer, as well as the payer deducts the amount of tax leaved on the income and issues a certificate on the deduction, according to which the taxpayer is not obliged to pay the amount of tax to the revenue office (irrespectively of the fact whether this amount was really paid by the employer to the revenue office). However, regarding most types of income the data of this certificate shall be indicated on the tax return.

3.3. Local government units

The goal of every state decentralization is to recognize and please the public needs, furthermore to encourage local and regional development. Only by achieving those goals of decentralization can the state motivate and satisfy its citizens for contributing to the accomplishment of public affairs.

The idea of local self-government dates back to a tradition of centuries in Europe. Local self-determination and exercise of power, although to different extends, appeared both in the concept of the Scandinavian ‘*tingsted*’ (i.e., locality, the materialized expression of local autonomy in the early Middle Ages²¹¹) and the British ‘devolution’ (i.e., decentralization of central authority). Marked differences and delimiting characteristics can be observed in both the horizontal and vertical structures of existing local self-governments of individual European countries, which developed with different characteristics. The systems having unique traits, despite the small and large differences, however, can be categorized according to the local government development path: they can be classified as per their formation, history, and related traits. Accordingly, European development path of local authorities draws up three main self-government models: the northern, the Napoleonic (Latin), as well as the intermediate model.²¹²

The models can be separated according to the level of autonomy. In the north, the Nordic model is the type of public administration based on stronger local self-governments, which fulfils traditionally a higher number and more significant public tasks, exercises wider powers providing considerable autonomy and allows greater flexibility (including, *inter alia*, Sweden, Denmark, Finland, Norway, Belgium, the Netherlands, Great Britain and Ireland)²¹³. The Napoleonic (or Latin) model compared to this grants a limited degree of autonomy to local governments (e.g., France, Spain, Italy, Greece and Portugal). The intermediate model is between these two types, by achieving local governments of medium level of power (such as Germany, Austria, Switzerland and Belgium).

²¹¹ See: Kecskés, A.: John Austin félíg megélt élete és félíg megírt jogbölcsélete. [Half lived life and half written theory of jurisprudence of John Austin], *Jogtudományi Közlöny* 2007/June-August, pp. 345-351.; See more: Kecskés, A.: John Austin gondolatai a jogról, a jogen kívüli tényezőkről és a szankciókról [Thoughts about law, terms out of the law and sancitons of John Austin] In: Gál, I. L. – Hornyák, Sz. (eds.): *Tanulmányok Dr. Földvári József 80. születésnapja tiszteletére* [Studies on the occasion of 80's birthday of Dr. József Földvári] Pécs, PTE-ÁJK 2006, pp. 113-127.

²¹² Nyitrai E.K. (ed.): *Helyi önkormányzatok és pénzügyeik* [Local Governments and Their Finances] Budapest, Muncipium Magyarország Alapítvány 2003, pp. 3-6.

²¹³ Torma, A.: Edited version of habilitation lecture held in the University of Miskolc on 2 May, 2002 http://www.uni-miskolc.hu/~wwwallin/kozig/hirek/eukozig/onk_reform.pdf (24/06/2010)

The Hungarian and Croatian self-government systems belong to the intermediate model of the three basic types of self-governments according to economic autonomy and funding aspects. Both the Hungarian and Croatian model follow the European trends, since the types move toward each other, and, as a result of European unification, the elements, which could be separated earlier, converge due to the unifying principles.

The local government models show a number of differences, however, certain similarities, some traditional values occur in all countries. Certain values are specified by the legal regulation of every EU Member State, and are also declared by the European Charter of Local Self-government (hereinafter referred to as the Charter) accepted by the Council of Europe.

Article 9 – which includes eight sections – (Financial resources of local authorities), the longest part of the Charter, regulates the finances of local governments. It provides detailed guidelines on local self-governments, and contains the following financial and economic management principles:

- principle of income: the local authorities are entitled to their own financial resources, of which they may dispose freely within the framework of their powers;
- local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the corresponding law (the principle of entitlement to the financial resources adequate to the responsibilities);
- the principle of local taxation powers (local taxation rights, and the right to introduce other local payment obligations; part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate);
- reduction of financial disparities between the local self-government units (so-called equalization principle);
- the use of funds as per the statutory limits (the principle of expenditure);
- as far as possible, grants to local authorities shall not be earmarked for the financing of specific projects (the limitation of earmarked funds);
- the autonomy of management decisions within their own jurisdiction (principle of discretionary powers);
- participation in the central decision-making concerning local self-government finances (principle of participation).

The most important principle, in our opinion, is the entitlement to appropriate financial resources, which means, on one hand that the volume of municipal funds shall be commensurate with the extent of local government responsibilities set forth in the corresponding law in the legislation,²¹⁴ and, on the other hand, the amount of funds allocated at the local self-governments can be considered as appropriate, if they keep pace with the cost of carrying out their tasks (Paragraph 4 of Article 9 of the Charter).

It is in accordance with the single European principles and unifying trends, that the Hungary developed its tax system in compliance with the requirements of the European Union, by fulfilling the related harmonization tasks, and that the Republic of Croatia has adopted solutions that are used by the majority of European countries. The current Hungarian tax system can be examined through two, and the Croatian through three fiscal levels. This paper deals especially with tax revenue of local and regional self-government units, by presenting the way of realizing tax revenue, levying and collecting taxes, furthermore satisfying public needs on state, county and city levels.

The establishment of the tax system of the Hungary and the tax reform starting in 1988 faced, similarly to the changes in Croatia, problems and difficulties during the peaceful political transition into a constitutional state ready to introduce parliamentary democracy,²¹⁵ and promote conversion to a socially alert market economy, and took similar examples as a basis. Furthermore, the harmonization need and tax legislation modified accordingly show several solutions that were used in the Republic of Croatia as well.

Since the declaration of its independence, the Republic of Croatia has commenced thorough reconstruction of its tax system as well, since it had to meet the requirements of the new political system terminating the war period, as well as the challenges of market economy closing the socialist character.²¹⁶ Essential tax reforms have brought the system closer to systems of the EU Member States, through its harmonization with taxation systems of developed European countries.

²¹⁴ Paragraph 2 of Article 9 of the Charter

²¹⁵ Cf. Halász, V. - Kecskés, A.: La Porta Magyarországra látogat? – Rafael La Porta professzor és munkaközössége kutatásai és értékelési szempontjai a magyar jog tükrében [Does La Porta visit Hungary? – researches and criteria for the evaluation Prof. Rafael La Porta and his working community in related to the Hungarian law] Európai jog 2013/ July, pp. 18-31.

²¹⁶ Cf. Kecskés, A.: Corporate Governance. Budapest, HVG-ORAC 2011, pp. 59-67.

3.3.1. Scope of authority of local and regional self-government units and their revenue

The local self-government is the local level of public finances, which performs specified public duties based on its revenue. The public duties, on which the revenue of the local self-government rests and has to be spent, are the following.

The system of local self-government units, which is the local level of public finance and was established as a result of the political changes, has gone through several amendments and reforms in the last twenty-three years. Among these, one of the most important is that the model based on four sub-systems according to Act XXXVIII of 1992 was dismissed in 2011, but the local self-government units still form the local level of the public finance as per the new regulation. Significant change was brought, however, regarding the operation of the self-government units by restoring the system of districts²¹⁷, the debt takeover²¹⁸, and the transformation of the school system.

The operation level of the local self-government units performing state functions play an important role in the life of the state and the citizens thereof in Hungary. The approximately 3,200 self-government units employ significant proportion of public servants and government officers, thus the self-government system is one of the biggest employer of the country. Therefore the opinion on the Hungarian administrative system is fundamentally determined by the quality of work of the self-government units, the services and the connection thereof with the clients and the local communities. One of the characteristics of the Hungarian self-government system from the financial point of view is that it forms the local level of public finances, therefore a strong separating boundary can not be established between the local and central level in connection with the tasks and responsibilities, these levels complete each other, perform their duties and carry out their activities relying on each other from the financial and informational point of view in the new system of task financing.

A few basic questions can be raised, however, relating to the operation of the financial management of the self-government. The first, is how the self-governance, the representation of local interests, local taxation, and the execution of the tasks specified by the state comply with each other. The Hungarian self-government units are provided with own revenues from

²¹⁷ Act XCIII of 2012 on the modification of the act on the establishment of the administrative districts and the attached acts

²¹⁸ Section 8 of the Act CXIII of 2012

1990, but the freedom of spending them is influenced by the necessary finance of the mandatory tasks, the subsidies provided by the state, and the calculation obligation of local tax power.²¹⁹

The former system of normative finance, which was in force until 2012, made the self-government units vulnerable, since the normative funds were not assigned according to the financial needs. The new type of task-related finance, introduced on 1 January 2013, relies on the own revenues of the self-government unit. A process started in 1998 with the increased utilization of local taxation, pressurizing the local self-government units to introduce, almost compulsorily, the local taxes effectively and almost totally. Local taxation indeed provides one of the most important parts of the own revenue, but it must be admitted that this revenue structure affects the poor and the rich local self-government units differently. Local taxes form a significant element of the revenue of the local self-government units that have great economic potential, but mean only theoretical revenue for many self-government units, on the territory of which there is no industry, no real estate market, and the level of employment is low. These matters should be taken into account, and should be endorsed differently regarding the funding of local self-governments, since there might be significant differences even between the municipalities of similar number of population. For instance, the annual budget of the city of Szeged with 170,000 inhabitants is approximately one third bigger than the budget of Pécs with 165,000 inhabitants. Even more extreme differences can be pointed out in relation to the comparison between the budget of Pécs with Budaörs or Tiszaújváros. Besides, the situation of the capital, Budapest, is completely different regarding taxation as well, due to, for instance, the high proportion of the tax on vehicles.

We do believe that self-governance can not be applied without the absolute and calculable disposition over the means necessary for the operation.²²⁰ The self-determination is possible only if the financial autonomy is provided, the condition of which is the creation of a calculable budget based on the own decision of the self-government unit in accordance with the available

²¹⁹ Similar system has been built in Slovakia in the field of independence of local governments management. In relation to this see more: Bencsik, A.: A szlovák önkormányzati rendszer [The Slovak local self-government system]. In: Fábrián, A. (ed.): Válogatott európai önkormányzati modellek [Selected European local self-local government systems]. Budapest-Pécs, Dialóg-Campus Kiadó 2012, pp 91-92.

²²⁰ It is confirmed by the regulation of Act on Local Governments and the Act on Amendments of the Act on Local Governments, which connect the definition of local public affairs with the condition of provision of resident population with public service, furthermore it defines that an activity, which is connected to the creation of systemic, financial and personal conditions of collaboration between local governments and resident population. Cf. A. Bencsik, 'A helyi önkormányzatok helye, szerepe a fogyasztóvédelem igazgatásában' [The place and role of local governments in the field of administration of consumer protection], in A. Fábrián ed., *20 éves a magyar önkormányzati rendszer* [The local government system is 20 years old] (Pécs, A Jövő Közigazgatásáért Alapítvány 2011) pp. 243-244.

funds, and the disposition right over the income items. The economic autonomy of the local self-governments is declared by the Hungarian Constitution. According to Section 32, the local self-government may dispose over the property thereof, which may be used to fulfil the local tasks. The self-government is entitled to create its own budget, and to decide on local taxes, but may decide on the expenditure the way that does not jeopardize the tasks thereof specified by the state in the applicable act. This approach, however, may be deemed as an important restriction, since the obligatory fulfilment order of the different tasks is set up by the legal regulation. Therefore the self-government unit is forced and even obliged to complete the possibly insufficient state subsidies by using its own revenue for the referred tasks, and the right to dispose over the own revenues is reduced accordingly. Thus the hierarchy of the public aims is established unintentionally by this approach. The self-government unit is entitled to state subsidies and other financial support proportionate with the mandatory powers and responsibilities, according to Section 34 of the Hungarian Constitution.

Similar provisions are included the Austrian Constitution,²²¹ and the Estonian Constitution declares²²² that the tasks specified by state acts shall be financed by the central state budget. Similar measures are taken by the French Constitution,²²³ and it is stated by the German Constitution²²⁴ that if a task is prescribed for the self-government, the related funds shall also be provided thereto. Contrary, the Portuguese and the Italian Constitution establish a balancing (compensatory) mechanism due to the economic differences between the self-government units.

The Charter referred above (European Charter of Local Self-government) was accepted in Strasbourg in 1985 and implemented by Act XV of 1997 in Hungary is important for the Hungarian local self-government system. Theoretical conditions are set forth for the European self-government units by the Charter,²²⁵ and the establishment of the financial opportunities of the self-governments are placed in focus.

3.3.2. The revenue of local and regional self-government units

Financing of local and regional self-government units in decentralized countries is of great importance, both for the development of the overall economy, as well as for the development

²²¹ in Subsections 116(1) and 116(2) of the Austrian Constitution

²²² Subsection 154(2) of the Estonian Constitution

²²³ Subsection 72(2) of the French Constitution

²²⁴ Subsection 104/A(2) of the German Constitution

²²⁵ Section 9 of the Charter

of local and regional self-government units which carry out the logic of polycentric development. To satisfy this postulate it is necessary to find the optimal method of financing.

The local and regional self-government units, in order to have the tasks performed, have to ensure revenues in their budgets, which are proportionate to expenditures, from their own sources, of shared (assigned) taxes and grants from state and, in the Republic of Croatia, county budgets.

3.3.2.1. The Property of the local government units

If we deem the property of local government as the condition of the authority of local self-government,²²⁶ it can be declared that there are significant differences within the subsystem of local self-government. The reconsideration of the management of local governments and budget financing are also part of the self-government reform. Within this, the following issues should be reconsidered, and regulated accordingly.

First is the normative financing, the major problem of which is that it is not sufficient enough to carry out the task. The experts' opinions are divided about the rate of percentage of normative financing,²²⁷ which are provided the needs. The normative financing does not make any difference between the different economic forces, because it is connected to task indicators objectively.²²⁸

The second problem is that the local self-government units should deal with tasks, which depend on the central funding, and could be operated more efficiently solely from central subsidies (e.g. education, health care, internal security policy).²²⁹ This has been initiated by the Government Regulation no. 1023/1995. (III.22.) that helps the stability of the management of the local government.

The third issue is reconsideration of local taxation, which should be placed into a new tax structure, with a higher status. It would be more effective if the local governments had more power in this area, and also in connection with the actual central taxes, because the context and

²²⁶ Cf. Ercsey, Zsombor: Az Szja- és az Áfa-szabályozás igazságossága a magyar adórendszerben [Fairness of personal income tax and value added tax in the Hungarian tax system] Pécs, PhD Thesis 2013, pp. 69-72. Available at http://doktori-iskola.ajk.pte.hu/files/tiny_mce/File/Vedes/Ercsey/ercsey_nyilv_ertekezes.pdf (July 8, 2013).

I. Ivancsics states that normative supports covers the 40% of costs from state budget. See: Ivancsics, I.: Önkormányzati közigazgatás [Management of municipal]. PTE ÁJK, Pécs 1995.

²²⁸ See also: Varga, S.: Stabilizáció a helyi önkormányzatok költségvetésében [Stabilization in related to the Budget of Local Governments]. In: Pénzügyi Szemle 1996/3, p. 184.

²²⁹ László, M.: Az önkormányzatok feladatai és finanszírozás [Assets of the Local Governments and Financing], in Csefkó, F. and Pálné (eds): Tények és vélemények a helyi önkormányzatokról [Facts and Opinions about the Local Governments] Pécs, MTA RKK 1993, p. 215.

the interdependence between the taxpayer and the local self-government unit can be demonstrated.

The fourth matter is connected to the undertaking model of local self-government units, so to the opportunity of the local government units to manage their own assets independently. The legislative framework of this economic involvement and participation should be clarified, the balance of the local and the central sources has to be established, and the suitable level of the income proportion has to be determined, with which it is possible to realize revenue, but also does not encumber local governments to force them to venture. The most important principal is that the sources, which were provided this way, must be used only for additional expenses, and for improving the quality of operation, but not for funding the primary tasks.

Whereas the status of the capital city and some city of county rank (Debrecen, Szeged, Győr, Székesfehérvár) are outstanding in many ways, it can be declared that the asset management for hundreds of small towns is confined to managing of some assets in absence of significant assets. As long as some towns have significant assets, municipal firms, property for undertaking, for other towns asset management is hardly applicable. The property of local government consists of real estates (urban properties, rural lands, and buildings), movable properties (machines, vehicles, hardware) and valuable rights and interests (tenancy, security, ownerships). The property of local government has been established after the regime change, and based on transfer of state property. This process happened in legal framework (act on the transfer of property), and in this process could be organically fit the local government reform steps in 2012.²³⁰

Theoretically the property of local government can be divided into two parts. The first one is the so called capital property, which serves the management, and carries out the basic tasks of the local government. In regard of that function these assets are not alienable, chargeable, or deliverable for utilization. So, because of these economic constraints we called them unmarketable, or limited marketable, which is a more limited range within. In this group could be rated the public roads, and their (art)works (overpasses, bridges, roadsides), public lands and most of the buildings are used by local governments. As long as the unmarketable parts of property are not alienable, chargeable and their value cannot be reduced with any legal device, the limited marketable elements are a temporary group with a kind of management protection. Their status is determined by law, or local regulation. These parts of property belong to the

²³⁰ See for instance school centre transformation, KIK, debt takeover

group, which is not directly protected in regard the basic functions by the local government, and which has this status by the law, or local regulation. This classification means legally that, these parts of property could be get out of the group of protected property by external initiatives or municipal decision and could be became marketable by means of a detailed procedure, what is laid down by local government. It is really important, that the local government has to establish rules covering all aspect of the process in the provision about these parts of property. In the absence of such a regulatory system the acts related to the part of property could be void/invalid. So the limited marketable parts of property could be transported to the group of undertaking property of local government.

The part of property of local government, which is cannot be classified into the two mentioned category can be managed or realize independently, so it is qualified as business or venture property. The local government can use, charge, alienate these kind of part of property with their own decision, but just on a controlled way. It is important to note, that for these activities are also applied to the principles of public finance/state budget: notably the principle of publicity and controllability.

