Peer country paper – Hungary

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Abstract

The Hungarian tax system basically corresponds with that of an advanced European economy. It provides the state with about 38-40% of GDP per annum in tax receipts what is much higher than in other V4 countries. The government has continuously aimed at reducing the tax burdens but because of high fiscal expenditures it has not succeeded until now. The GDP growth and some decrease in government expenditures (mainly interest payment) in recent times will enlarge the room of maneuver of the government to reduce taxes from next year.

The major taxes are the same as any other EU country: corporate income tax (CIT), personal income tax (PIT), Value added tax (VAT) and Excise taxes (ET). In producing an overview of these taxes, we rely on the publications of the National Tax and Customs Administration and statistics published by the Hungarian State Treasury.

Chapter 1 provides an overview about the major items of the tax system in Hungary: PIT, CIT, VAT and other taxes. It presents the share of individual form of taxes in total tax revenues, tax rates, tax brackets and tax reliefs.

Chapter 2 outlines the trends in the collection of taxes. It highlights the changes in the organization of administration of tax collection. Furthermore, it analyses the shift in the structure of different types of taxes.

Chapter 3 deals with magnitude of tax gaps in VAT, PIT and CIT. Concerning VAT gap the only source available is the study by a special task force of the European Commission which estimated and compared hypothetical VAT gaps in different countries. PIT gaps are difficult to calculate, this chapter describes several points of this estimation. CIT is not

Chapter 4 presents methods used by the Tax administration against tax evasion, including those new methods which were introduced in recent years. Among other, two new methods are described, the introduction of online cash machine and of the Electronic Public Road Trade Control System. Both have significantly contributed to tax paying of producers and traders.

The study is closed by the Conclusion drawn on the basis of previous chapters. The Annex contains some informative graphs on tax ratio and tax structure in Hungary.

1. The tax system in Hungary – An overview

The Hungarian tax system basically corresponds with that of an advanced European economy. It provides the state with about 38-40% of GDP per annum in tax receipts. The major taxes are the same as any other EU country: social contribution tax, corporate income tax, personal income tax, VAT and excise taxes. In producing an overview of these taxes, we rely on the publications of the National Tax and Customs Administration[1] and statistics published by the Hungarian State Treasury[2].

1.1. CORPORATE TAXATION

1.1.1. CORPORATE TAX

Corporate tax generates a relatively small albeit considerably growing source of revenue of the Central Budget in recent years. With HUF 549 billion revenue in 2015 and with a projected HUF 690 billion in 2016, although important, Corporate Tax lags behind VAT, Excise tax as well as Personal income tax in size. Yet, as the major tax item of corporations it carries a great importance as part of the operating environment of businesses. In July 2010, the threshold of lower Corporate Income Tax rate (10%) was raised from HUF 50 to 500 million (EUR 1.8 million) in term of income of the company[3]. Above this limit, the tax rate was set at 19 percent what is 1 percentage lower than before. These rates and threshold are valid in 2016, too.[4]

Hungarian corporate taxation is in line with EU principles and Hungary essentially operates a regular corporate tax system. Some specificities, however, can be recognized and will be elaborated in the followings.

Resident taxable persons are either business associations established under Act V of 2013 on the Civil Code, and, before 15 March 2014, Act IV of 2006 on Business Associations, such as joint-stock company, limited liability company (kft.), general partnerships (kkt.), limited partnerships (bt.) and other organizations (e.g. foundations, associations); or non-resident taxable persons with a place of business management in Hungary. In general, the tax year corresponds with the calendar year. Yet, companies can decide on a different financial year for themselves, especially if characteristics of their operations warrant so.

Until 2013, there was one option for SMEs and micro enterprises for simplified enterprise tax (EVA) payment, introduced in January 2003. EVA was very popular among small businesses, because it was a simple (didn't require double accounting) and beneficial form of taxation. In 2012, the rate of EVA was increased from 30 to 37% (tax base is the gross sum of income including VAT) what made EVA not so beneficial any more but remained furthermore simple. Since 2013 however, two new types of simplified corporate tax schemes were

[1] See http://en.nav.gov.hu/taxation/taxinfo

[2] See http://www.allamkincstar.gov.hu/en/

[3] In 2010 taxpayers could apply the new treshold only in the second half of the year, so - according to the law - for the half of their annual income they used the half of the treshold.