The actors of the Hungarian local government system realized many venture activities in the last twenty-two years e.g. they established and operated industrial parks, operated airports and harbours, founded public service companies for the local population, or they did property leasing. It can be concluded that the range of undertaking activities is wide, but their efficiency, market productivity are different by places, ages and local governments. It can be stated some barriers of these local government activities. The first confine, which is determined by law too, is that the local governments only can carry out their venture activities for community,²³¹ but on the other hand it is difficult to control it. The second barrier is that the undertaking activity cannot endanger the compliance of the basic tasks of local government. The third is that the local governments can take risk limited in their concern, so they cannot participate in any form of company where they should take unlimited liability. This rule is necessary, because there is no provided any exemption, or allowance by the law against the local governments in their venture activities, so they have equal position with other economic actors. The local governments shall bear the consequences of their decisions or their management, so that is the reason, why should be limited the type and level of the venture activity of the local government

²³¹ Subsection 3 of Section 80 of Act LXV of 1990, furthermore Subsection 2 of Section 111 of Act CLXXXIX of 2011

in many ways.²³² There are many examples in the last twenty-two years for the bad or hasty decisions and unsubstantiated developments, which caused significant damages for the local governments. Such as the case of Sopron Local Government's investment, hotel investment in Globex Holding, and also in Budapest the investment of underground line four, sewage farm, or the CET exhibition centre, furthermore in Pécs the investments in the airport building, or Expo Centre, all of these projects caused significant burden, debt for these local governments. These bad, reckless decisions often restrict the potential and economic possibilities of municipal leaderships, city and its residents for decades, because of the four-year election cycle in the local government system. However the management of bankruptcy is regulated by a special law, neither the local government firms enjoy any exemption against the market failure.²³³

Finally it must be pointed out that the model of undertaking local government was available for only a small group of local governments. It can be stated that the demand from the local governments to venture is acceptable, but their basic task is not the venture activity, because just a few local governments have the necessary economic, human or market knowledge for this. Actually the model of undertaking local government, what was supported for a long time, is exists limited due to the shrinking market and absence of competence, but anyway for most of the local governments the undertaking local government never was a real, available possibility.

3.3.2.2. The budget of the local governments

These principles (unity, commitment of annual budget, transparency) are also valid/authoritative in related to the system of the budget of local government. Despite the insignificant differences, many similarities can be noticed between the process of preparation, adoption, implementation of the local government's budget and same procedure of state budget. Naturally some fundamental differences can be defined in the budget of local government compared with to the state budget in related to the magnitude of budget, the time structure of acceptance, name of the actors.

The annual budget of local government is the central element of the local government's operation and foundation, and also the framework of local governments' founding, what is accepted by the Body of Representatives in form of municipal decree. The municipal decree of

²³² Delimitation of civil and administration cases in related to the local government as parties to legal proceedings. Cf. Király, L.: Polgári Eljárásjog II. Szakvizsgára felkészítő segédkönyv [Civil Procedure Law II. assistance book to civil law examination] Budapest-Pécs, Dialóg Campus Kiadó 2006, p. 382

²³³ Act XXV of 1996 on Procedure of Debts Settlement of Local Governments

budget chronologically follows the acceptance of state budget, because the state budget determines the elements of local government's operation, such as the entitlement, rate of tasks support in related to the group and proportion of income given up. It can be stated that the support framework of state budget determines fundamentally the conditions of local government managing.²³⁴ E.g. the specific amount and type of norms was determined by the appendix 3 and 4 of state budget until 2013. After 2013 the appendix 2 of state budget determined the entitle and appropriations of support for local governments.

Article 11 of the Act on Hungarian Local Government declares that the operation of local government is based on the annual budget. However it adds that the budget of local government is part of the state budget. It defines the budget as the connection of the local and central level, and by the way of it can be realized the financial, and operation task of state. The proof for this connection is Paragraph (3) of Article 112 of the Act on Hungarian Local Government, what declared, that budget of local government is also regulated by the state budget and implementing regulations. The notary liable for publish the details of the operation of local government to the resident population at least once a year the usual way. The obligation of establish the local government budget is one of the most important obligation of local governments, because unless it, they cannot get state aid. So the establishment of local government budget has to take the lead of the adoption of state budget, but at the same time the planning and preparation of local government budget has been already started, and the local regulation will have adopted in February and March based on new appropriations of budget, what shall take effect on first day of fiscal year. In the local government budget the independent budgetary authorities compose budget articles, so budgetary authorities, which perform the same activities can composed one budget article. The local government budget fundamentally is based on plans, so we can speak in related to it about appropriations of budget, like as in related to the state budget. E.g. the local government has to set aside a reserve until the establishment of local budget and for the implementation of the budget is connecting to the similar legal instruments like cancellation, and redeployment. The local budget is contained income and expense appropriations, and it can be different operation and accumulate income, furthermore the budgetary position also has to be define with a limitation, that in budget regulation cannot be planned operation deficit. The operator of budget preparation and adoption is the notary. In related this task the notary's most important obligation is to prepare the

²³⁴ It depends on the actual state of state budget and the tax incomes. In related to this see: L. Király, 'Jövedéki módosítások' [Amendments of excise] 9. *Tájélotó* (2000) pp. 6-7.

conception of budget for 30th of November the last year, and show to the committee of local government and the local minority government, furthermore get their opinions. The mayor shall submit to the body of representative the prepared document (draft Regulations), which shall be adopted after their argument. The body of representatives is liable for the operation of local government, the Mayor is accountable for the regularity of management, and the Notary is responsible for the legality.

On the local level of the preparation of the budget the obligation of preparing the budget establishing economic studies is also appeared, furthermore the body of representative is bound to subsume their long-term conception in the development plan. A managing program or development plan shall be the term of the office of the body of representative or the period exceeding this term. This local development plan is fit in the county development plan and contained the realization for the improvement of the level of public services. in the sic mount after the creation of The body of representatives shall adopt this managing program, development plan, and revise the existing plans.

The Mayor shall submit the prepared draft regulations and the related documents to the body of representatives in forty-five days after the day of publication of state budget. If the body of representatives does not accept it, the local government shall have the obligation to the elaboration and adoption of temporary management. The local government also has the permanent reporting and control obligations. The corresponding law sets forth that the mayor is obliged to inform the local representatives of the situation of the budget several times a year. It is a basic obligation of the mayor to draft the budget report as well. Accordingly, , similarly to the annual accounts of the central budget, the mayor is obliged to draft reports during and at the end of the year on the significant processes and the actual figures achieved.²³⁵ The local self-government also drafts annual accounts on the execution of the local budget, which may be submitted to the representatives by the mayor until the last day of April following the budget year.²³⁶

²³⁵ It should be noticed in related to the public interest, which is connected normal local government management, that the control of Court of Auditors is part of the supervision over local governments in the UK. Cf. Bencsik, A.: Az angol önkormányzati rendszer [The English local self-government system] In: Fábrián A. (ed.): Válogatott európai önkormányzati modellek [Selected European local government systems] Budapest-Pécs, Dialóg Campus Kiadó 2012, p. 56.

²³⁶ Sections 23-29 of new act on the State Budget

3.3.2.3. Handling the debts of the local self-government units

The debts of the local self-government units became one of the most significant problems of the Hungarian local government system at the end of the first decade of the 21st century.

The municipality financial approach changed after 2011, since the corresponding law burdens the losses on the local government. It is declared clearly that the central budget is not responsible for the losses of the local management. This approach is reflected by the provision, in which it is declared that the local self-government units cannot plan deficit in their budgets.²³⁷ From the budgetary point of view this means that the revenue of most local government units did not reach the level of expenditure therefore deficit was found. Thus it shows that the municipalities could not provide the funds necessary for financing the tasks performed thereof with regard to their three major revenue categories in scope of their normal operation.

The increase of debts was caused by several reasons. First the local self-governments cannot rely continually on collecting the own revenue within their everyday operation since local taxes are collected twice a year (in March, and in September) by most of the municipalities according to the Act on local taxes. These taxes provided the highest proportion of the revenue but the expenditures (paying salaries, purchasing operating assets) shall be financed continuously therefore the local government units are forced to pick up liquidity loans, in order to eliminate the temporary lack of funds. The lack of self-contribution for launching bigger investments may be mentioned as the second reason. Furthermore the subsidies provided by the states are frozen, and this is third reason accordingly the local self-government units involved external financing and funds, in order to finance the operation, function, and to make investment projects and development. Therefore bonds were issued, and or bank loans were obtained. The use of these financial measures caused the growth of debts. The level of debts became critical when the municipalities consumed, and or sold those properties which were marketable, and it became clear that the direct profit of the launched investments and developments cannot equalized the related loans. The situation became even more serious when local taxation possibilities narrowed in 2008 due to the economic crises, the level of shared revenue decreased simultaneously in nominal value and the normative subsidies did not increase either as a result of these factors most of the local self-government units could not spend 10-40% of their budgets on the mandatory tasks, and or development, but this proportion was solely spent on loan repayment. This financial trap narrowed the financial leeway of the municipalities. The

²³⁷ 2011. évi CXXXIX Mőtv. 111. § (4) bekezdés Subseciton 4 of Section 111 of Act CXXXIX of 2011 on Modified Act on Local Governments

recognition of the problem made the Hungarian self-government launch a program for taking over the debts of the local government as a result of which 100% of the amount of debts of the municipalities caused this thing less than 5000 persons was over taken, and based on individual agreements, 50-60% of the debts of the bigger local self-government units were taken over. These measures decreased significantly the financial burdens and debts of the municipalities, however, the system of scope and mandatory thus as well as the government subsidies and state aids were transformed simultaneously by the government. Taking all of these into account it can be stated that all of the elements of the financial operation of the local self-government units cannot be seen clearly at the beginning of 2013 and the exact balance of the introduced measures is still missing.

3.3.2.4. The financial resources of the local self-government units

The units of the Hungarian local government system have three major revenue categories basically, irrespectively of the economic strength, population number and location. The first and most important category is the own revenue, the second is the state subsidies, and the third is the shared or assigned revenues. This is set forth by the new act on local governments the way that the local government provides the funds for fulfilling the obligations thereof from its own revenues, the revenue received from other economic organizations, furthermore central state subsidies. The proportion of the free sources of revenue defer significantly by each local government unit. It is a general principal that the less economic strength has the local government, the more important rule is played by the state subsidy.

3.3.2.5. State subsidies

The state subsidies are the sources of revenue which determine the function of the local government system mostly. The subsidies are provided on the grand that local governments, as the local level of the state and national budget, fulfil and perform state functions and tasks the way specified by the central budget in the specified cases, therefore they are entitled to government subsidies in proportion of the tasks. The title, the proportion and the method of financing are determined and defined by the budget act, the public finance act, and new local government act together. The concrete annual amounts of the subsidies are not effected directly by the local government units. Many changes and amendments have been introduced in this area of subsidies in 2013. The government terminated the system of normative financing, which was used before 2013 this former way of financing was based on the practice that the tasks specified by the appendix of the budget act were subsidized by an annual amount, the expenditure of this which was free or bound by the central budget for the local government unit. Therefore

the amounts were linked to the tasks based on an objective index number (number of recipients, population-based amounts). This system was terminated 2012, and the method of addressed and targeted subsidies was dismissed to this two form of subsidies were related to certain large investments specified by the state and linked to tenders from the beginning from the 90's. Accordingly these resources could be obtained by the local governments according to tenders by a certain proportion of self-contribution. Besides under certain conditions, the central budget provided ad hoc aid as well, for instants for the local governments which ended up in a disadvantages financial situation, due to factors outside their control. The new system was introduced in 2013, the tasks and functions of local governments were modified, and thus the financing of the local governments was transformed totally. The state introduce the task-based support, thus tasks to be performed by the local government associations and the nationality municipalities were provided by founds bound for the task itself. According to the new provisions, the minister responsible for the local governments publishes the form and amend of the subsidies for the local governments, national municipalities and local governmental associations by 5 January of the budget year. The amount is paid for the local governments by the Hungarian State Treasury in each month with net financing. A very important element of the new provision is that the Mayor is liable for the management of the local government units, and the subsidies which are obtained without proper authorization (illegitimate) are sanctioned and the related procedure has been put in place as well.

3.3.2.6. Own revenues

The most important revenue source from the point of view of self-governments is the category of own revenues, which derive on the jurisdiction of the local government based on its own decision and related to the local economic events, therefore this type of revenue is levied and collected by the local government unit. The most important element of the self own revenue are the local taxes, which is regulated by the Act C of 1999, which regulates the local taxes uniformly in the last twenty-three years with minor amendments. The major is characteristic of the local tax is that the local government may decide up on it within the framework of the referred act. The significant and proportion of the own revenues is different by each municipality. It is obvious that those local self-government units are in advantages situation in this regard as well, the territory of which has high level of economic activity. Unfortunately many local self-government units in Hungary cannot realize high proportion of local taxes, many underprivileged self-governments work in Hungary, to which have no or negligible income from the local taxation.

The *local taxes*, since its introduction in 1991, played an important role in a significant number of local self-government units. Sixty percent of the local self-government units apply this, while more than 95% of cities use some form of local tax. The proportion of revenue from local taxes increase continue at the financial management of local governments, in Hungary this was 1,8% in 1994, while in OECD countries it was 12% in 1985. These numbers show that in this area for the self-government units reside in the new tax structure potential reserves.

The other big group of the own incomes consists of the *penalties* coming from the local governments territories. The types of these penalties and the local government's interest quota are determined in the Paragraph 33 of Act CCIV of 2012 on the 2013 Central Budget of Hungary. The self-government units receive the 100% of environmental fines taxed by the notary of the self-government, over and above the 30% of the amount of environmental fines taxed by the Environment, Nature Conservation and Water Management Inspectorate. The self-government gets the 100% of the income from offence money and on-the-spot fine which is taxed by about offenses, infringement procedures and inventory systems Act of 2012. The self-government gets also the 40% of penalty which must pay event of a breach the Road Traffic Act, if the notary of the self-government implemented the implementation of tax authority in. This also includes 100% of the fine imposed by the public land inspectors of the local self-government.

The whole of income from sale of *hunting rights* concern the local self-government, together with the financing framework – from the medical care aid by OEP – can appear at the budget of the local self-government units. Among the self-government's own revenues the *loan* and the other incomes from *emissions of securities* should be mentioned. The *benefaction, heritage and gift* offered by individuals, firms, enterprises could mean significant income for the self-government units.

3.3.2.7. Shared taxes

The least source of local government's management was so-called transferred or shared revenues. Those items belong here, which the budget assigned for the local governments, but the parliament laid down the rate of financial elements, the way of transference connected with the budget act in every years. The self-government got these incomes from the central budget and had not direct influence at the extent thereof. The local governments got two from the three major transferred revenues, the personal income tax and duty from the budget, while the third, the motor vehicle tax collected themselves. The local governments had disposal of incomes like these.

Revenue deriving from the personal income tax

The first and the most significant item was the transferred part from the personal income tax until 2013. This meant that the local government units returned from the budget the collected personal income tax in their competent area after to collect it. In recent years this proportion was 100%, 50% and 40% too, but in 2012 this expand 8% of personal income tax. Since 1996 distribution system of personal income tax operated in such a way that the local government units did not receive the full amount of personal income tax what their collected during back division, but the budget applied a balancing mechanism in favour of skinner self-governments. Basically, the allotted appeared in three groups by the governments. The 10-15% of the first amount stayed where it formed, while the second group distributed normatively, the third group favoured the smaller economic strength's governments on the score of positive discrimination. In 2012 these distribution rate expanded the 8% of personal income tax and the local governments have already got back divided 2 groups. The part of 4,1% was assigned sector jobs, while the part of 3-9% overall aid was distributed. The abandonment rate decreased to 0 in 2013, so led out ott he system the remission of a certain percentage of the personal income tax. The 3,9% of personal income tax changed to state aid. In 2013 the government terminated the system to reduce the income gap too, the aid integrated to general operating support.

Tax on vehicles

The vehicle tax are at the second group, which is not a local tax, because the budget and the parliament defined its rate. Misunderstanding is a reason that it was collected and used bay the local governments. The vehicle tax, which was initially known as the weight tax, stayed by local governments only 50% like real transferred income. From 2003 the total amount was entitled to the local self-government units and in recent years was imposed on the basis of engine power and not the weight of vehicles. Its extent was about 45 milliard forint refer to whole of the system of local governments in 2012. The 2013 changes also meant connected to vehicle tax that the percentage of the collected amount reduced. The Act of 2012 is determined at 40%, which represents a nominal amount to 29.4 billion in 2013, of which given back as a general government source to the local self-governments.

Revenue from transfer taxes

The third, previously substantial transferred revenue stemmed from the related assets to charges levied by NAV, so the governments shared in levies of traffic or barter of motor-vehicles and properties, initially at rate of 50%. It should be noted that here various compensation

components are also turned into the payback, in order to get not only the local governments, but also counties and the capital government. The whole of these types of levies had to the government's system in 2012, namely 12,3 billion Hungarian forints. In 2012 the whole of tax revenues meant income only by the county towns and capital, but it came to an end in 2013.

Assigned revenue deriving from the personal income tax levied on the rental of arable land

The smallest item among the transferred revenues in the 100% of the personal income tax of the income from land rental collected by governments, which those government could get, on which is the land.²³⁸ In this connection you should know that it does not have significant revenue for local governments, as the Income Tax Act, that a contract term longer than 5 years is tax-free.²³⁹

3.3.2.7. Concluding remarks

The autonomy of self-governments, from the conceptual point of view and particularly from the practical approach is the assessment of the economic opportunities, the amount and structure of resources, and the freedom of use of the resource. The actual operating conditions of each system depend not on the legal regulation, but instead on the the local economic circumstances of the self-government and their involvement of local economic development, furthermore on the economic and fiscal policy of the state. The self-government systems are categorized accordingly to the clientist (e.g. France, Italy, Spain and the Greek and Turkish self-government systems), economic development (USA), and the welfare system (e.g. Germany, Great Britain, the Nordic countries).²⁴⁰

The local self-governments of the two countries in focus of this study have similar income structure, they manage their finances from the same sources and cover the obligatory and optional functions specified in Chapter III above with similar types of funds. The types of income are the same, the self-governments provide the funds covering their budgetary expenses from their own revenues, assigned (shared) central taxes, furthermore different grants and subsidies received from the central budget.

As current tax systems of the European countries show many similarities and much less differences, the principles of taxation and the trends are quite similar. In recent decades, one of

²³⁸ Subsection 2 of Section 32

²³⁹ 9.4.1. point about tax exemptions of Appendix 1 to Act CXVII of 1995 on Personal Income Tax

²⁴⁰ Goldsmith, M.: Local autonomy. Theory and practice. In: King, D. and Pierre, J. (eds.): Challenges to Local Government. London, Sage 1990, pp. 18-32.

the most important European taxation tendencies has been tax cuts, so reducing the tax burden, one element of which is the introduction of flat tax systems. Another important trend is the shift towards cooperative tax administration, and the increase of the role of local and regional taxation. In our views, both the Croatian and Hungarian legislation is in line with the EU efforts and regulatory trends. The determining concepts (taxbase, tax subject, car), and the method of calculating the tax rates accordingly are defined by the Hungarian and Croatian legislature. Similarity, in both states the tax (in Hungary the municipal, in Croatia the county governments) are collected and used by local authorities.

The noticeable differences between the Hungarian and Croatian local and regional levels of taxation derive from the significant difference between the two states regarding the regional involvement and the position in the system of redistribution. The Hungarian structure of local self-government units are closer to the clientist model – so there is a remarkable centralizing tendency of the state, most of the local resources come from the state, often by determining the way and aim of use –, thus the level of economic development activity of the self-governments is lower. Contrary, the Croatian model, due to the important county and municipality taxes, is closer to the welfare and economic development models²⁴¹ of self-governments, in which, besides the central dependence, a structure was established with more active self-governments providing notable services.

In the European Union, the tax on motor vehicles was considered as a potential obstacle for the creation of the Common Market already in the sixties. The Commission, in order to eliminate the discrimination and the factors that distort competition, already made a proposal to harmonize the taxation of commercial vehicles in 1968, but till the early nineties, the harmonization of this direct tax did not happen. Although the EU has achieved considerable success in harmonization on the field of the commercial vehicle taxation, the harmonization of taxation of private cars is still to be done. The current tax rules largely leave the issue of taxation of passenger cars to Member States, and as a result, except for some Member States (e.g. France), annual tax is due in all Member States after the passengers car. According to the Commission's current proposal for harmonization taxes on the car registration should be paid in the form of sales tax in all Member States by gradually reducing the annual registration fees.

²⁴¹ In the welfare model, the self-government units fulfil their obligations within strong central dependence, they focus on providing the services, and they deal less with the development of the local economy, which is undertaken mostly by the central state. The self-governments act as undertakings in local economy, their local need of resources is higher than the central one, therefore they establish a more intense relationship with the local actors of the economy.

The harmonization of taxation of personal motor vehicles is still a significant issue. Basically the matter of type and level of taxation on motor vehicles has come under the Member States yet. The registration tax is prevalent in many countries, which because of the nature of one-time (setup charge) has not implemented the requirement of fairness and proportionality, as there is significant difference in the rate defined by Member States.²⁴²

The Hungarian regulation entitles the local self-governments to introduce property tax and building tax as wealth tax. The self-government may choose how to determine the tax base of these types of taxes: either according to the net floor space of the real estate expressed in square meters, or the adjusted market value thereof. The decision, however, shall be made uniformly together for both types of tax. Both of them are annual taxes, therefore the taxpayer shall remain the same, even in case of change of ownership during the tax year, that is connected to the title and ownership as per the first day of the tax year. Tourism tax is a community tax in the Hungarian system, one form of which – tax levied on holiday building located at the territory of the self-government – shows conformity with the tax on Croatian holiday homes.

Thus the regulation of tax on holiday homes is part of the tax system of both countries, although with different names, but with the same content. The object and subject of tax, as well as the tax base are completely the same in both statutes. The only difference is that the Hungarian provisions determine the upper limit on the one hand, and the Croatian act determines a frame including a lower limit as well on the other hand, also includes broad exemptions, which are entirely lacking from the Hungarian system.

The inheritance and gift tax differ in the two states basically due to the local or central nature of the type of these taxes (duties) and because of the related characteristics thereof. Accordingly, these form entirely the revenue of county self-government units in the Republic of Croatia, while in Hungary they are shared between the central government budget and the local authorities. The Croatian county may decide, in relation to these types of taxes, on the introduction, the rate within the statutory ceiling, and the scope of exemptions, whereas no such opportunity is provided for the local governments in Hungary.

The Croatian inheritance and gift tax, however, differ not only because of the local characteristics unlike the central type of the Hungarian one, but also because these local taxes do not extend to the free acquisition of real estates, whereas inheritance and gift duties are levied

²⁴² Öry, T. (ed.): *Az Európai Unió adójoga* [The Tax Law of the European Union] Budapest, Osiris Kiadó 2003, pp. 403-405.

on those transactions in Hungary. Further difference is that a wider range of exemption is provided by Croatian system, and the exemptions are primarily of personal nature, much less exemptions are related to certain types of transaction. The collateral kin as beneficiary for the second group is not exempt from tax at all in Hungary. It is a common element of the two systems though, that gifts provided for certain purposes are exempt from tax.

In our opinion, in order to guarantee the four freedoms of the Single Market²⁴³ and to ensure the optimal level of completion²⁴⁴ of the internal market, the system of local taxation should be standardized in the territory of the European Union: an itemized list of local taxes should be established, and clearly unified rates, or at least minimum and maximum rates shall be declared, furthermore the tax allowances should be harmonized. The various methods of levying taxes, the different determination of the tax base, and the significant diversity regarding the tax rates distorts competition between the Member States, and hinders the free movement of persons and the free flow of capital, since unpredictable tax environment is set up accordingly. Therefore the European Union may take measures regarding the harmonization of this field of law, and could at least provide a unified frame for the taxation rights of the self-government units.²⁴⁵

Nevertheless, the normative distribution is a mutual requirement of the financing systems, in which the state declares the aims and priorities to be supported thereby, as well as those parameters and conditions, which determine the decision of redistribution with normative power, taking into account that state distribution is always based on political decisions and preferences of value.²⁴⁶

It is a fundamental problem of both the Hungarian and the Croatian central, regional, and local taxation, which is also a tendency all around the world, that despite the continually expanding scope of central and local activities, new types of public revenue cannot be found neither in the central, nor within local taxation, which could improve the increasing revenue that covers the government services, therefore there is no other option, but to tune these systems carefully, and to harmonize their operational reserves, furthermore to improve tax compliance. For this work,

²⁴³ Cf. Mohay, Á. – Szalayné, E. S. (eds.): *Az Európai Unió joga* [The law of the European Union] Budapest-Pécs, Dialóg Campus Kiadó 2011, p. 229

²⁴⁴ Meaning such a free flow of working people, goods, services and capital in a borderless Europe.

²⁴⁵ Should such a legal measure be adopted, attention will have to be paid to selecting the proper legal basis of the harmonization measure, as an erroneous legal basis could lead to a future challenge against the legal act in question. See: Mohay, Á.: *Az Európai Parlament részvétele az uniós jogalap-vitákban* [Participation of European Parliament in the debates in related to the legal basis of European Union] In: *Európa Jog* 2012/12, pp. 1-14.

²⁴⁶ Hockley, C.G.: *Fiscal Policy*. London, Routledge 1992, p. 19.

it is essential to understand the theoretical and practical problems of the functioning of the tax system.

4. Practical issues

4.1. VAT matters

4.1.1. Deduction of input VAT

According to the basic mechanism, the collected amount of VAT may be deducted by the taxable persons (i.e. VAT-registered enterprises) with the sum of tax they paid to other taxable persons on purchases for their business activities.²⁴⁷ In other words, the VAT due on any sale as per the percentage of the sale price may be deducted with all the tax already paid at the preceding stage. Therefore, double taxation is avoided and tax is paid only on the added value at each stage of production and distribution.

The right to deduct input VAT and the related conditions set forth by Hungarian law have been disputed since the current effective Hungarian VAT regulation²⁴⁸ (hereinafter referred to as the Law on VAT) was introduced in 2007. This new piece of legislation, replacing the former Act on VAT²⁴⁹, was enacted in order to be harmonized with the corresponding EU legislation²⁵⁰.

4.1.1.1. The right to deduct input VAT in case of an error of an invoice

A judgement was recently passed by the Court of Justice of the European Union²⁵¹ (hereinafter referred to as the Court of Justice) in this regard: *Pannon Gép Centrum Kft* (hereinafter referred to as the applicant) v *APEH Központi Hivatal Hatósági Főosztály Dél-dunántúli Kihelyezett Hatósági Osztály* (hereinafter referred to as the tax authority). In this judgement²⁵², the Third Chamber of the Court of Justice ruled on 15 July 2010 that ‘Articles 167, 178(a), 220(1) and 226 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as precluding national legislation or practice whereby the national authorities deny to a taxable person the right to deduct from the VAT which he is liable to pay the VAT due or paid in respect of services supplied to him on the grounds that the initial invoice, in the possession of the taxable person when the deduction is made, contained an incorrect

²⁴⁷ Cf. The lecture of Ercsey, Zs. – Süle, Z. – Kovács, T. – Bertok, B. – Kovács, Z.: Business Process Synthesis with Various Resource Needs. 9th International Conference Computational Management Science. Imperial College London, UK, 18-20 April, 2012. Book of Abstracts, 76

²⁴⁸ Act CXXXVII of 2007 on Value Added Tax

²⁴⁹ Act LXXXIV of 1992 on Value Added Tax, which had been passed by the Hungarian legislation at the time before Hungary has become a member of the European Union, and was amended several times after it had entered into force.

²⁵⁰ The focus of EU VAT legislation is Directive 2006/112/EC since 1 January 2007. This directive is effectively a replacement of the Sixth VAT Directive of 1977 (77/388/EGK), which was amended many times over the years. The effective Directive contains a correlation table providing the bridge between the provisions of the Sixth VAT Directive, and those of the new Directive.

²⁵¹ The name of the court was changed from European Court of Justice with the Treaty of Lisbon in 2009.

²⁵² EU: Case C-368/09

completion date for the supply of services and the numbering of the subsequently corrected invoice and the credit note cancelling the initial invoice were not sequential, if the material conditions governing deduction are satisfied and, before the tax authority concerned has made a decision, the taxable person has submitted to the tax authority a corrected invoice stating the correct date on which that supply of services was completed, even though the numbering of that invoice and the credit note cancelling the initial invoice are not sequential'²⁵³.

The facts were the following. On 2 May 2007 the applicant entered into a contract with Betonút Szolgáltató és Építő Zrt (hereinafter referred to as Betonút), whereby the applicant undertook to carry out repairs to a bridge. The applicant entrusted the referred work to a sub-contractor, J és B Pannon-Bau Kft (hereinafter referred to as the sub-contractor).

On 20 November 2007 the applicant issued to Betonút the invoices relating to the execution of the contracted work stating the date of completion was the date of issue of the invoice, 20 November 2007²⁵⁴. At the same time the sub-contractor presented to the applicant two invoices related to the work, stating that the completion date would be 14 December 2007.

On 3 October 2007 the applicant entered into a contract with Gebrüder Haider Építipari Kft (hereinafter referred to as Haider), whereby the applicant undertook to carry out storm sewer construction work. For the performance of that contract, the applicant entrusted that work to the same sub-contractor. Haider issued a certificate of completion of that work stating the date of completion to be 11 December 2007, and the final invoice which was issued by the applicant to Haider also specified that date as the date of completion of the work. The sub-contractor, for its part, issued an invoice to the applicant stating 18 December 2007 was the date of completion of that work.

The applicant, in its tax return for the fourth quarter of 2007, recorded the three abovementioned invoices from the sub-contractor and exercised its right to deduct VAT²⁵⁵. However, the tax authority²⁵⁶ inspected this tax return and found that the completion dates contained in the work completion certificates issued by Betonút and Haider on the one hand and in the invoices issued by the applicant to those companies on the other hand, preceded the dates appearing in the

²⁵³ Ruling of Pannon Gép Centrum Kft v APEH Központi Hivatal Hatósági Főosztály Dél-dunántúli Kihelyezett Hatósági Osztály (Case C-368/09)

²⁵⁴ Please note that it is quite common in Hungary that the enterprises, in order to simplify the issue of an invoice, appoint the date of issue of the invoice as the date of fulfilment, irrespectively of the real date of performing their contractual obligations.

²⁵⁵ As per Section 119 of Act CXXVII of 2007 on Value Added Tax

²⁵⁶ The competent tax office, the Hungarian Tax and Financial Control Administration (APEH and its territorial bodies) merged with the Hungarian customs and Finance Guard, thus on 1 January, 2011 the National Tax and Customs Administration (NAV) has been established.

invoices issued by the sub-contractor and used by the applicant to carry out a deduction of VAT. The applicant and the sub-contractor informed the tax authority that the completion dates stated in the invoices issued by the latter were incorrect²⁵⁷.

On 29 September 2008 the sub-contractor cancelled the three incorrect invoices and replaced them with new ones. The work completion date stated in the new invoices was the same as that appearing in the invoices issued by the applicant.

However, by a decision of 21 January 2009, the first level tax authority ordered the applicant to pay the VAT relating to the services supplied by the subcontractor, which the applicant had deducted from the tax payable by him in the fourth quarter of 2007. Additionally, both a late payment penalty and a fine were imposed due to the non-fulfilment of tax obligations²⁵⁸.

They argued that the applicant could not use the invoices initially issued by the sub-contractor for the purposes of deduction of VAT, since those invoices did not contain the correct date of completion of the work by the subcontractor. Furthermore the new corrected invoices could not be used either as the basis for deduction of VAT, because the numbering had not been sequential²⁵⁹.

By a decision of 29 April 2009 the tax authority upheld the decision of the first level tax authority of 21 January 2009.

In order to seek remedy, the applicant brought an action before the Baranya county court²⁶⁰, which decided to refer the following questions to the Court for a preliminary ruling²⁶¹:

'(1) Do the provisions of national law contained in Article 13(1)(16) of the Law on VAT in force at the material time when the disputed invoices were issued and in Article 1/E(1) of Order 24/1995 of the Hungarian Ministry of Finance, specifically the provision in Article 13(1)(16)(f) of the Law on VAT, comply with the features of invoices, and the concept of an invoice, laid down in Article 2[(2)] of Council Directive 2001/115?

²⁵⁷ According to Section 169 of Act CXXVII of 2007 on Value Added Tax, invoices shall contain, inter alia, the date of issue; a sequential number, which uniquely identifies the invoice; the date of supply, if other than the date of issue of the invoice.

²⁵⁸ According to Sections 165-167 and 170-172 of Act XCII of 2003 on the Rules of Taxation.

²⁵⁹ There are two ways of issuing an invoice in Hungary. The most common is to filling out a form in the block of blank invoices. The other method is using an official certified invoice program. In the latter case, all issued invoices are numbered automatically, and no change can be made at all, furthermore no mistake can theoretically occur regarding the numbering. However, in case of the invoices filled out manually from a printed block, it can also happen that due to an administrative error, more pages are turned when issuing the next invoice. The challenged unfair and unlawful practice of the Hungarian tax authorities would be applicable in such cases as well accordingly.

²⁶⁰ Baranya Megyei Bíróság.

²⁶¹ According to Section 155/A of Act III of 1952 on the Rules of Civil Procedure.

In the event that the first question is answered in the affirmative:

(2) Is a Member State's practice which consists of penalising formal defects in invoices intended to be used as a basis for the right to deduct by denying that right contrary to Article 17(1), Article 18(1)(a) and Article 22(3)(a) and (b) of the Sixth Directive?

(3) In order to be able to exercise the right to deduct, is it sufficient to fulfil the obligations laid down in Article 22(3)(b) of the Sixth Directive, or is it possible to exercise the right to deduct and accept the invoice as an authentic document only if, at the same time, all the details required under Directive 2001/115 are provided and all the obligations laid down in Directive 2001/115 are fulfilled?²⁶²

The Court of Justice stated that since all the facts of the main proceedings post-date 1 January 2007, only the interpretation of the provisions of Directive 2006/112 (hereinafter referred to as Directive 2006/112) is relevant to the main proceedings. The fact that the national court has, formally speaking, worded the questions with reference solely to provisions of the Sixth Directive does not preclude the Court of Justice from providing to the national court a complete interpretation regarding the corresponding EU law. Accordingly, the Court provided the interpretation of Articles 167, 178(a), 220(1) and 226 of Directive 2006/112.

The Court of Justice pointed out that the right to deduct provided in Article 167 et seq. of Directive 2006/112 is an integral part of the VAT scheme and in principle may not be limited. The right to deduct is exercisable immediately in respect of all the taxes charged on transactions relating to inputs.²⁶³

The challenged services were in fact used for the purposes of taxed transactions, carried out by the taxable person in the Member State concerned. It was stated that it is not open to Member States to make the exercise of the right to deduct VAT dependent on compliance with conditions relating to the content of invoices which are not expressly laid down by the provisions of Directive 2006/112.

Since the tax authority was already in possession of invoices corrected by the subcontractor when the first level tax authority denied the applicant the right to deduct the VAT, and the

²⁶² Ruling of *Pannon Gép Centrum Kft v APEH Központi Hivatal Hatósági Főosztály Dél-dunántúli Kihelyezett Hatósági Osztály* (Case C-368/09) at [26]

²⁶³ See also Case C-62/93 *BP Soupergaz* [1995] ECR I1883; Joined Cases C-110/98 to C-147/98 *Gabalfriša and Others* [2000] ECR I1577, and Joined Cases C-439/04 and C-440/04 *Kittel and Recolta Recycling* [2006] ECR I6161.

invoices contained all the details required by the Directive 2006/112, all the conditions for deducting the VAT relating to the supply of services by the sub-contractor were satisfied.

Therefore, the Court of Justice declared in the ruling thereof that national legislation or practice can not deny to a taxable person the right to deduct the input VAT due to an incorrect completion date for the supply of services and the numbering of the subsequently corrected invoice.

Accordingly, despite an error regarding the completion date indicated on the invoice, the invoice itself is appropriate for the taxation procedure. The only matter that shall be taken into account is that the taxpayer may exercise its right to deduct the input VAT relating to the correct date of performance, and the invoice shall be corrected prior to the issue of the related decree of the revenue office.

In fact, 'an invoice performs three basic functions: (1) it contains the information needed to determine which VAT regime is applicable to a particular transaction, (2) it enables tax authorities to carry out enforcement controls, and (3) it allows the purchaser to prove their right to deduction'²⁶⁴. Accordingly, the invoice was referred to as 'the ticket of admission to right to deduct.'²⁶⁵

This judgment will be definitely referred to in similar cases, and the Hungarian revenue office shall take it into account when deciding on the deduction of the input VAT.

4.1.1.2. Deduction regarding a reverse charge regime²⁶⁶

In a judgement passed on 30 September 2010²⁶⁷, the Court of Justice declares that 'Articles 167, 168 and 178 of Directive 2006/112 must be interpreted as precluding the retroactive application of national legislation which, in the context of a reverse charge regime, makes the deduction of VAT relating to construction works conditional upon the amendment of invoices for those services and the submission of a supplementary, amending tax declaration'²⁶⁸. The competent tax authority definitely has all the information necessary to establish that the taxable person is liable to VAT, and to ascertain the amount of tax deductible.²⁶⁹

²⁶⁴ Case 123/87, *Lea Jorion, nee Jeunehomme v. Belgian State*, 1988 E.C.R. 4517.

²⁶⁵ Famously said by AG Sir Gordon Slynn. Cited in Ainsworth, Richard Thompson: *Biometrics: Solving the Regressivity of VATs and RSTs with "Smart Card" Technology*

²⁶⁶ A reverse charge is a self-assessment obligation imposed on businesses purchasing taxable supplies.

²⁶⁷ *Uszodaépítő Kft. v APEH Központi Hivatal Hatósági Fosztály*, Case C-392/09

²⁶⁸ *Uszodaépítő Kft. v APEH Központi Hivatal Hatósági Fosztály (C-392/09)*, at [46].

²⁶⁹ The wording of the ruling is almost just the same as this 46th point of the reasoning.

The facts regarding the main proceedings were the following. On 9 June 2006, the applicant in the main proceedings (Uszodaépítő Kft., hereinafter referred to as the taxpayer) concluded a contract for construction works with NÁS MPS-4 Kft, the developer (hereinafter referred to as the developer). The taxpayer carried out the works with the participation of various subcontractors. The construction work began in the spring of 2007 but came to a halt in the summer of 2007 due to financial problems. The invoices related to the work completed at that point were all issued. Both the taxpayer and its subcontractors complied with their obligations as regards the declaration and payment of VAT under the previous VAT law²⁷⁰.