[4] The Hungarian government intends to introduce a flat Corporate Income Tax with a single digit rate (9%) in 2017. It is now under discussion among the government, and associations of employers and employees.

introduced: KATA and KIVA. Under the KATA (small taxpayers' lump sum tax) scheme, micro businesses can pay a fixed HUF 50 000 (EUR 179) per month (half of this if the taxpayer is employed in full time) in place of the main taxes on profits and payroll. KIVA (Small Business Tax) is an option for businesses with 25 or less employees and annual revenue of below HUF 500 million (EUR 1.79 million). Under this scheme the business have to pay a flat 16 per cent on its cash-flow profit and payroll. However, fewer than expected firms opted for KIVA, which is mainly due to accountants' disinclination to apply a cash-flow tax. Based on the experiences of the first years of the regime new measures will take effect from 2017. The regulation of Small Business Tax (KIVA) will be significantly simplified from 2017. Moreover the rules of loss carry forward will be more favorable from 2017 and thus KIVA will become more growth-friendly. From 2017, businesses up to 50 employees will be eligible for this tax (instead of 25 employees) and they can stay under this system till their revenues do not exceed HUF 1 billion or their number of employees do not exceed 100 persons.

There are several options to reduce the tax base by **donation**. Donations granted for non-profit and non-governmental organizations, for the National Cultural Fund, for the Hungarian Remediation Fund, and academic institutions can be deducted from the tax base (20-50% of the donation).

Furthermore, corporates may donate for film productions, performing arts organizations and sports clubs of so called spectacle team sports (football, handball, basketball, water polo, hockey); 100% of the donations is deductible from the tax liability. A new law regulates the deduction opportunity of donations for the preparation of the Hungarian bid to organization of Olympic Games in Hungary in 2024.

There is no upper limit of donation (only the total tax base or the total tax liability).

In October 2016, the Parliament adapted a Law, in exceptional procedure, which declares all information on the donation of corporates as tax secret: the name of the taxpayer and of the beneficiary, and the amount of transactions. The argument was that the tax relief belongs to the private sphere and is not part of the state budget.

For further technical details of corporate taxation, see Annex 1.

1.1.2. OTHER CORPORATE INCOME TAXES

Municipalities can impose local business tax of maximum 2% of their adjusted turnover that is collected by tax authorities of municipalities.

1.1.3. TAXES ON CORPORATE PROPERTY

Local taxes, i.e. building tax and land tax, are to be paid for municipalities. The annual maximum rate of the building tax is HUF 1,100 per square meter or a maximum of 3.6% of the market value of the property. The annual maximum rate of the land tax is HUF 200 per square meter or 3% of the market value. These taxes can be regarded as costs with respect to the formation of corporate tax base.

1.2. PERSONAL INCOME TAX

During the last decade, there were several changes in the PIT system. Tax rates and tax exemptions changed practically every year, depending on the fiscal stance. In 2010, the tax brackets were increased and the rates were decreased from 18 and 36%, to 17 and 32%, but a 27% multiplier was introduced (super-grossing). A 30% withholding tax was imposed on the dividends from resident companies paid to individuals.

In 2011 a completely new PIT system, a flat tax (16%) was introduced. It applies not only on salaries but also to all categories of income subject of PIT such as sale of real estate, dividends and interests. The aim of this tax reform was to make the PIT system more transparent and easier. Since 2016, the rate of the personal income tax was further cut to 15%.

At the same time, tax relief for families increased significantly in 2011 and were further raised in coming years. In 2016 it amounts to 66 670 HUF with 1 child, 83 330 HUF with 2 children (in 2017: 100 000 HUF, in 2018: 116 670 HUF, in 2019: 133 330 HUF), and 220 000 with 3 children:

From January 2015, a new form of tax relief for newly-weds was introduced, in the amount of HUF 5 000/month for two years or up to entitlement to family benefit after child. Those couples may benefit from this tax relief in which at least one member of the couple married first time. According to the data of the central Statistical Office the number of newly-weds increased in the last two year.

Private persons resident in Hungary are obliged to personal income tax after their income whether it was earned in Hungary or abroad. The tax year is the calendar year.