On 14 February 2008, following the entry into force of the new VAT law²⁷¹, the applicant in the main proceedings, the developer and the subcontractors, by a joint decision and in accordance with Subsection 269(1) of that law²⁷², requested that the provisions of the new VAT Law be applied to the work carried out under both the contract between the applicant in the main proceedings and the developer, as well as the contract between the applicant and its subcontractors.

Following an examination by the tax authority²⁷³ of the VAT declaration made by the taxpayer for the financial year 2007, by decision of 23 May 2008 the authority pointed out a VAT debt of HUF 52 822 000 in respect of the period from April to September 2007²⁷⁴. The revenue office stated that the invoices issued by the subcontractors did not provide a basis for the applicant's right to deduct, since those invoices did not comply with the provisions of the Law

²⁷⁰ The provisions of the 'previous VAT Law' (Act LXXIV of 1992 on value added tax)

²⁷¹ According to Article 70/A of Act CXXVII of 2007 on Value Added Tax entered into force on 1 January, 2008, the provisions of the previous Hungarian VAT regime contained harmonized provisions with the Sixth Council Directive and the amendments thereof adopted before 1 January, 2005.

²⁷² 'In the event if this Act [the Law on VAT] and the [former] VAT Act both contain provisions affecting the same party or parties and concerning the same rights and obligations relating to self-assessment based on the same facts, the rights and obligations relating to self-assessment shall remain to be governed after the time of this Act entering into force exclusively by the provisions of the VAT Act, unless this Act contains provisions to abolish the obligations (...), or provides for less stringent obligations, or introduces new rights or additional entitlements. In the latter case, the rights and obligations may be established and applied - upon the mutual consent and decision of all parties concerned - under the relevant provisions of this Act, even if they originate from any period before the time of this Act entering into force (...), provided that all parties concerned supply a written statement on this decision in advance, conveying their mutual understanding, to the state tax authority, where these statements must reach the competent branch of the state tax authority by 15 February 2008. (...)'

²⁷³ According to Subsection 86(1) of the Act XCII of 2003 on the Rules of Taxation, 'In order to combat attempts to evade taxes and any unlawful activity for claiming central subsidies and tax refunds, the tax authority shall conduct regular audits of taxpayers and other persons involved in the taxation system. The objective of audits is to enforce the provisions of tax laws and other relevant legislation and detect any violation or infringement of these regulations. The tax authority shall investigate the facts and circumstances of any alleged violation or infringement of tax regulations and gather data and information as evidence to support such allegations in the ensuing proceedings.'

²⁷⁴ As per Subsection 170(2) of Act XCII of 2003 on the Rules of Taxation, 'A tax difference established to the debit of a taxpayer shall be considered tax arrears; in the case of self-assessment, it shall be regarded as such only if the tax difference has not been paid up to the due date or if central subsidies have been claimed'.

on VAT, and because of the declaration of 14 February 2008, the new VAT law's provisions relating to the reverse charge procedure were applicable retroactively to the invoices issued during the financial year of 2007. Accordingly, the taxpayer could have exercised its right to deduct if it had amended its VAT declaration, and its subcontractors had amended their issued invoices as well. This decision of the Hungarian revenue office was upheld by a decision made on 5 September 2008.

The taxpayer filed a lawsuit against the Hungarian revenue office in the Baranya regional court²⁷⁵ (hereinafter referred to as the national court) for the annulment of the referred decision. The national court considered that Subsection 269(1) of the new VAT law infringes Articles 17 and 20 of the Sixth Directive and various general principles of European Union law, since it retroactively cancelled the taxpayer's right to deduct lawfully exercised thereby in accordance with the previous VAT law.

Therefore the national court suspended the proceedings and referred the following questions to the Court of Justice for a preliminary ruling²⁷⁶:

'(1) Is a provision of a law of a Member State, which entered into force on 1 January 2008, after the right to deduct had arisen, and which, for the purposes of the deduction of VAT paid and declared in relation to supplies of goods or services made in the 2007 financial year, requires the amendment of the content of invoices and the submission of a supplementary declaration, compatible with Articles 17 and 20 of the Sixth Directive?

(2) Is the measure laid down by Paragraph 269(1) of the new VAT Law, according to which, if the conditions set out in that paragraph are met, rights and obligations must be determined and applied in accordance with the provisions of that Law, even where they arose before the entry into force thereof, subject to limitation, compatible with the general principles of [European Union] law, and, in particular, is it objectively justifiable, reasonable, proportionate and consistent with the principle of legal certainty?'²⁷⁷

The Hungarian government argued that proceedings raise a question of the interpretation of national law, not European Union law, since the retroactive application of the provisions of the

²⁷⁵ Baranya Megyei Bíróság

²⁷⁶ According to Section 155/A of Act III of 1952 on the Code of Civil Procedure, the court may request the Court of Justice to provide a preliminary opinion in accordance with the Treaty establishing the European Community. The court shall request the European Court of Justice to provide a preliminary opinion by way of a ruling, and shall simultaneously suspend the proceedings. The court shall define the matter for which the preliminary opinion of the Court of Justice is required, and shall outline the facts - to the extent required - and the pertinent passages of the Hungarian legal system.

²⁷⁷ *Uzodaépítő Kft. v APEH Központi Hivatal Hatósági Főosztály* (C-392/09), at [20].

new VAT law is based exclusively on the common decision of the taxpayer and the other involved parties as per the declaration referred above, and the main proceedings at the national court arose from the misinterpretation by the taxpayer of the transitional provisions of the Law on VAT.

The Court of Justice stated that despite the national court's reference concerns, the interpretation of Articles 17 and 20 of the Sixth Directive, the Court of Justice shall provide to the national court all the elements of interpretation which may be of assistance in adjudicating on the case pending before it, irrespectively of the exact wording of the asked questions. Furthermore, only the interpretation of the provisions of Directive 2006/112 is relevant to the present case, since in accordance with Articles 411 and 413 of Directive 2006/112, that directive repealed and replaced the Sixth Directive from 1 January 2007, and the relevant facts in the main proceedings post-date 1 January 2007. Thus, it must be held that the first question referred concerns the interpretation of Articles 167 and 168 of Directive 2006/112, which correspond to the provisions of the Sixth Directive mentioned in the order for reference, furthermore that it also concerns the interpretation of Article 178 of Directive 2006/112.

Thus, the national court asks whether Articles 167, 168 and 178 of Directive 2006/112 preclude national legislation, which, in the context of the retroactive application of new provisions relating to the reverse charge procedure, makes the deduction of VAT conditional upon the amendment of invoices for the services provided before the new law entered into force and the submission of a supplementary tax declaration.²⁷⁸

‘[T]he right to deduct provided for in Articles 167 and 168 of Directive 2006/112 is an integral part of the VAT scheme and in principle may not be limited’²⁷⁹, as stated by the Court of Justice²⁸⁰. Therefore the fact that the new VAT law was applied instead of the previous one due to the sole decision of the taxpayer can not affect the right to deduct the input VAT paid, which arises directly from Articles 167 and 168 of Directive 2006/112.

Furthermore, taking into account that the issue is related to a reverse charge procedure, the Court of Justice argued that only Article 178(f) is applicable regarding the procedures for exercising the right to deduct VAT. Thus, only the formalities laid down by the Member State within the options determined by the referred Article have to be fulfilled by the taxpayer in

²⁷⁸ *Uszodaépítő Kft. v APEH Központi Hivatal Hatósági Főosztály* (C-392/09), at [33].

²⁷⁹ Point 34 of the referred judgement.

²⁸⁰ For a wider study, see *Skatteverket v AB SKF* (C-29/08), and *BLP Group Plc v CC&E* (C-4/94), furthermore *Abbey National Plc v CC&E* (C-408/98)

question, in order to be able to exercise his right to deduct. Additionally, due to the principle of fiscal neutrality, deduction of input tax has to be allowed ‘if the substantive requirements are satisfied, even if the taxable person has failed to comply with some of the formal requirements’²⁸¹.

The European Commission pointed out that due to the formal requirements imposed in the main proceedings could make the taxpayer unable to exercise the have right to deduct thereof, although the revenue office was in possession of all the information necessary to establish that the taxpayer was liable to VAT, so no additional conditions should have been introduced.

Taking into account all the facts, arguments and circumstances, the Court ruled as stated above²⁸², and declared that due to the answer to the first question, there is no need to answer the second question asked by the national court.

4.1.2. Application for VAT refund

4.1.2.1. Application for the refund of excess value added tax

The eligibility for refunds shall be determined according to the domestic rules of the Member States for VAT deductions, although certain expenditures may be excluded or certain conditions imposed.

According to Hungarian law, at the end of the tax year, taxable persons may apply for the refund of excess VAT only in so far as that excess exceeds the amount of the VAT payable on transactions which have not yet actually been paid for.²⁸³ However, this provision as per the standpoint of the European Commission is not in compliance with Directive 2006/112. Therefore an action was brought by the European Commission v the Republic of Hungary on 1 June 2010²⁸⁴.

In this particular case the European Commission declared that the Republic of Hungary has failed to fulfil its obligations under Directive 2006/112 by requiring taxable persons, whose tax declaration for a given tax period records an excess,²⁸⁵ to carry forward that excess or a part of

²⁸¹ *Uszodaépítő Kft. v APEH Központi Hivatal Hatósági Főosztály (C-392/09)*, at [39].

²⁸² The Operative part of the judgment can be read also in the Official Journal of the European Union, C 317/10, 20.11.2010

²⁸³ According to Section 131 of Law on VAT, a domestic taxable person may make the deduction by subtracting from the total amount of VAT due for a given tax period the total amount of VAT in respect of which, during the same or previous period or periods, the right of deduction has arisen. If the margin calculated accordingly is negative, the taxable person established in the domestic territory may reclaim the difference from the state tax authority under the conditions and method set out in Section 186.

²⁸⁴ Case C-274/10

²⁸⁵ As per Article 183 of the Directive 2006/112.

it to the following tax year where the taxable person has not paid the supplier the full amount for the purchase in question. As a result of that obligation, certain taxable persons whose tax declarations regularly record an excess may be required more than once to carry forward the excess to the following tax year.

As per this provision, a taxable person may not apply for a refund of the part of the excess corresponding to the VAT chargeable on purchases which have not been paid for, but must carry it forward to the following tax year. If, at the end of the tax year, the amount of the excess VAT is less than or equal to the amount of the VAT chargeable on purchases not paid for, the taxable person must carry forward the whole of the excess VAT to the following tax year. Thus, the input VAT may be deducted only via offsetting against output VAT, and any reclaimable excess VAT that is higher than the VAT due to the authority, must be carried forward. The same procedure shall be followed at the end of the following tax year: the legislation places no temporal limit on the procedure with the result that it is possible for a taxable person to be required to carry forward excess VAT indefinitely.

If, at the end of the tax year, taxable persons have a credit of VAT, they may apply for the refund of this excess VAT. However, the refund will only be made in so far as this credit exceeds the amount of the VAT payable on transactions, which have not yet actually been paid for.

The Commission does not dispute that Article 183 of Directive 2006/112 grants the member states discretion whether to carry forward or refund excess VAT. However, the member states may only exercise that discretion in accordance with the principles of the common system of VAT as a whole and in particular the principle of tax neutrality²⁸⁶. As a provision which impedes the full application of the principle of tax neutrality, Article 183 of the directive, which allows Member States to carry forward a VAT excess to the following year once, must be interpreted narrowly and may not serve as a basis for the adoption of national provisions contrary to the principle of tax neutrality or the purpose of the deduction mechanism.²⁸⁷

²⁸⁶ The Court of Justice passed judgements regarding the principle of fiscal neutrality, stating that deduction of input tax shall be allowed if the substantive requirements are satisfied, even if the taxable person has failed to comply with some of the formal requirements (See Joined Cases C-95/07 and C-96/07 *Ecotrade* [2008] ECR I-3457, paragraph 63, referred to also in point 39 of Case C-392/09 detailed above).

²⁸⁷ In accordance with the principle of neutrality, the purpose of the deduction mechanism is to free a trader entirely from the burden of VAT which he has to pay or has paid in the course of any of his business transactions. That principle precludes the Member States from imposing requirements for the refund of excess VAT which entail a burden on the taxable person and affect that person's financial position or liquidity or commercial decisions.

Accordingly, as indicated on the homepage of the European Commission, '[a] taxable person whose input VAT exceeds his output VAT is entitled to a refund of the excess from his national treasury. However, Member States may decide to carry forward the excess to the next taxable period and offset it against tax due in that period'²⁸⁸.

The withholding of the VAT excess as per the contested Hungarian provision has such negative effects on the taxpayer for, inter alia, the following reasons. A surplus of deductible VAT over VAT to be paid is an amount due to the taxable person. The postponement of payment of that amount reduces the profitability and/or liquidity of the taxpayer and increases his commercial risk. The VAT due on the goods or services supplied by the taxpayer shall be paid, even if the countervalue thereof has not been paid. In this regard, the Court of Justice²⁸⁹ ruled that the 'method of refund adopted must not entail any financial risk for the taxable person'²⁹⁰.

Furthermore, the withholding of the VAT excess constitutes a burden not only for the taxpayer in the position of seeking a refund, but also on the taxable person who is the other party to the taxable transaction (so the seller). The decrease in the buyer's liquidity leads to an increasing risk that the seller will not receive the consideration for the goods or services supplied or will receive it late, while, regardless of whether he does or not, the seller is required to hand over the VAT on his supply of goods or services.

In the view of the Commission, the fact that the legislation places a burden on taxable persons cannot be offset by the imposition of further burdens on taxable persons. The balance which the legislation seeks to attain can only be achieved if, to offset the burden falling on the taxable person in the position of debtor, that is to say, to offset the obligation to pay the tax, it provides for the possibility for the taxable person in the position of creditor to obtain a refund of the VAT paid when he was in the position of debtor.

Finally, given that Article 183 of the directive only provides for the excess VAT to be carried forward once 'to the following tax year' the contested Hungarian legislation breaches that article in that it does not provide for the taxable person to obtain a refund of the excess at the latest by the end of the second tax year. Moreover, the Hungarian legislation which, essentially, by reducing the buyer's liquidity, is in its turn reducing the likelihood of the refund being made and does not guarantee that the taxable person will ever recover the excess. If the taxable person

²⁸⁸ http://ec.europa.eu/taxation_customs/taxation/vat/traders/vat_refunds/index_en.htm [2011.02.22.]

²⁸⁹ At that time the ECJ.

²⁹⁰ Case C-78/00 Commission of the European Communities v Italian Republic. Cited by Schenk, Alan – Oldman, Oliver: Value Added Tax: A Comparative Approach. Cambridge University Press, New York, 2007 p. 170.

ceases activity without paying for all purchases made because he is insolvent, there is no means of recovering the VAT chargeable on transactions, which were not paid for, as the State will ultimately retain it.

Having regard to the arguments mentioned above, the Commission takes the view that the Hungarian legislature has exceeded the discretion granted to it, and has infringed Article 183 of the Directive 112/2006 by adopting legislation on the requirements to be met for the refund of excess VAT which infringes the principle of tax neutrality and allows the excess to be carried forward year after year.

4.1.3. Concluding comments

The VAT regime is one of the most harmonized types of tax in the European Union. The rules, operation, exemption methods and exempt goods and persons are very similar. However, there are still certain open issues that are regulated differently by the member states, for instance the number and level of tax rates²⁹¹, standard and preferential rates, administrative measures, conditions of tax refund²⁹² and the right to deduct input VAT, furthermore the detailed provisions regarding the formal elements of the invoice. Accordingly, despite the scheme of the Hungarian VAT is harmonized with the EU regulations, the applicable directives, and the corresponding provisions, certain problems regarding the practice and enforcement occur.

I do believe that, in order to guarantee the four freedoms of the Single Market²⁹³, the same VAT obligations shall be enacted on the national level regarding same types of enterprises in all member states of the European Union. This goal, however, can not be achieved without the related pieces of EU-legislation, thus standardized detailed provisions shall be put in place and generally implemented in addition to the interpretation work of the Court of Justice ensuring the equal application of EU law across all member states.

It is obvious that according to the judgements of the Court of Justice, the right to deduct provided as per Directive 2006/112 may not be limited, and can not be refused from a taxpayer due to a formal error of an invoice in case it is corrected before the audit of the tax authorities. The invoice allows the purchaser to prove his right to deduction and from that point of view

²⁹¹ The standard VAT rate, as discussed must be at least 15%, and the reduced rate at least 5%, otherwise the Member States have wide discretion to determine the exact rate.

²⁹² The exact rules shall be determined by the domestic rules of the Member States.

²⁹³ The Single Market or Internal Market of the European Union (formerly the Common Market) aims to guarantee the free movement of goods, capital, services, and people within the 27 member states thereof.

can not be challenged or dismissed because of an error, even if it is related to the date of fulfilment.

Furthermore, despite certain discretion is provided for the member states to decide whether the excess VAT shall be carried forward to the following tax year or refunded, it shall be exercised in accordance with the principles of the common system of VAT and in particular the principle of tax neutrality. However, the withholding of the VAT excess as per a contested Hungarian provision may cause the taxpayer serious problems of liquidity and financial risk, since the postponement of payment may last for more than a year, and the VAT to be refunded may be carried forward through more than one fiscal year.

Taking into account the cases and their consequences discussed in this paper, the Hungarian VAT regime and the provisions thereof, despite they are harmonised with the corresponding EU provisions, shall be reviewed, reconsidered, and, if necessary, amended.

4.2. Interaction of private and financial law in Hungary

Many problematic issues can be pointed out regarding the relationship between private law and financial law in Hungary. Some of these interactions derive from the principals of the Act XCII of 2003 on the Rules of Taxation²⁹⁴. 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.²⁹⁵ 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,²⁹⁶ and dismissing the possible tax avoidance measures used through transfer pricing.

²⁹⁴ About the relationship between the Act XCII of 2003 on the Rules of taxation and the Act CXL of 2004 on the General Rules of Administrative Proceedings, see Bencsik, A.: A fogyasztóvédelem alapelveinek tükröződése a Nemzeti Fogyasztóvédelmi Hatóság eljárásában, in: Bencsik, A. et al (eds): *Jogász Doktoranduszok II. Pécsi Találkozója*, Pécs: Pécsi Tudományegyetem Állam- és Jogtudományi Karának Doktori Iskolája, 2012, p. 344, ISBN 978-963-642-405-3, pp. 59-60.

²⁹⁵ According to Paragraph 7 of Article 1 of the Act on the Rules of Taxation, 'Contracts, transactions and other similar operations shall be judged in accordance with their true content. For the purposes of taxation, an invalid contract or any other transaction of the like shall be considered to have any bearing to the extent of the apparent economic results it carries.'

²⁹⁶ According to Paragraph 8 of Article 1 of the Act on the Rules of Taxation, 'The transactions of affiliated companies shall be recognized at fair market prices for taxation purposes irrespective of whether or not the underlying contracts are concluded at fair market prices. This provision shall not apply if the conduct of the affiliated companies is consistent with market practices that could reasonably be expected from independent parties under the given circumstances.'

Another major field of the relation²⁹⁷ between civil law and financial law is the matter of public-private partnerships. Such developments are commonly used in Hungary on the field of education, logistics,²⁹⁸ 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.²⁹⁹

However, the most debated matter regarding the interaction between private and financial law 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.

4.3. The government measures to reduce retail mortgage debts

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

²⁹⁷ Kecskés, A.: Tanulmány a gazdasági magánjog interdiszciplináris szemléletéért. In: Ünnepi tanulmányok Kecskés László professzor 60. születésnapja tiszteletére, Pécs: Pécsi Tudományegyetem Állam- és Jogtudományi Kar, 2013, p 615, pp. 301-322.

²⁹⁸ The first really public-private partnership project was the construction of motorway no. 6 (M6) from Budapest to Pécs. This was prefunded by huge construction companies, and the price to be paid by the users of the motorway is included in the price of the motorway ticket.

²⁹⁹ About the changing of task-sharing between the operators and the state, see Bencsik, A.: A fogyasztóvédelem szakigazgatási alapjai. In: Lapsánszky, A. (ed): Közigazgatási jog. Fejezetek szakigazgatásaink köréből. II. kötet. Gazdasági közigazgatás, infrastruktúra igazgatás, Budapest: CompLex Kiadó, 2013, p. 679, pp. 348-351.

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.³⁰⁰

A new set of provisions entered into force on 27 November 2010,³⁰¹ 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.³⁰²

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.³⁰³ 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

³⁰⁰ There were obviously measures on other fields of law as well, for instance, the act on legal enforcement was modified in May 2010 first. The aim of the new provisions was to prolong the eviction moratorium first until 31 December 2010, then until 15 April 2011, finally until 1 July 2011, then enacted that no eviction can take place regarding the rightful owners and/or users between the periods from 1 December to 1 March. Furthermore until 1 July 2011, an auction moratorium was provided as well. Furthermore the auction of flats, apartments, and family houses has been bound to much stricter rules, in order to provide social security for the insolvent debtors, furthermore to prevent the market from too many real property auctions and the related price fall. These measures prevented that the bankrupt or insolvent debtors lose their homes and be thrown to the streets, which would have caused a social disaster.

³⁰¹ The Act XCVI of 2010 amended the related financial acts, in order to help the consumers repay their foreign currency mortgages partially or entirely at fixed exchange rates.

³⁰² The loan contract for accommodation may only be modified unfavourably for the debtor only regarding the rate of interest and in cases specified by the applicable government decree in force, due to the significant change of the basic rate of interest determined by the Hungarian National Bank, the applicable regulation in force, etc.

³⁰³ Act CXXI of 2011 on the Amendment of Certain Acts in connection with Home Protection.

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 Authority³⁰⁴, 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.³⁰⁵ The debtor is entitled to offer a higher monthly instalment, 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,³⁰⁶ 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.³⁰⁷

³⁰⁴ This used to be called PSZÁF (Pénzügyi Szervezetek Állami Felügyelete), but the powers thereof were taken over by the Hungarian National Bank, since according to the Act CXXXIX of 2013 on Magyar Nemzeti Bank (Hungarian National Bank) with effect as of 1 October 2013, the Hungarian Financial Supervisory Authority and the Hungarian National Bank are integrated into one institution.

³⁰⁵ HUF 270 to CHF, HUF 340 to EUR, HUF 3,3 to JPY

³⁰⁶ For a detailed study regarding the loan processes, see Ercsey, Zs. – Kovács, T. – Kovács, Z.: Workforce Synthesis of Loan Processes: Parametric Study. 8th International PhD & DLA Symposium, Pécs, Hungary, October 29–30, 2012, Abstract Book, p. 87

³⁰⁷ The eviction moratorium was also prolonged until 30 April.

4.4. Practical anti-avoidance measures taken recently in Hungary

4.4.1. Tax planning

It is essential that business players react on taxes. High and progressive taxes cut back performance and will not stimulate production.³⁰⁸

The recent study of Csaba Szilovics³⁰⁹ shows that Hungarian taxpayers unilaterally vote against tax rises, especially that of the value added tax and the personal income tax (only 17 per cent of the interviewed would support the increase of personal income tax rates). 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 opinion³¹⁰. 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 authority³¹¹. 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 permanent investment account³¹², the calculation of cost invoices for individual entrepreneurs, or when real estate or other property is sold³¹³). I believe that tax planning is by no means harmful, but its wide option much rather promotes that

³⁰⁸ Streissler, Erich: Gazdaságelméleti kétségek a progresszív jövedelemadó ésszerűségét illetően. In: Közgazdasági Szemle 1990/1. p. 79.

³⁰⁹ See more in detail Szilovics, Csaba: Adózási ismeretek és adózói vélemények Magyarországon (2002-2007). G & G Nyomda Korlátolt Felelősségű Társaság, Pécs, 2009

³¹⁰ Brother Layman says for example that today only 10 per cent is really paid for personal income tax, and large personal revenues have long been tax free due to offshore or domestic non-existing accounts, because the actual revenue, after which personal income tax should be paid, is extracted from companies that way. (Brother Layman: Az offshore halála. HVG Kiadó Zrt., Budapest, 2010 p. 331.

³¹¹ Since January 1, 2011 the National Tax and Customs Office (NAV) has authority in personal income tax issues instead of APEH.

³¹² See Section 67/B. of the Act on Personal Income Tax.

³¹³ The effective law has retained taxpayers' chance to choose from three cost types

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 municipalities³¹⁴, 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.³¹⁵

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 form³¹⁶. 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

³¹⁴ Based on the 2011 budget of the Republic of Hungary, i.e. Act no. CLXIX of 2010, Section 38, (1) local municipalities in total are entitled to 40 per cent of the personal income tax declared for the year 2009 according to taxpayers' permanent addresses. 8 per cent of this sum based on administrative areas is actually going to the local municipality.

³¹⁵ Statement by Willy Kiekens, Executive Director for Hungary and Szilard Benk, Senior Advisor to the Executive Director January 18, 2012 pp. 2. Online: <http://www.imf.org/external/pubs/ft/scr/2012/cr1213.pdf> [2012.02.25.]

³¹⁶ The declaration liability was so far possible through self-declaration (classical individual tax payment or simplified declaration with authority assistance) or by employer's tax statement.

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 conditions³¹⁷. 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.

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

³¹⁷ These share the common conditions also with regard to the nature of revenue types that

- individuals have not / will not deduct expenses or a part of expenses (except for the 10 per cent cost ratio) by a calculation of item by item;
- deduction, family allowance from revenue or tax allowance or reduction has been registered with a single employer only, which also calculates the tax advance and the afore mentioned are calculated only to the extent as employer had considered them by its tax advance statement;
- no declaration on voluntary pension fund tax payment or pension saving statement is prepared;
- tax and advance have been deducted in full amount and
- all his/her revenue in the tax year have not surpassed the limit of tax allowance or no tax allowance has been or will be registered.

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 31st 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.³¹⁸ However, this possibility may be used for the tax year of 2013, but the referred provisions will not be effective from 1 January, 2014.

4.4.2. Procedural issues

It is essential that business players react on taxes.³¹⁹ High and progressive taxes cut back performance and will not stimulate production.³²⁰ 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 opinion³²¹. 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 authority³²². As a result, taxpayer will only receive the net salary amount reduced by its tax content together with a certificate, in

³¹⁸ See Subsection 65(5) of the personal income tax act.

³¹⁹ See the lecture of Zsolt Ercsey and the related abstract book. Cf. Ercsey, Zs. – Süle, Z. – Kovács, T. – Bertok, B. – Kovács, Z.: Business Process Synthesis with Various Resource Needs. 9th International Conference Computational Management Science. Imperial College London, UK, 18-20 April, 2012. Book of Abstracts, 76

³²⁰ Streissler, E.: Gazdaságelméleti kétségek a progresszív jövedelemadó ésszerűségét illetően. In: Közgazdasági Szemle 1990/1, p. 79.

³²¹ Brother Layman says for example that today only 10 per cent is really paid for personal income tax, and large personal revenues have long been tax free due to offshore or domestic non-existing accounts, because the actual revenue, after which personal income tax should be paid, is extracted from companies that way. (Layman, B.: Az offshore halála, Budapest: HVG Kiadó Zrt., 2010, p. 984, p. 331.

³²² Since January 1, 2011 the National Tax and Customs Office (NAV) has authority in personal income tax issues instead of APEH.

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 account³²³, the calculation of cost invoices for individual entrepreneurs, or when real estate or other property is sold³²⁴). 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 municipalities³²⁵, 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 salary³²⁶ 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

³²³ See Section 67/B. of the Act on Personal Income Tax.

³²⁴ The effective law has retained taxpayers' chance to choose from three cost types

³²⁵ Based on the 2011 budget of the Republic of Hungary, i.e. Act no. CLXIX of 2010, Section 38, (1) local municipalities in total are entitled to 40 per cent of the personal income tax declared for the year 2009 according to taxpayers' permanent addresses. 8 per cent of this sum based on administrative areas is actually going to the local municipality.

³²⁶ Kecskés, A.: Theoretical Approach of Executive Compensation in the United States and Europe. In: Acta Universitatis Bogdan Voda – Series Oeconomica 2013/16, pp. 61-74.

that the minimum wage hike, introduced by the government, reduce this type of tax fraud, and therefore shall be deemed good measure.³²⁷

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 opened from 2012, which really simplifies the preparation of a tax form³²⁸. 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 conditions³²⁹. 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

³²⁷ Statement by Willy Kiekens, Executive Director for Hungary and Szilard Benk, Senior Advisor to the Executive Director January 18, 2012 p. 2. Available at <http://www.imf.org/external/pubs/ft/scr/2012/cr1213.pdf> (29 November, 2013)

³²⁸ The declaration liability was so far possible through self-declaration (classical individual tax payment or simplified declaration with authority assistance) or by employer's tax statement.

³²⁹ These share the common conditions also with regard to the nature of revenue types that individuals have not / will not deduct expenses or a part of expenses (except for the 10 per cent cost ratio) by a calculation of item by item;

deduction, family allowance from revenue or tax allowance or reduction has been registered with a single employer only, which also calculates the tax advance and the afore mentioned are calculated only to the extent as employer had considered them by its tax advance statement;

no declaration on voluntary pension fund tax payment or pension saving statement is prepared;

tax and advance have been deducted in full amount and

all his/her revenue in the tax year have not surpassed the limit of tax allowance or no tax allowance has been or will be registered.

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.

4.4.3. Recent experience

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 social security contribution), stimulated the economy, and promote employment.³³⁰

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.³³¹ 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.³³² In comparison, in the Act CLXIX of 2010 on the Hungarian Central Budget of 2011³³³ 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 2012³³⁴.

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 tax³³⁵, 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.³³⁶ These figures show that the

³³⁰ http://www.piacesprofit.hu/kkv_cegblog/penz/marad_az_egykulcsos_szja.html [2012.04.12.]

³³¹ IMF Country Report No. 12/13, p. 31. Available online: <http://www.imf.org/external/pubs/ft/scr/2012/cr1213.pdf> [2012.03.10]

³³² See Appendix 1 of the Act CXXXIII of 2011 on the Execution of the Budget of 2010.

³³³ Please do note that the official figure of the amount collected from individual income tax in 2011 is not available yet, that will be enacted by the legislation in the annual accounts of the budget.

³³⁴ See Appendix 1 of Act CLXXXVIII of 2011 on the Hungarian Central Budget of 2012.

³³⁵ Appendix 1 of Act CXXXIII of 2011 on the Execution of the Budget of 2010

³³⁶ Appendix 1 of the Act CLXIX of 2010 on the Hungarian Central Budget of 2011

measures taken by the Hungarian government ‘have led to less than optimal economic outcomes’³³⁷. 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 duties³³⁸, 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 most³³⁹, 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.³⁴⁰ 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.³⁴¹ 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 amounts³⁴² is on the one hand in harmony with the

³³⁷ See IMF Survey online January 25, 2012 <http://www.imf.org/external/pubs/ft/survey/so/2012/NEW012512A.htm> [2012.01.30.]

³³⁸ Appendix 1 of the Act CLXXXVIII of 2011 on the Hungarian Central Budget of 2012

³³⁹ Budgetary concept of LMP (the Hungarian Green Party, Politics Can Be Different). <http://lehetmas.hu/wp-content/uploads/2011/09/Az-LMP-2012.-%C3%A9vre-sz%C3%B3l%C3%B3k%C3%B6lts%C3%A9gvet%C3%A9si-javaslat.pdf> [2012.03.04.] p. 17.

³⁴⁰ As Dr. György Surányi highlighted in his presentation on May 19, 2011 at 6 pm at CIB Bank Zrt. headquarters, the rich also have one dinner, therefore it doesn't matter if more money stays with them after tax payment, if they don't spend it.

³⁴¹ For more details see latest Gfk survey http://www.gfk.hu/imperia/md/content/gfk_hungaria/pdf/press_2012/press_eng/press_2012_03_16_eng.pdf [2012.04.05.]

³⁴² These government moves have been urged by several market players and analysts for many years. See e.g. Brother Layman: Az offshore halála. HVG Kiadó Zrt., Budapest, 2010 pp. 272-274.

connecting international trends, albeit the introduction of flat tax rate is preferably used by East-Central European states, and hardly used in Western countries.

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,³⁴³ 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'³⁴⁴. 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'³⁴⁵.

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.³⁴⁶ These practical solutions show a good example of the two options used in the European Union: high personal income tax and low contribution

³⁴³ See for example <http://www.nepszava.hu/articles/article.php?id=464441> and http://adozona.hu/szja_ekho_kulonado/LMP_tobbkulcsos_adora_van_szuksege_UPU7YH [2012.04.10.]

³⁴⁴ IMF Survey online January 25, 2012 <http://www.imf.org/external/pubs/ft/survey/so/2012/NEW012512A.htm> [2012.01.30.]

³⁴⁵ IMF Survey online January 25, 2012 <http://www.imf.org/external/pubs/ft/survey/so/2012/NEW012512A.htm> [2012.01.30.]

³⁴⁶ The average unemployment rate of the Euro zone was 10 per cent by surveys in December 2010, while the EU average was 9.6%. This figure in Hungary has been on the rise since December 2009 and it reached 11.7% by the December 2010 official survey. (See more in detail: Eurostat Newsrelease, 2011/18)

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).³⁴⁷

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 allowances³⁴⁸ 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.

4.4.4. Legal background

According the latest amendment of Act CXXVII of 2007 on Value Added Tax (hereinafter referred to as the VAT Act), Point c) paragraph 1 of 260 point c, and e-h), the minister responsible for tax policy is authorized to regulate in a ministerial decree the method of issuing an invoice and other types of receipt, taking into account that the National Tax and Customs Administration Directorate (hereinafter referred to as the Revenue Office) may supervise and control the data disclosure regarding the issue of all types of receipt. The taxpayers shall provide all relevant data regarding any economic activities (e.g. especially sales) according to Paragraph 1 of Article 178 of the VAT Act, the Revenue Office may control this disclosure through an information technology system as well, also by controlling directly the cash registers. With this activity, the Revenue Office may check the current data of the cash registers through the system

³⁴⁷ Cf. Lykketoft, Mogens: The Danish Model. A European success story. In: Internationale Politikanalyse 2009/12. p. 5.

³⁴⁸ Taxpayers can deduct costs in several countries, even if the revenue was earned by non-independent activity. E.g. in Belgium the revenue can be declined by a progressive flat amount (see more in detail: Boeijen-Ostaszewska, Ola van (ed.): European Tax Handbook 2010. IBFD, Amsterdam, 2010 p. 127.

immediately. There is a possibility that based on corresponding law and upon the separate request of the taxpayer, individual exemption may be granted.

The aim of the regulation is to improve the level of tax compliance, and to reduce the possibilities of tax evasion, in order to increase the budgetary revenue. The Government decided on the matter on October 2012, and based the new regulation on the amendment of the act on VAT, which entered into force on 1 January 2013.³⁴⁹

The Government resolution 1059/2013. (II. 13.) determined the schedule of introduction of the cash registers that provide data directly to the Revenue Office. The detailed provisions were specified by the ministerial decree. According to the above regulation, the minister for national economy issued the decree 3/2013. (II. 15.) regarding the obligatory obligation of the new cash registers and taxi meters.³⁵⁰ As per appendix no. 1 of the referred decree, the pharmacies and all the retailers, as well as taxpayers of catering industry and accommodation services, furthermore taxi services shall use the new machines. Only a few exemptions can be applied in relation to the fulfillment of such obligations, all of which referred to extraordinary circumstances, such as malfunction of the cash register, blackout, steal and loose, and destroy of the machines, etc. In these exceptional cases, there is a moratorium period, in which the taxpayer can act in compliance with the regulation, but without using the machine and without being connected directly to the Revenue Office's server.³⁵¹

4.4.5. Tax control unit

The new technical solution is the tax memory unit (hereinafter referred to as the tax control unit), which is unique in Europe, but similar to some solutions used in other member state of the European Union (for instance: Bulgaria). It shall be pointed out that many countries use such methods, but not for a long time.³⁵² Thus the already gained experiences have to be

³⁴⁹ Cf. Z. Mester, Pénztárgépek Összekötése az adóhatósággal [*Cash registers connected to Revenue Office*] <http://www.hkik.hu/hu/kereskedelem/cikkek/penztargepek-osszekotese-az-adohatosaggal-a-nav-kozlemenye-47537> (18/04/2013)

³⁵⁰ Wide public consultation was conducted prior to the publication of the decree, in which professionals, experts, distributors and other organizations shared their opinions and proposals, which were also taken into account.

³⁵¹ The moratorium period is specified in paragraph 3 of Article 1 in detail. For example, in case of blackout, it lasts until the end thereof, and in case of any other problems occurring in relation to the machine, for maximum of fifteen days. Additionally it shall be pointed out that the taxi services shall be completely suspended until the problem is solved.

³⁵² Cf. The online cash registers were introduced on 1 January 2013 in Croatia, in order to reduce the proportion of black market and increase government revenue. The taxpayers, among which the host institutions (e.g. restaurants) were in focus, reported a 31% extra turnover to the revenue office in January. Later, due to the restricted control of the tax authorities, this number seems to be growing. The new provisions are not applied to postal service providers, banks, insurance companies, passenger transport service providers, since these enterprises are controlled differently by the revenue office. <http://www.onlinekassza.hu/hirek/esettanulmanyok/537-bevalt-az-onlinekassza-horvatorszagban>, (01/02/2013)

scrutinized, in order to solve the possibly occurring avoidance activities, and definitely count with them.

The tax control unit is a separate, closed, data storing and communicating part of the cash register, which contains the receipts relevant to tax matters, and the electronic records.³⁵³ It furthermore provides the secret data flow between the cash register and the server of the Revenue Office. It records continually all the events in connection with the cash register, such as the issue of the receipts, the blackout, switch on, and switch off, etc. It signs the possibility of data transferring to the server of the Revenue Office, however, the data are only transferred if the server of the Revenue Office orders that. This provides that the taxpayer does not have information on the latest report. The unit also provides that the registered data can not be deleted. The relevant technical data are specified in the appendices of the decree.