All types of personal income are subject to income tax. The Personal Income Tax Act (Act CXVII of 1995 and its amendments, abbreviated as PIT) distinguishes between the following categories of income:

- Incomes to be consolidated, such as income from activities other than self-employment, income from activities of self-employment and other incomes to be consolidated;
- Incomes taxed separately, such as income from capital gains, income from private businesses and income from the sale of movable and immovable assets.

Tax-exempt benefits include:

- State support for fostering and raising a minor;
- Scholarships paid by non-residents to students studying in a foreign educational institution or researchers working abroad;
- Certain services of the insurance companies;
- Pensions.

Revenues from Personal income tax (PIT) in 2015 reached HUF 1689 billion, constituting 14% of Central Budget revenues. For 2016, the projected figure is HUF 1695 billion of 16%. This means that along with VAT and the so called Social contribution tax that finances the Social Security Funds providing state pensions and public healthcare, PIT is the third single most important tax revenue of the Central Budget.

1.3. VAT

The standard VAT rate is 27%. Until 2012, the standard rate was 25%. There is a 5% reduced rate on certain foodstuff, including bulk supply of live pigs, cattle, sheep, lamb, goat and pork, pharmaceutical products intended for human use, medical equipment for disabled persons, books, newspapers and periodicals and from 2018 on restaurants meals. There is an 18% rate on certain foodstuffs, admission tickets to certain open air concerts and hotel accommodation and from 2017 on restaurants meals and internet access. The aim of the introduction of reduced rates was to give selective incentives for particular industries, to some extent, their customers to consume more of their products, and social aspects were considered as well. This was meant both to stimulate the economy and to score politically among the electorate. In case of foodstuff the reduced rate aimed at stopping tax evasion, too.

VAT revenues in 2015 reached HUF 3286 billion (28% of Central Budget revenues) and in 2016 are expected to reach HUF 3389 billion (32%). Based on the data in first ten months of the year, this goal seems to be excessive although this year a stronger Christmas shopping is expected than last year due to growing purchasing power of households.

The tax point (time of supply) rules determine when VAT is due. It is then payable 20 days after the VAT reporting period ends, either on a monthly or a quarterly basis. For most goods, it is the time of delivery or passage of the title. For services, it is the completion of the service.

1.4. OTHER SIGNIFICANT TAXES

A number of other tax items play important role in funding the central budget and the social security funds.

In 2010, surtax on financial institutions was introduced, both on credit institutions and on insurance companies. The amount of tax was determined on the basis of the adjusted amount of balance sheet of 31 December 2009. Effective from 4 December 2010 a turnover-based, progressive sector specific surtax on retail trading, telecommunication and energy supplier activities, declared to be maintained until 31 December 2012. In the year of its introduction, in 2010 and 2011, banking tax and specific surtaxes represented a significant part, 4.3 percent of total revenues of the central budget.

Opposite to the original declaration, the surtax on financial institutions was not halved in 2013, since government decided in November 2012 to retain it indefinitely for banks as a permanent bank sector levy. The surtax on insurance companies has been phased out as of 2013 but a consumption-type insurance tax was introduced.

Concerning extra tax on energy suppliers, this tax was extended to other utilities and the rate increased also. The extra tax in the retail sector was abolished as of 2013, but at the same time, new taxes were introduced on the infrastructure of energy companies and on telecommunications services.

Between 2013 and 2016 some lightening of sector specific surtaxes happened, the importance of these taxes decreased but albeit non-negligible. In 2015, 1.73% of entire revenues of the state came from specific taxes (including infrastructure tax) and banking tax and this rate is planned to fall to 1.29%.

Among taxes on consumption, **Excise tax** generated HUF 998 billion revenue in 2015 (8% of Central Budget revenues) and is expected to produce HUF 984 billion (9%) in 2016. A third major tax on consumption along VAT and Excise tax is **Financial transaction tax** that resulted in HUF 208 billion revenues in 2015 (2% of Central Budget revenues) and is expected to bring in HUF 201 billion in 2016 (2%).

Finally, Social Security Funds are primarily financed from the so called **Social contribution tax and other contribution** that generated HUF 4054 billion in 2015 (34% of Central Budget revenues) and are expected to generate HUF 4230 billion in 2016 (40%).