The data that have to be provided for the Revenue Office should be transferred through an electronic communication network (GPRS, EDGE, HSDPA, UMTS), thus not an internet connection, but certain mobile data connection is required.³⁵⁴

In case of individual exemption, the taxpayer shall copy the data of the tax control unit to a non-rewritable optical storage media (CD/DVD), and shall send it to the competent body of the Revenue Office until the 10th day of the following month. This method shall be used also by the taxpayers in the moratorium period regarding the traditional tax registers that have an electronic diary. The individual exemptions may only be applied for the taxpayer who physically can not fulfill this obligation due to lack of network connection. In such cases the National Media and Infocommunication authority shall provide a professional opinion, stating that the electronic communication network is not available in the area, where the economic activity is performed. The individual exemption lasts for one calendar year and may be renewed at least ninety days before the expiry thereof.

4.4.6. The usage of the new technical devices

Regarding the daily routine, an opening and closing has to be done, in order to register the opening amount of cash, and to draft the daily turnover report. The taxpayer is furthermore

³⁵³ The cloud electronic document management system is one of the possible future models of handling documents and records electronically. This method supports the business processes as well. For a detailed study, see Ercsey, Zs.: Üzleti folyamatok támogatása a felhőben. Pollack Press, Pécs, 2014

³⁵⁴ In relation to IT networks, for precise and detailed study see Ercsey, Zs. – Heckl, I. – Kovacs, Z.: A matematikai szigorúság fontossága a kiindulási struktúra meghatározásakor szétválasztási hálózatok szintézise esetén. In: Magyar Kémikusok Lapja 2001/10, pp. 372-377, and Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: Separation-network synthesis: global optimum through rigorous super-structure IN: Computers and Chemical Engineering 2000/8., pp. 1881-1900

obliged to provide the network connection between the tax control unit and the server of the Revenue Office, and shall solve all problems related to the data flow.

The cash register diary shall include all the events related to the cash register. All changes (e.g. suspension of the use of the machine, changing the place of use of the machine³⁵⁵) shall additionally be reported to the Revenue Office. Any problems occurring in connection with the cash registers shall be recorded and indicated in the relevant diary as well.

An administrative fee shall be paid for the application of distribution of the cash registers, which is HUF 600,000/license, and HUF 200,000 for taxa meter/license, furthermore other fees shall be paid for the modification and extension of the license.

The introduction of the new cash registers will be completed in a few phases,³⁵⁶ which provides enough time for all taxpayers to comply with the new regulation and change their system accordingly. The special cash registers and taxi meters may be sold and traded with upon special permission (license) of the Hungarian Trade Licensing Office. Furthermore the repair services shall be registered upon a special application to be filed at the Revenue Office.³⁵⁷

Furthermore the tax control unit shall be stored by the taxpayer until the statute of limitation for the tax assessment. Also, there is an obligation for service control to be performed annually, in order to check whether the machine is intact (no illegal intervention was done) and, if necessary, the battery of the tax control unit is replaced. These services shall also be recorded in the diary of the cash register.

4.4.7. Direct control

The staff of the Revenue Office controls and inspects the obligations regarding the operation, distribution, and repair of the cash registers, and it is declared that any breach thereof will be sanctioned seriously.

³⁵⁵ In relation to detection in other fields of science and practice, see Ercsey, Zs. – Radó, J – Müller, P.: Ragweed Detection in Computer Vision Environment. In: Peter Ivanyi (ed.): Architectural, Engineering and Information Sciences - 9th International PhD & DLA Symposium: Abstracts Book. Konferencia helye, ideje: Pécs, Magyarország, 2013.10.21-2013.10.22. University of Pécs Pollack Mihály Faculty of Engineering, Pécs, 2013, p. 110

³⁵⁶ The operation of the new cash registers shall take place until 30 April 2013. There is a moratorium period until 30 June 2013, in which there are no sections for using old (former type) machines. The old types shall not be used after the moratorium period, and the types thereof are indicated on the website of the Revenue Office. However those traditional cash registers, which do have an electronic diary, can be used until 31 December 2013 and in that case the taxpayer shall send the electronic diary files electronically to the tax authorities between 1 July 2013 and 31 December 2013 according to the technical details published on the homepage of the Revenue Office. Completely different provisions apply for the taxpayer who is not obligated to use a cash register: they can operate traditional cash registers until unified deadline of 31 December 2014.

³⁵⁷ The Revenue Office decides on such registration within fifteen days.

The communication between the cash registers and the Revenue Office provides lot of information regarding the inspection of the violation of law, which is sanctioned by the Act on the Rules of Taxation³⁵⁸. The main obligations are the following: usage of the new types of the cash registers, providing the data connection between the cash register and the server of the revenue office, data disclosure regarding all relevant events (e.g.: repair, annual services, all changes). In case of any violation the revenue office may even revoke³⁵⁹ the cash register on suspicion of any abuse, in order to establish the relevant facts and circumstances. The suspicion can be detected both during the control activity and the supervision of the operation of the cash register. In the latter case, the cash register can even be blocked.

The most serious sanctions may be employed on the distributors, who performed such activities without valid license.³⁶⁰ Other violations are fined with default penalty imposed on the taxpayer by the Revenue Office.³⁶¹

4.4.8. Concluding remarks

In order to reduce tax evasion and tax avoidance, a stable, calculable regulation is needed, furthermore the ongoing monitoring is important as well, in order to guarantee the recognition of illegal activities and the application of the related sanctions. According to the last two decades, it became clear that the taxpayers should be forced to issue invoices for their transactions, and it seems that the current regulation enforces this obligation of the taxpayers effectively. In my opinion, the new measures analyzed in this paper help significantly to achieve this important goal.

Therefore, the introduction of the new system may increase the budgetary revenue, and definitely improves tax compliance among retailers, also decreases the proportion of the black market. It is much more fishy not to assess a certain amount of revenue, and it is easier to follow the value and number of sales as well. However, the compliance costs are relatively high, and some of the retailers may not be able to maintain business in an appropriate manner in

³⁵⁸ Act XCII of 2003 on the Rules of Taxation

³⁵⁹ Than the related inspection is down by the Hungarian Trade Licensing Office, which can order even the distraction of the cash register.

³⁶⁰ Fine of HUF 10,000,000 may be imposed on that.

³⁶¹ The maximum amount of the default penalty is HUF 500,000 for natural person taxpayers and HUF 1,000,000 for other enterprises.

compliance with the new regulation. Furthermore, despite the investigation and audit gets much easier, the continuous control of the Revenue Office is still inevitable.³⁶²

In addition to the simplification, the control activity of the Revenue Office may be even more successful against the tax evasion behaviors. The up-to-date information shows clearly the trading activity (exact amount and time of purchase, opening hours, cash register operation data).

By using these, and through comparative analyses, the different methods and routines of tax avoidance matters can be pointed out. For instance, it is a basis for suspicion if the cash register does not operate through the opening hours, or most of the sales are done just before closing, there is a significant decrease of the value of the daily turnover, the average sales value is extremely low comparing to the activity of taxpayers of similar conditions, frequent technical errors, lack of data transfer for a longer period.

It seems that in practice, the new system will also support the site inspection controls. The tax investigators may check and compare the data transferred by the cash register to the revenue server with the real number of costumers appearing or even purchasing on the site, and obviously the non-registered cash registers can be pointed out much easier as well.³⁶³

³⁶² In 2012, one of every four enterprises violated the corresponding law regarding the issue of receipt in one way, or another. See Z. Mester, Pénztárgépek Összekötése az adóhatósággal [*Cash registers connected to Revenue Office*]
<http://www.hkik.hu/hu/kereskedelem/cikkek/penztargepek-osszekotese-az-adohatosaggal-a-nav-kozlemenye-47537> (18/04/2013)

³⁶³ It can easily be checked whether the sale was registered in the cash register, but the revenue is really assessed and reported to Revenue Office.

5. Summary

The international economic competition is partly tax competition as well. I do believe that an effective tax system means a real competitive advantage for the economy, public administration, and the whole society. In case an innovatively planned tax system is established, the economic and financial position of the state and the citizens and/or residents thereof becomes much more favourable. Each tax reform shall be based on such grounds, in order to reach the proposed goal thereof.

Each country establishes its own tax regime in accordance with the unique needs and traditional principles thereof, its choices reflect a significant amount of convergence regarding the parameters for taxing income that arises in an international setting.

There are no definitive and mandatory models, not a single one could be drawn up either. The societies obviously differ regarding their level of development; economic, legal and tax structures; experience and capacity in administration; and the level of literacy. Consequently, a design feature that works well in one country might not work in another.

As Bird points out, No-One-Size-Fits-All model applies³⁶⁴, but certain common features can be found through comparison of the common design features of the tax systems in different countries in the context of their legal, economic and tax structures. For instance, there is no best scenario approved for the number and level of tax rates either. Thus similarities and common lessons can be drawn up.³⁶⁵

For example, within the scope of the fiscal sovereignty thereof, most countries recognize and exercise the right to tax income of a foreign person, which is derived within the borders and territory of the country (so-called source-based taxation, or the principle of source in an international tax law perspective). Also, most of the countries levy tax, regardless of citizenship, on the income of its residents even if that income is derived outside of the country's borders (so-called residence-based taxation, or the principle of residence in an international tax law perspective).

³⁶⁴ Bird, Richard M.: Value Added Taxes in Developing and Transitional Countries: Lessons and Questions. ITP Paper 0505, International Tax Program, Institute for International Business, Joseph L. Rotman School of Management, University of Toronto, Toronto, Canada, 2005.

³⁶⁵ The reason for this is partly that the income structure and tax compliance re income taxes differ more due to their complexity, while the concept and system of VAT (e.g. structure of selling goods and providing services) are similar and simpler all around the world. Therefore VATs are very similar.

It can be stated that the structure of revenue and types of income is very similar in many countries, and the related categories are defined more or less the same way. However, Hungary distinguishes certain revenues, for which different sets of rules shall be applied, and such distinction is usually not specified by the other tax systems, and these amounts are handled uniformly.

Accordingly, the difference regarding the determination of tax base arises from this measure and the supplementary tax base establishment provisions in the Hungarian system. In our opinion, the latter solution is not the kings' way of levying tax burden, but a step that makes the Hungarian flat personal income tax at least a bit more progressive.

The taxes, quite obviously, shall be paid by the taxpayers to whom the tax laws in question shall be applied. The system shall be designed by the government that is basically responsible for economic and business activity of the citizens and undertakings thereof. It is liable for the actions of the people thereof, since it has the right and authority to regulate these activities by legislation that shall be based on relevant information. This information shall be collected and analyzed by qualified employees of government offices and agencies.

Accordingly, the transparent and honourable state function shall be established. That is of significant importance, since the people, as well as undertakings know and are able to estimate the value of the public services. It is their basic need to receive appropriate counter services for their paid taxes. They have to feel that their payments and tax burdens are not useless. Accordingly, the public needs and state tasks shall be determined, and if you prefer, specified very clearly. It is the main interest of the politics and the society to specify clearly the state services, and to determine the minimum thereof.

Innovation and intellectual capital is of vital interest on this field. Sorting out the information, taking into account the different factors, and establishing a structure that addresses the relevant issues and finds solution for the major problems bring a country into a much better position among competition. Unfortunately innovation and research development do not play an important role in the Hungarian economy. The added domestic value is low, innovative undertakings form only 17% of the economy, however, this proportion is 44% average within the European Union.³⁶⁶

³⁶⁶ Vértés, András: Adórendszer és versenyképesség. See more at http://www.magyarorszagolnap.hu/pdf/5_versenykepesseg.pdf (downloaded on 15 May, 2010)

It should be declared that the state is established for the citizens and not the other way around. All the actions shall be taken accordingly, and the legal framework, as well as the structure of tax system shall be formed by taking account this principle.

It is urgent to re-establish the regulation of public finance and tax laws. Tax legislation shall not follow, but conduct and prevail social changes. Taxpayers' rights shall be defined clearly; taxpayers should be in the same position as the state. This might be one of the most important tasks of tax legislation: to specify the rights and obligations of the taxpayers, and, in a wider approach, the basic values of the tax system. The conditions of the relationship between the individuals and the community regarding taxation shall be incorporated in the constitution, the function of which, among others, is to defend the individuals against the state.

Tax administrations shall acknowledge or even accept that the individuals and enterprises want to make decisions regarding their own money, therefore the amount of money remaining in their pocket shall be increased.

These conditions make the tax system in question attractive for domestic and foreign capital and investments. Ongoing changes make the taxpayers unable to plan their income, taxes and financial situation; they can not count on the system, and therefore might look for other, countable solutions.

One solution could be, in order to strengthen the position of the taxpayers, to establish a kind of tax ombudsman (either with investigating powers, or even with the right to make obligatory proposals) or a government office with the same powers. For instance, similar offices with general authority operate for protecting the rights of the taxpayers in approximately 15 OECD countries. Another body with similar powers could be also within the system of tax administration, or a separated tax committee (like for instance in Belgium), or just as in other countries, a committee of the parliament may decide regarding such disputes (e.g. in Germany).

The state and science should not be negligent with taxation. This is such a failure, the exact negative results of which may be determined more or less easily, but could be corrected very hardly and only in a long term.

I believe that the tax system can have a principled structure. It should be simple, comprehensive, transparent and understandable for all taxpayers. Clear, simple worded and straight forward provisions shall be enacted and made known publicly. Administrative limits (e.g. short tax return forms, which are easy and quick to fill out) shall be introduced. Long term structure shall be introduced, and only really reasonable and necessary amendments shall be made.

Tax burden shall be allocated a more righteous way, both horizontally and vertically. Legislation, case law and practice continually evolve and up to date information should always be used to determine tax liabilities. The optimal balance of tax mix and tax burden shall be found. The huge difference regarding the tax burden of the different groups of the society. It is unacceptable that there are mainly supported as well as just mainly taxed social groups. Accordingly, the tax burden of the employees shall be made more advantageous, however, due to the requirement of being competitive from economical aspect, the tax burden of the enterprises can not be increased either. This is a very difficult and complex question. In case the taxes levied on the income of the enterprises are increased, the system of the deductible costs shall be widened.

Furthermore, the tax burden can be reduced without abolishing taxes by reducing the tax rates, increasing allowances or widening exemptions for existing taxes. However, recent researches show that reduced rates do not help the lower paid, do not significantly increase incentives and “have no effect on the poverty trap -- raising tax allowances was a better way of helping the poor. It is also reasoned with two major justifications: one is political -- to keep pace with inflation; the other is administrative -- to prevent a significant number of people from being drawn into the tax system by the process known as fiscal drag”.³⁶⁷

Another method is to create new allowances, exemptions, and reliefs. The direct tax burden is reduced if the structure of the direct tax system is altered by providing new reliefs. These reliefs can be very effective, if they are planned carefully. With innovative ideas, the support can be provided for the aimed groups. This method is, in our opinion, politically favourable as well.

It is very disadvantageous that both the direct and indirect income taxes are high as individual ones and together as well. In case one or more tax rates are higher, the total amount of tax to be paid is obviously bigger. Therefore it is quite obvious that in case a tax rate is higher, the tax burden is increased, the situation of the taxpayers get worse, the remaining profit becomes less, and, as an outcome, the taxpayers who are able to choose according to which tax system they would like to pay taxes (e.g. on the territory of which tax administration they do their business activities), may move forward in order to realize profits where the tax rates are lower, and at the end of the day, the total state revenue may be less.

³⁶⁷ Tiley, John: Away from a virtuous tax system? In: British Tax Review 1998/ 4, pp. 327-330.

The different types of taxes shall be harmonized and the effects thereof shall be analyzed. Tax rates shall be valorised according to the inflation, since the lack thereof might mean tax increase in real.

The measurement of the level of redistribution does not provide a real picture of the changes of tax burden. In order to be more competitive, the elements of tax and social policy shall be separated, since an effective tax system of a society may be able to achieve such wirement of taxes, which assures the funds of the social policy. The state, within the scope of social policy, often has to solve problems that were not issues, if the taxpayers could realize more income due to the smaller level of tax burden. It would be fruitful, if the mandatory solidarity was exchanged by selfcare; on condition the net individual income is increased.

The constitutional and legal system of conditions of taxation shall be in focus. For example, the Hungarian constitution does not contain much in this regard. Taxation is the most sensitive and continuous limit regarding citizens and undertakings, and it should be handled accordingly.

Realistic levels of subsistence should be defined that shall be exempt from tax, also taking into account the basic models of conditions of the taxpayer, for instance the size of the family. The doctrine that a minimum of subsistence should be exempt from taxation provides a certain safeguard for all these underprivileged groups, families, and individuals. This principle, as a limit to the whole tax system, establishes a subjective right, providing the security of existence³⁶⁸, or a guarantee for the financial security of the individual.

One of the main characteristics of modern society is that it pays attention to and also handles social issues, taking care of the subsistence of the underprivileged groups and families. The reasons for underprivileged status include the low level of income per capita, disadvantageously high rate of dependents, unemployment, poor quality of accommodation, illness, underqualification, etc. The low level of income per capita plays a very important role in the underprivileged status, especially if it only provides such a low level of consumption that it cannot satisfy the generally accepted needs.³⁶⁹ Therefore this underprivileged status shall be compensated by the state by providing certain benefits and reasonable financial support to those who are below the commonly accepted minimum level.

Accordingly, subsistence-level standard of living involves a number of concepts: it calls for consideration of such things as the minimum income that the particular government guarantees

³⁶⁸ FÖLDES, Gábor: A pénzügyi alkotmányosság. In: Társadalmi Szemle, 1996/1, p. 65.

³⁶⁹ Létminimum és társadalmi minimum, Esély. Társadalom- és szociálpolitikai folyóirat 1991/6, p. 84.

(such as the minimum income provided by welfare) or below which is no taxation (for example, the standard deduction and personal exemptions under US federal income tax law). No uniform or generally accepted minimum exists for subsistence level, due to the relative factors that shall be taken into account, but it is clear that this idea is somehow related to the basic necessary costs of maintaining population.³⁷⁰ In other words, the minimum of subsistence contains the necessary cost of population, and subsistence level is “a standard of living in which the income is so low that only the bare necessities can be afforded”³⁷¹, or even keeping it more simple: “living in a way that means you only have enough food to keep you alive”³⁷².

However, the measurement of subsistence level may differ according to cultural, geographical and economic features of the country and therefore the consumer price level thereof, and furthermore according to the conditions and situation of each individual (such as talents, abilities, marital status, family size, age, etc.). Therefore the content of the category, as well as the socially acceptable level of wealth, assets and wage, differ by country and across time.³⁷³ Also, if subsistence includes more than just material to survive with, then it is a social construct, not a fact of nature.

There is no allowance, relief, or credit provided for taxpayers in Hungary due to their low level of income, and every single Forint of revenue (even the minimum wage) is taxed irrespectively of the level of subsistence of the taxpayer. This is contradictory to the modern principles of taxation, and makes the tax system less fair. The Croatian system, however, takes into account a minimum amount earned by the taxpayer, which is, in our opinion, a more just solution, the introduction of such personal allowance might be of value in the Hungarian structure as well.

In my opinion, a personal income tax system, being either a flat or a progressive one, shall additionally take into account the level of subsistence as a family category, since there are families in the society in which only one member earns significant income, and if the normal rate of tax is levied on that particular earning, the members of the family might live at or below the level of subsistence.

In theory, the tax rate structure has to be designed to provide the retention of sufficient income to meet needs of the individual on subsistence level, plus a certain portion of the amounts in

³⁷⁰ Buehler, Alfred G.: Taxation and the Minimum of Subsistence. In: The American Economic Review 1933/2, p. 234.

³⁷¹ <http://www.allwords.com/word-subsistence%20level.html> (downloaded on 30 March, 2007)

³⁷² <http://www.bbc.co.uk/skillswise/glossary/index.shtml?00723> (downloaded on 30 March, 2007)

³⁷³ Kristensen, Nicolai – Cunningham, Wendy: Do Minimum Wages in Latin America and the Caribbean Matter? Evidence from 19 Countries. The World Bank, Washington D.C., 2006.

excess thereof. Therefore the state does not levy tax on the individual, due to the aspects of fairness, rightness, and equity, since the individual shall not be obliged to contribute to the public funds and government expenditures, if the subsistence thereof is jeopardized, and the state interest shall not anticipate the elemental requirements of subsistence.³⁷⁴

Supporting dependents is also a very important element, and it is a major issue in the context of our topic, since it has occurred from time to time that the subsistence level of the dependants shall be exempt from tax.³⁷⁵ The classic argument for a dependency exemption available to taxpayers regardless of income level is based on the concept of clear (or discretionary) income that is defined by Lawrence Zelenak as “income above that needed to sustain life at a subsistence level”³⁷⁶. The ability to pay derives only from that clear income, the income in excess of subsistence needs. Each taxpayer should have to pay tax only on the clear income thereof that is above the income necessary to support the taxpayer’s family at a subsistence level.³⁷⁷ However, the minimum of subsistence is difficult to determine, besides subsistence needs might differ. For instance, a family may spend much more than the amount at subsistence level and maintain a substantially higher lifestyle. Thus, the discretionary approach is unlikely to track the actual expenditures of the family with greater than subsistence-level income, even if only necessities (e.g. food, shelter, clothing) are taken into account.³⁷⁸

Considering the above, certain additional exemptions (e.g. dependency exemptions) might be provided for each family member (the larger the family, the larger the income is needed for subsistence). Furthermore, children can not be considered just as consumption, because, even if you like to simplify from the financial perspective, they are a long-term, expensive, unpredictable financial obligation and investment, and the related obligation entails a unique level of commitment and responsibility. This is well recognized by law. Children are particularly dependent, they substantiate an inalienable moral obligation in addition to social and legal ones, since they have the moral and legal right to expect a certain level of subsistence and care, and their interests have to be represented as well. They impose a unique economic burden because of this combination of factors. It is obvious that raising a child significantly differs from other consumption choices, due to the mixture of the parenting obligation and the

³⁷⁴ Csaba Szilovics, endnote 4, 103, and Gábor Földes, endnote 2, 65.

³⁷⁵ It is also a political issue and has arisen regarding the new personal tax system in Hungary. For instance see Czelnai, Éva: Adómentes létminimumot mindenkinek! In: Magyar Hírlap, 19 October 1992, 6.

³⁷⁶ Zelenak, endnote 16, 358.

³⁷⁷ Zelenak, Lawrence: Redesigning the Earned Income Tax Credit as a Family-Size Adjustment to the Minimum Wage. In: Tax Law Review 2004/1, p. 335.

³⁷⁸ Ayla A. Lari: Sharing Alike: French Family Taxation as a Model For Reform. In: Duquesne Law Review 1999/4, pp. 243-245.

unique nature of the related economic matters. Therefore the tax rate can depend on the age of the child, on the place of living thereof (whether being a resident in a city or in the countryside), and on the certain subsidies it receives (family allowance or scholarship).³⁷⁹

Since the state is theoretically obliged to provide the minimum of subsistence to all of its citizens or even residents, it is quite common that it provides certain tax relief, allowance, credit, or exemption based on the size of the family and the number of dependants.

Accordingly, the taxpayer may be entitled to certain credits for his/her spouse and children, since the position is taken by many theorists that a person working full-time even at the minimum wage should be able to support his/her children and also his/her spouse at the subsistence level. In that case a minimum wage worker with an unemployed spouse and two children shall be entitled to three credits. However, the spousal credit amount might differ from the per child credit amount. Usually, in order to reflect the greater subsistence needs of an adult, the spousal credit amount is more than the per child credit amount. This system would promote the conservative favoured model of the family, reinforcing gender role stereotypes, but is contrary to increased redistribution.

In fact this solution is disputed. Legislators, policymakers, but even taxpayers may argue, also based on cultural grounds, that a full-time minimum wage worker's earning, shall or shall not be sufficient to support both the worker's children and a stay-at-home spouse. Many politicians and experts argue that an able-bodied spouse of a minimum wage worker shall be supported appropriately only with various government subsidies. Besides, if a spousal credit may be provided at all, it should apply only when the couple has dependent children, but additional distinctions might be drawn based on the children's ages, and spousal credit might be allowed for example until the age of 15 or the school age, but not thereafter.³⁸⁰

The compromise might be that a spousal tax credit is only appropriate, if the society in question believes that a full-time minimum wage worker should be able to support both his/her children and a full-time caregiver married spouse.

The earned income tax credit should be designed to serve as an adjustment to the minimum wage based on the size of the family, in order to lift all families headed by full-time workers out of poverty, providing a substantially higher lifestyle than poverty line, or at least the minimum of subsistence, although the details of the ways it can be realized are still disputed

³⁷⁹ Éva Czelnai, endnote 41, 6.

³⁸⁰ Lawrence Zelenak, endnote 43, 343-344.

(e.g. whether the credit should be designed to cover the subsistence needs of a worker's stay-at-home spouse and the worker's children). Despite these disputes and the various arguments, the credit as a minimum wage adjustment could be a significant step in the development of a more rational and more effective anti-poverty program for working families, as well as a more fair and more righteous taxation practice.

These additional exemptions are basically adjustments to the tax rate schedule, in order to reflect the difference between the utility curve for such persons who bear certain expenses in question, and the curve for those who have no such expenses. Since it is not possible to structure individualized utility curves for every single taxpayer, only rough adjustments are made usually for identifiable circumstances which are common occurrences.

As a conclusion, the principle of tax exemption for subsistence level guarantees the financial security of the individual. This doctrine encourages the legislators and policymakers to provide a certain safeguard as financial support and privilege for the underprivileged groups and individuals of the society, since it is implicitly agreed among tax lawyers, experts, and theorists that individuals at or below subsistence level shall have at least the negative right to be free from certain types of tax. There shall be certain limits to the state and governmental intervention occurring through taxation, and the tax exemption for the minimum of subsistence shall play an important role in this regard. In order to achieve that goal, realistic levels of subsistence should be defined that shall be exempt from tax, also taking into account the basic models of conditions of the taxpayer, for instance the size of the family. Accordingly, tax exemption for subsistence level shall not be limited to personal income tax, since the financial safety of existence is a much wider concept, and further categories have to be analyzed, also taking into account the total level of wealth of the taxpayer.

In most tax regimes the two most important tax bases, direct taxes on income and value added taxes on consumption are simultaneously in force, although their operation differs significantly. Income tax imposes tax on income transactions, while VAT is collected on a transaction basis. Therefore, the VAT hidden for the average people, since the ultimate consumer does not know what proportion of the paid purchase price is the tax,³⁸¹ and the consumer may blame the seller or service provider for charging a huge amount (even if the portion of tax is high). Additionally,

³⁸¹ McGee, Robert W. op. cit. p. 180. and 192.

many experts (e.g. Ballerini, Marc, Lehmkuhl) believe that VAT, as an indirect tax, is purely penal.³⁸²

In case higher tax burden is levied on consumption (for instance, higher VAT rates are enacted), taxation of savings might be reduced, and the taxpayers have a wider discretion opportunity for their own decisions.

Indirect taxation has become more and more important over recent decades and years. Accordingly, the VAT has become the main source of government finance and public revenue in many countries in both the developed and developing world.

The main reason for that is, in my opinion, that levying VAT is one of the most effective measures of increasing government revenue. Besides, I do believe that this aim of the state can be achieved on the ground of fairness, efficiency, simplicity and transparency through the VAT. In case higher tax burden is levied on consumption (for instance, higher VAT rates are enacted and come into force), taxation of savings might be reduced, and the taxpayers have a wider discretion opportunity for their own decisions.

The regime of VAT, in order to achieve the goal thereof and as the result of any reform, should be simple, comprehensive, transparent and understandable for all taxpayers. Clear, simple worded and straight forward provisions shall be enacted and made known publicly.

The VAT, in my opinion, is one of the most effective, fair and simple measures of increasing government revenue. Therefore, it has spread to most countries throughout the world and has become the major sources for government finances in many of them. It is generally accepted that the VAT can be even more efficient than income taxes, affects the savings decisions of the individuals, and the whole system of consumption there through.

Furthermore this is the type of tax that was chosen half a century ago as the preferred consumption tax for the European Economic Community in part due to the perceived advantage thereof in dealing with cross-border sales within a single economic community.³⁸³ Accordingly, the European Union wanted potential new members to charge at least a minimum VAT rate as a condition of accession.³⁸⁴ Thus a neutral and transparent turnover tax system has been

³⁸² Crowe, Martin T.: *The Moral Obligation of Paying Just Taxes*. The Catholic University of America Press, Washington D.C., 1944, pp. 72-77.

³⁸³ Krever, Richard: *Value Added Tax and Direct Taxation: Similarities and Differences*. In: *British Tax Review* 2010/4, pp. 393-394.

³⁸⁴ McGee, Robert W.: *The Philosophy of Taxation and Public Finance*. Kluwer Academic Publishers, Boston/Dordrecht/London, 2004 p. 105

established and the standard VAT rate must be at least 15%, and the reduced rate³⁸⁵ at least 5%.³⁸⁶

A VAT is a broad-based tax on the supply of goods and services, with systematic crediting of the tax paid on inputs. The structure thereof should be designed carefully, in order to address equity and efficiency issues, furthermore effective administration shall be put in place. It is of high importance to choose the rate(s), whether to introduce a standard rate and a reduced one, or even further non-zero rates. VAT shall have certain and appropriate exemptions, also taking into account the guidelines drawn up by OECD.

The VAT regime is one of the most harmonized types of tax in the European Union. The rules, operation, exemption methods and exempt goods and persons are very similar. However, there are still certain open issues that are regulated differently by the member states, for instance the number and level of tax rates³⁸⁷, standard and preferential rates, administrative measures, conditions of tax refund³⁸⁸ and the right to deduct input VAT, furthermore the detailed provisions regarding the formal elements of the invoice. Accordingly, despite the scheme of the Hungarian VAT is harmonized with the EU regulations, the applicable directives, and the corresponding provisions, certain problems regarding the practice and enforcement occur.

In case the VAT regime is designed and administered properly, it could form a very efficient, transparent, fair and simple type of taxation and public revenue.

A simplified and transparent VAT regime within the tax system, offering an understandable structure of deductions, exclusions, exemptions, and credits could improve the efficiency of the whole system as well. However, I do believe that simplicity regarding VAT is not as important issue as it is in relation to the different types of income taxes, due to the hidden form thereof. Since because of the indirect type thereof, the ultimate payer (tax bearer) most likely is not a taxpayer, the system of VAT shall be known more or less only by the undertakings of the society.

Another element of the efficiency of the VAT is that in case the structure, rates, deductions and exemptions are well designed, a reduction in the activity of the underground economy may be

³⁸⁵ Only for supplies of goods and services referred to in an exhaustive list.

³⁸⁶ The actual rates applied vary between Member States and between certain types of products. In addition, the Member States have retained separate rules regarding specific areas.

³⁸⁷ The standard VAT rate, as discussed must be at least 15%, and the reduced rate at least 5%, otherwise the Member States have wide discretion to determine the exact rate.

³⁸⁸ The exact rules shall be determined by the domestic rules of the Member States.

achieved, despite some participants of the black market and the underground economy will always want to avoid taxes.

It is also of high importance to choose appropriate rate(s). High rates, despite they are only implicitly visible for individual taxpayers, obviously increase tax evasion and avoidance efforts, and reduce the level of compliance. “Experience in Europe has shown that very high VAT rates can have similar negative consequences to very high income tax rates.”³⁸⁹ If the rates are too high, economic activity is discouraged, furthermore black market, the proportion of illegal and underground economy grows. This results in slower growth and more wasted resources, but not necessarily higher revenues. Last, but not least, another disadvantage of relatively high tax rates is that economic inefficiencies could be created thereby.³⁹⁰

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.

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 payments³⁹¹.

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

³⁸⁹ Reuven S. Avi-Yonah: The Three Goals of Taxation. In: Tax Law Review 2006/8.

³⁹⁰ Gouvin, Eric J: Radical Tax Reform, Municipal Finance, and the Conservative Agenda. In: Rutgers Law Review 2004/4, p. 434.

³⁹¹ This projection of the Hungarian government can be seen in the budgetary act of 2012 (Appendix 1 of the Act CLXXXVIII of 2011 on the Hungarian Central Budget of 2012 indicates that in detail), in which the planned amount to be collected from corporate income tax is 356,200 million HUF, so much higher than in the previous years (an amount of 323,369.9 million HUF central budget revenue derived in 2010 according to Appendix 1 of Act CXXXIII of 2011 on the Execution of the Budget of 2010, which was reduced significantly to HUF 288,020.9 million in 2011 according to Act CLXIX of 2010 on the Hungarian Central Budget of 2011, so the tax cut of individual income tax was not compensated by the increase of the corporate income tax revenue either in 2011).

transferred to employee and the tax advance is paid to the tax authority³⁹². 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.

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 for income derived from interest. 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.

However, the most debated matter regarding the interaction between private and financial law 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.

It is understandable that every amendment 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 completely achieved yet through the new Hungarian structure. In spite of this, it is also unquestionable that development and progress have been made, and 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.

³⁹² Since January 1, 2011 the National Tax and Customs Office (NAV) has authority in personal income tax issues instead of APEH.

For example, a new set of provisions entered into force on 27 November 2010,³⁹³ 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.³⁹⁴

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.³⁹⁵ 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 Authority³⁹⁶, 169, 256 debtors repaid their forint currency loans of the

³⁹³ The Act XCVI of 2010 amended the related financial acts, in order to help the consumers repay their foreign currency mortgages partially or entirely at fixed exchange rates.

³⁹⁴ The loan contract for accommodation may only be modified unfavourably for the debtor only regarding the rate of interest and in cases specified by the applicable government decree in force, due to the significant change of the basic rate of interest determined by the Hungarian National Bank, the applicable regulation in force, etc.

³⁹⁵ Act CXXI of 2011 on the Amendment of Certain Acts in connection with Home Protection.

³⁹⁶ This used to be called PSZÁF (Pénzügyi Szervezetek Állami Felügyelete), but the powers thereof were taken over by the Hungarian National Bank, since according to the Act CXXXIX of 2013 on Magyar Nemzeti Bank (Hungarian National Bank) with effect as of 1 October 2013, the Hungarian Financial Supervisory Authority and the Hungarian National Bank are integrated into one institution.

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.³⁹⁷ 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.³⁹⁸

The role of marketing is inevitable as well. New ideas can always make the taxpayers understand the importance and role of paying taxes. Therefore, in case the advertising is successful, the taxpayers get to know the main reasons of collecting taxes, and get acquainted with the “countervalue” they receive in return of paying taxes. This may result in a higher level of tax compliance, higher percentage of taxes paid and lower rate of tax avoidance or tax evasion.

Tax fraud, tax evasion, and tax avoidance are serious problems for all tax systems.³⁹⁹ Taxpayers always want to find the ways of avoiding tax payments, in order to reduce their tax liabilities. Unfortunately, from a global perspective and in an international comparison, tax avoidance is high in Hungary. Hiding the real and actual turnover is the most effective way to hide income,

³⁹⁷ HUF 270 to CHF, HUF 340 to EUR, HUF 3,3 to JPY

³⁹⁸ The eviction moratorium was also prolonged until 30 April.

³⁹⁹ Prebble, R.: Does Croatia need a general anti-avoidance rule? Recommended changes to Croatia’s current legislative framework. In: *Financial Theory and Practice* 29 (3), p. 211

or even certain proportion thereof, furthermore to avoid VAT obligations as well.⁴⁰⁰ Therefore one of the most common methods to avoid taxes is the business performance (providing services and/or selling goods) without an invoice.⁴⁰¹ This activity, the failure of issuing an invoice is sanctioned by Paragraph (2) of Section 172 of the Act XCII of 2003 on the Rules of Taxation.⁴⁰² However, in case the volume of income is followed and controlled precisely, the proportion of black market and the level of tax avoidance may be reduced significantly. Additionally, the control and monitoring of income is cheaper and easier to achieve, thus it is a much more effective way to fight against tax fraud and tax avoidance.

In order to reduce tax evasion and tax avoidance, a stable, calculable regulation is needed, furthermore the ongoing monitoring is important as well, in order to guarantee the recognition of illegal activities and the application of the related sanctions. It is essential that business players react on taxes. High and progressive taxes cut back performance and will not stimulate production.⁴⁰³

According to the last two decades, it became clear that the taxpayers should be forced to issue invoices for their transactions, and it seems that the current regulation enforces this obligation of the taxpayers effectively. In my opinion, the new measures analyzed in this paper help significantly to achieve this important goal.

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.

The new technical solution is the tax memory unit (hereinafter referred to as the tax control unit), which is unique in Europe, but similar to some solutions used in other member state of

⁴⁰⁰ Krekó, J. –Kiss, G. P.: Adóelkerülés és a magyarországi adórendszer. [Tax avoidance and the Hungarian tax system.] MNB-tanulmányok 65. [Essays of the Hungarian Central Bank, no. 65.] p. 36

⁴⁰¹ Note that especially regarding services, this is materialized in the cooperation of the seller and the buyer, which aims the avoidance of tax liability. By this behavior, both the VAT, and the income tax (e.g. personal income tax regarding private entrepreneurial, and corporate income tax of enterprises) may be avoided. Accordingly, even the personal exemption regarding VAT can be applied for, which makes this phenomenon even more harmful for the economy.

⁴⁰² 'Taxpayers may be fined up to one million forints for any failure to meet the obligation to issue invoices, simplified invoices or receipts, or for issuing invoices, simplified invoices or receipts for an amount other than the actual consideration received. Taxpayers shall be fined up to one million forints for employing a non-registered employee currently or previously. If the taxpayer has complied with the obligation of notification of any new employment contract before the commencement of the audit in respect of the entire duration of employment, the tax authority shall proceed in accordance with what is contained in Subsection (6), or in Subsection (21).'

⁴⁰³ Streissler, Erich: Gazdaságelméleti kétségek a progresszív jövedelemadó ésszerűségét illetően. In: Közgazdasági Szemle 1990/1. p. 79.

the European Union (for instance: Bulgaria). It shall be pointed out that many countries use such methods, but not for a long time.⁴⁰⁴ Thus the already gained experiences have to be scrutinized, in order to solve the possibly occurring avoidance activities, and definitely count with them.

Therefore, the introduction of the new system may increase the budgetary revenue, and definitely improves tax compliance among retailers, also decreases the proportion of the black market. It is much more fishy not to assess a certain amount of revenue, and it is easier to follow the value and number of sales as well. However, the compliance costs are relatively high, and some of the retailers may not be able to maintain business in an appropriate manner in compliance with the new regulation. Furthermore, despite the investigation and audit gets much easier, the continuous control of the Revenue Office is still inevitable.⁴⁰⁵

In addition to the simplification, the control activity of the Revenue Office may be even more successful against the tax evasion behaviours. The up-to-date information shows clearly the trading activity (exact amount and time of purchase, opening hours, cash register operation data).

By using these, and through comparative analyses, the different methods and routines of tax avoidance matters can be pointed out. For instance, it is a basis for suspicion if the cash register does not operate through the opening hours, or most of the sales are done just before closing, there is a significant decrease of the value of the daily turnover, the average sales value is extremely low comparing to the activity of taxpayers of similar conditions, frequent technical errors, lack of data transfer for a longer period.

It seems that in practice, the new system will also support the site inspection controls. The tax investigators may check and compare the data transferred by the cash register to the revenue

⁴⁰⁴ Cf. The online cash registers were introduced on 1 January 2013 in Croatia, in order to reduce the proportion of black market and increase government revenue. The taxpayers, among which the host institutions (e.g. restaurants) were in focus, reported a 31% extra turnover to the revenue office in January. Later, due to the restricted control of the tax authorities, this number seems to be growing. The new provisions are not applied to postal service providers, banks, insurance companies, passenger transport service providers, since these enterprises are controlled differently by the revenue office.

<http://www.onlinekassza.hu/hirek/esettanulmanyok/537-bevalt-az-onlinekassza-horvatorszagban>, (01/02/2013)

⁴⁰⁵ In 2012, one of every four enterprises violated the corresponding law regarding the issue of receipt in one way, or another. See Z. Mester, *Pénztárgépek Összekötése az adóhatósággal [Cash registers connected to Revenue Office]*

<http://www.hkik.hu/hu/kereskedelem/cikkek/penztargepek-osszekotese-az-adohatosaggal-a-nav-kozlemenye-47537> (18/04/2013)

server with the real number of costumers appearing or even purchasing on the site, and obviously the non-registered cash registers can be pointed out much easier as well.⁴⁰⁶

All in all, the Hungarian tax system has gone through significant changes in the past four years, which resulted in remarkable development, however, I do believe that further measures have to be taken and amendments are required by taking into account the different elements of the tax system, the global economic situation, and the economic position of the taxpayers.

⁴⁰⁶ It can easily be checked whether the sale was registered in the cash register, but the revenue is really assessed and reported to Revenue Office.

6. Bibliography

- Ádám, A.: A posztmodernitás jogi sajátosságairól. In: Társadalmi Szemle, 1996/4.
- Ádám, A.: Bölcelet, vallás, állami egyházjog. Dialóg Campus Kiadó, Budapest-Pécs, 2007.
- Ádám, A.: Észrevételek a magyar alkotmányozáshoz. In: Jura, 2011/1.
- Ainsworth, R. T.: Biometrics: Solving the Regressivity of Vats and Rsts with “Smart Card” Technology. Boston Univ. School of Law Working Paper No. 0620. 2006
- Antman, F. – McKenzie, D.: Poverty Traps and Nonlinear Income Dynamics with Measurement Error and Individual Heterogeneity (Policy Research Working Paper). The World Bank, Washington D.C., 2005
- Avi-Yonah, R. S.: The Three Goals of Taxation. In: Tax Law Review 2006/3.
- Bankman, J. - Weisbach, D. A.: The Superoity of an Ideal Consumption Tax over an Ideal Income Tax. In: 58 Stan. L. Rev. 1413, 1423, 1425, 2006
- Bell, B. E.: Environmental taxation. In: VAT Dig., 2008/68(Jul/Aug), 1-26.
- Bencsik, A.: A fogyasztóvédelem alapelveinek tükröződése a Nemzeti Fogyasztóvédelmi Hatóság eljárásában. In: Bencsik, A. et al (eds): Jogász Doktoranduszok II. Pécsi Találkozója. Tanulmánykötet. Pécsi Tudományegyetem Állam- és Jogtudományi Karának Doktori Iskolája Pécs, 2012
- Bencsik, A.: A fogyasztóvédelem szakigazgatási alapjai. In: Lapsánszky, A. (ed): Közigazgatási jog. Fejezetek szakigazgatásaink köréből. II. kötet. Gazdasági közigazgatás, infrastruktúra igazgatás. CompLex Kiadó, Budapest, 2013
- Bencsik, A.: Gazdaságigazgatás – gazdasági versenyjog. In: Bencsik, A. (ed): Közigazgatási jog. Különös rész. Dialóg-Campus Kiadó, Budapest-Pécs, 2012
- Bird, R. M.: Value Added Taxes in Developing and Transitional Countries: Lessons and Questions (ITP Paper 0505, International Tax Program, Institute for International Business, Joseph L Rotman School of Management). University of Toronto, Toronto, Canada, 2005
- Boeijen-Ostaszewska, O. (ed.): European Tax Handbook. IBFD Publication BV, Amsterdam, 2010
- Buehler, A. G.: Taxation and the Minimum of Subsistence. In: The American Economic Review 1933/2.
- Chen, Sh. – Ravallion, M. – Wang, Y.: Di Bao. A Guaranteed Minimum Income in Urban China? (Policy Research Working Paper) The World Bank, Washington D.C., 2006
- Cockfield, A.: Income Taxes and Individual Liberty: a Lockean Perspective on Radical Consumption Tax Reform. In: South Dakota Law Review 2001, 8-71

Coverdale, J. F.: The Flat Tax Is Not a Fair Tax. In: Seton Hall Legislative Journal 1996. 285-291

Crowe, M. T.: The Moral Obligation of Paying Just Taxes. The Catholic University of America Press, Washington D.C., 1944

Czelnai, É.: “Adómentes létminimumot mindenkinek!” Magyar Hírlap, 19 October 1992, 6.

Deák, D.: Igazságos-e a magyar adórendszer? (Egy törvényhozási csapdahelyzet elemzése). In: Jogtudományi közlöny, 1997/7-8.

Dybiec, K.: Greening Polish and Lithuanian Tax Systems. In: Social Transformations in Contemporary Society 2013/1. <http://stics.mruni.eu/wp-content/uploads/2013/06/173-184.pdf> (5 December 2013)

Ercsey, Zs. – Ercsey, Zs.: Some aspects of the Hungarian regulation on ragweed. Being published. Masaryk University, Brno, Czech Republic.

Ercsey, Zs.: Üzleti folyamatok támogatása a felhőben. Pollack Press, Pécs, 2014

Ercsey, Zs. – Radó, J.: Android API for Weed Surveys. In: Peter Ivanyi (ed.): Architectural, Engineering and Information Sciences - 9th International PhD & DLA Symposium: Abstracts Book. Konferencia helye, ideje: Pécs, Magyarország, 2013.10.21-2013.10.22. University of Pécs Pollack Mihály Faculty of Engineering, Pécs, 2013

Ercsey, Zs. – Radó, J.: Android API for Licensed Pescitides in Hungary. In: Peter Ivanyi (ed.): Architectural, Engineering and Information Sciences - 9th International PhD & DLA Symposium: Abstracts Book. Konferencia helye, ideje: Pécs, Magyarország, 2013.10.21-2013.10.22. University of Pécs Pollack Mihály Faculty of Engineering, Pécs, 2013

Ercsey, Zs. – Radó, J – Müller, P.: Ragweed Detection in Computer Vision Environment. In: Peter Ivanyi (ed.): Architectural, Engineering and Information Sciences - 9th International PhD & DLA Symposium: Abstracts Book. Konferencia helye, ideje: Pécs, Magyarország, 2013.10.21-2013.10.22. University of Pécs Pollack Mihály Faculty of Engineering, Pécs, 2013

Ercsey, Zs. – Süle, Z. – Kovács, T. – Bertok, B. – Kovács, Z.: Business Process Synthesis with Various Resource Needs. 9th International Conference Computational Management Science. Imperial College London, UK, 18-20 April, 2012. Book of Abstracts, 76

Ercsey, Zs. – Kovács, T. – Kovács, Z.: Workforce Synthesis by P-graph Method. 8th International PhD & DLA Symposium, Pécs, Hungary, October 29–30, 2012, Abstract Book, 51

Ercsey, Zs. – Kovács, T. – Kovács, Z.: Workforce Synthesis of Loan Processes: Parametric Study. 8th International PhD & DLA Symposium, Pécs, Hungary, October 29–30, 2012, Abstract Book pp. 87

Ercsey, Zs. – Kovács, T. – Kovács, Z. – Golya, G.: Agricultural Logistics Information System. Presented at the Research Conference on Information Technology. Pécs, October 2011

Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: New Method to Determine the Globally Optimum Solution of SNS Problems with NLP Model. Presented at Veszprém Optimization Conference: Advanced Algorithms (VOCAL 2006). Veszprém, Hungary, December 13-15, 2006

Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: Rigorous Super-Structure in Action. Keynote Lecture at the 15th International Congress of Chemical and Process Engineering, (CHISA 2002), Praha, Czech Republic, August 25-29, 2002

Ercsey, Zs. – Heckl, I. – Kovacs, Z.: A matematikai szigorúság fontossága a kiindulási struktúra meghatározásakor szétválasztási hálózatok szintézise esetén. In: Magyar Kémikusok Lapja 2001/10, 372-377

Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: Separation-network synthesis: global optimum through rigorous super-structure IN: Computers and Chemical Engineering 2000/8. 1881-1900

Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: Exact Super-Structure for the Synthesis of Separation Networks with Multiple Feed-Streams and Sharp Separators. Presented at the 9th European Symposium on Computer Aided Process Engineering (ESCAPE-9), Budapest, Hungary, May 31 - June 2, 1999

Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: Exact super-structure for the synthesis of separation-networks with multiple feed-streams and sharp separators. In: Computers and Chemical Engineering 1999/Supplement 1, S1007-S1010

Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: Separation-Network Synthesis: Global Optimum through Rigorous Super-Structure. Presented at the AIChE Annual Meeting, Miami Beach, Fl., U.S.A., November 15-20, 1998

Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: Redundancy in a separation-network. In: Hungarian Journal of Industry and Chemistry 1998/3, 213-219

Ercsey, Zs. – Kovacs, Z. – Friedler, F. – Fan, L. T.: Retrofit Synthesis of Optimal Wastewater Treatment Systems. Presented at the 13th International Congress of Chemical and Process Engineering (CHISA '98), Praha, Czech Republic, 23-28 August 1998

Erős, A. – Ivicz, M.: Egykulcsos adórendszer. A bölcsek köve, avagy egy lehetséges megoldás a sok közül? In: Dissertationes, Iustum Aequum Salutare, II. 2006. 1–2, 203-212.

Földes, G.: A pénzügyi alkotmányosság. In: Társadalmi Szemle 1996/1. 58-66

Fried, B. H.: The Puzzling Case For Proportionate Taxation. In: Chapman Law Review 1999/1. 157-195

Gifis, S. H.: Law Dictionary (Barron's Legal Guides). Barron's Educational Series Inc., New York, 1996

Gfk survey,

http://www.gfk.hu/imperia/md/content/gfk_hungaria/pdf/press_2012/press_eng/press_2012_03_16_eng.pdf (5 April, 2012)

Gourdon, J. – Maystre, N. – de Melo, J.: Openness, Inequality, and Poverty. Endowments Matter. The World Bank, Washington D.C., 2006

Gouvin, E. J.: Radical Tax Reform, Municipal Finance and the Conservative Agenda. In: Rutgers Law Review 2004/4.

Hauwe, L.: German income tax policy between equity and efficiency. In: European Journal of Law & Economics 1998/5.

Heady, C.: The Conflict Between Equity and Efficiency in Designing Personal Income Tax Systems. In: The Role of Tax Reform in Central and Eastern European Economies. OECD, Paris, 1991

IMF Country Report No. 12/13, p. 31

<http://www.imf.org/external/pubs/ft/scr/2012/cr1213.pdf> (10 March, 2012)

IMF Survey online January 25, 2012

<http://www.imf.org/external/pubs/ft/survey/so/2012/NEW012512A.htm> (30 January, 2012)

Kahn, J. H.: Personal Deductions - a Tax "Ideal" or Just Another "Deal"? In: Law Review of Michigan State University Detroit College of Law 2002/1, 1-55

Kecskés A. et al: Stock Corporations – A Guide to Initial Public Offerings, Corporate Governance and Hostile Takeovers. HVG-ORAC – LexisNexis, Bécs–Budapest, 2013

Kecskés, A.: Tanulmány a gazdasági magánjog interdiszciplináris szemléletéért. In: Ünnepi tanulmányok Kecskés László professzor 60. születésnapja tiszteletére. Pécsi Tudományegyetem Állam- és Jogtudományi Kar, Pécs, 2013

Kecskés, A.: Theoretical Approach of Executive Compensation in the United States and Europe. In: ACTA UNIVERSITATIS BOGDAN VODA – Series OECONOMICA, 2013/16.

Kiekens, W. et al: Statement. <http://www.imf.org/external/pubs/ft/scr/2012/cr1213.pdf> (14 September, 2013)

Kirsch, M. S.: Taxing Citizens in a Global Economy Taxing Citizens in a Global Economy. In: New York University Law Review 2007/5.

Kristensen, N. – Cunningham, W.: Do Minimum Wages in Latin America and the Caribbean Matter? Evidence from 19 Countries. The World Bank, Washington D.C., 2006

Lari, A. A.: Sharing Alike: French Family Taxation as a Model For Reform. In: Duquesne Law Review 1999/4, 207-260

Layman, B.: Az offshore halála. HVG Kiadó Zrt., Budapest, 2010

LMP (the Hungarian Green Party, Politics Can Be Different): Budgetary concept. <http://lehetmas.hu/wp-content/uploads/2011/09/Az-LMP-2012.-%C3%A9vre-sz%C3%B3l%C3%B3-k%C3%B6lts%C3%A9gvet%C3%A9si-javaslat.pdf> (4 March, 2012)

Lykketoft, M.: The Danish Model. A European success story. In: Internationale Politikanalyse 2009/12.

McGee, R. W.: The Philosophy of Taxation and Public Finance. Kluwer Academic Publishers, Boston-Dordrecht-London, 2004

Mieszkowski, P. M. et al: Is a Negative Income Tax Practical? In: Yale Law Journal, 1967/1.

Murgai, R. – Ravallion. M.: Is a Guaranteed Living Wage a Good Anti-Poverty Policy? The World Bank, Washington D.C., 2006

Murray, A.: The carbon tax - can it work? In: International Company and Commercial Law Review 1992/3(4), 147-149

Musgrave, R. A. et al: Public Finance in Theory and in Practice. (5th ed., international ed.) McGraw-Hill Book Company, New York, 1989

O'Kelley, Ch. R. Jr.: Tax Policy for Post-Liberal Society: a Flat-Tax-Inspired Redefinition of the Purpose and Ideal Structure of a Progressive Income Tax. In: Southern California Law Review 1985/3, 727-776

Pieprzyk, P.: The Polish Health Care System's Endless Journey to Perfection – A Never Ending Story. In: Social Transformations in Contemporary Society 2013/1. Available at <http://stics.mruni.eu/wp-content/uploads/2013/06/34-44.pdf> (5 December 2013)

Radó, J. – Ercsey, Zs. – Gólya, G. – Vaszari, Sz. – Reisinger, P.: Development and practice of an android weed survey application for precision weed management. / Android alapú gyomfelvételezési alkalmazás kifejlesztése és bevezetése a precíziós gyomszabályozás folyamatszervezése céljából. In: Magyar Gyomkutatás és Technológia 2013/2, 53-62

Staudt, N. C.: The Hidden Costs of the Progressivity Debate. In: Vanderbilt Law Review 1997/5, 919-991

Streissler, E.: Gazdaságelméleti kétségek a progresszív jövedelemadó ésszerűségét illetően. In: Közgazdasági Szemle 1990/1.

Szalai, J.: Some thoughts on poverty and the concept of subsistence minimum. In: Rudolf Andorka, R. – Kolosi, T. – Vukovich, Gy. (ed.): SOCIAL REPORT. Társadalomkutatási Informatikai Egyesülés, Budapest 1992, 296-304

Szilovics, Cs.: Csalás és jogkövetés az adójogban. Gondolat Kiadó, Budapest 2003

Szilovics, Cs.: Adózási ismeretek és adózói vélemények Magyarországon (2002-2007). G&G Nyomda Korlátolt Felelősségű Társaság, Pécs 2009

Tiley, J.: Away from a virtuous tax system? In: British Tax Review 1998/4, 317-347

Tóth, I. G.: Gyermekes és eltartottak figyelembevétel a jövedelemadóztatásban. In: Semjén, A. (ed.): Adózás, adórendszerek, adóreformok. Szociálpolitikai Értesítő – Különszám, 1993/1-2, MTA Szociológiai Intézet, Budapest, 1993

Treich, C.: Taxable treatment of the subsistence level of income in German Natural Law, Accounting, Business and Financial History 2005/3, 255-278

Yesegat, W. A.: A Comparative Analysis of VAT/GST Design in Ethiopia, Kenya and New Zealand. In: New Zealand Journal of Taxation Law and Policy 2008/9.

Van Den Hauwe, L.: German income tax policy between equity and efficiency. In: European Journal of Law & Economics 1998/5(3), 267-279

Vording, H. et al: The rise and fall of progressive income taxation in the Netherlands (1795-2001). In: British Tax Review 2007/3.

Vértes, A.: Adórendszer és versenyképesség. (downloaded on 12 May, 2010, from http://www.magyarorszagholnap.hu/pdf/5_versenykepesseg.pdf)

Viard, A. D.: Comment on Leonard E. Burman, "A Blueprint for Tax Reform and Health Reform". In: Virginia Tax Review 2008/3.

Vording, H. – Ydema, O.: The raise and fall of progressive income taxation in the Netherlands (1795-2001). In: British Tax Review 2007/3, 255-279

Vosslamber, R.: How Much? Taxation on New Zealanders' Employment Income 1893-1984. In: New Zealand Journal of Taxation Law and Policy 2009/12.

Zelenak, L.: Children and the Income Tax. In: Tax Law Review 1994/1, 349-418

Zelenak, L.: Redesigning the Earned Income Tax Credit as a Family-Size Adjustment to the Minimum Wage. In: Tax Law Review 2004/1, 301-353

Internet:

- <http://www.allwords.com/word-subsistence%20level.html> (downloaded on 30 March, 2007)

- <http://www.bbc.co.uk/skillswise/glossary/index.shtml?00723> (downloaded on 30 March, 2007)

- http://en.wikipedia.org/wiki/Flat_tax#_ref-0 (downloaded on 30 March, 2007)