2. Trends in tax collection

The completion of tax returns is based on self-assessment. Private individuals not engaged in entrepreneurial activities may request the assistance of the Tax Authority with respect to the completion of tax returns. Employers and payers are obliged to deduct taxes and/or tax advances from wages and other payments. Private individuals are obliged to pay income tax and/or income tax advances themselves if their income is from sources other than payers or employers. Private individuals must file their annual tax returns by the 20 May of the year following the given tax year. Private individuals required to pay VAT and individual entrepreneurs must file by the 25 February of the following year.

Concerning tax administration it should be mentioned that the organization of tax bureaucracy has significantly changed since 2011. In 2011, the National Tax and Customs Office (NAV) was created by merging the former Tax and Financial Control Administration (APEH) and the Customs and Finance Guard VP). Then, as of 1 January 2016, the NAV ceased to exist as a Government Office but became a department of the Ministry for National Economy.

The overall taxing rate in Hungary is traditionally higher than in other V4 countries. The ratio of tax revenues to GDP fluctuated between 37-40% of GDP over the past 10 years. In 2014 tax revenues amounted 38.3 of GDP and to 39.3% in 2015. The maximum rate of tax concentration at almost 40% was reached in 2007-2008 when, due to high government deficits of the previous years, budget austerity measures were necessary, which were manifested both in increase of revenue and in reducing expenditure. After 2009, a slight decrease was observed, but from 2012 on the tax to GDP ratio rose again to above 38% (Annex II. Graph 2.1.).

The structure of tax revenues in Hungary slightly differs from those in other V4 countries. Consumption is stronger, while capital is less taxed than the average (Annex II. Graph 2.1.). Between 2004 and 2014, there has been a certain shift in the tax structure: the share of consumption taxes grew by more than 5 percentage points (from 10.3 to 16%) and taxes paid by businesses (not only CIT but other types of taxes, fees, surtaxes and rents) decreased from 6.7 to 4.8 percent of GDP.

Hence, the collection of major tax items became more efficient. Yet, when one compares this performance to 2012 as a base year, a slightly different picture emerges. Back then, budgetary centralization as a share of GDP was a mere 32.8%, and all major tax items except for Corporate Tax represented a higher share of the Central Budget than in 2015. When, in turn, revenues from major taxes compared in 2012 and 2015 as a ratio of GDP, one can again witness considerable rise in revenues from Corporate tax (from 1.2% to 1.6%) and a slight increase in revenues from VAT (from 9.6% to 9.7%), whereas Excise tax and Personal income tax produced less government revenues than four years earlier (3% against 3.2%, and 5% against 5.2%, respectively).

However, the situation is somewhat complicated, although not particularly difficult to interpret. One can argue that for the government, raising revenues from Corporate Taxation was preferred over taxing individuals, while tax efficiency was enhanced with respect to the collection of VAT, especially after a relatively large drop in VAT revenues in 2013 in terms of both the GDP and as a share of the revenues of the Central Budget. In fact, corporations have not only been taxed by the corporate tax but also through surtaxes levied on particular economic sectors, such as finance, retail trade, telecommunication and energy provision. Over time, the importance of these taxes decreased, but upon their introduction they formed a powerful tool of the government in disciplining big business, not only raising revenues but also sending the signal that any company and sector might become subject to special taxes.

As one of Fidesz' pledges before the 2010 election was the introduction of a flat personal income tax, a considerable cut in PIT revenues was politically unavoidable. On the other hand, a 2 percentage point rise in VAT, from 25 to 27 percent was one way of compensation for that. Against this backdrop occurred the relative decline of VAT revenues in 2013 amid a relatively fast annual real economic growth of 2.1%. In absolute terms, VAT revenues still increased, though. One of the reasons for this relative decline was most probably tax avoidance. In response, the government made sure that retail shops start using so called on-line cash machines (see Section 4). Another reason for the relative decline in VAT revenues could be the forced cut in the retail price of energy that was part of government policies alleviating financial burdens of households. Lower retail energy prices, though, meant lower VAT revenues on energy and related goods.

For graphs on tax collection, see Annex 2.

3. Magnitude of tax gaps

No recent estimates are available on the tax gap in Hungary. In the following we review the results of previous studies, prepared mainly in the middle of 2000's and by considering the changes in conditions since then we try to estimate the extent of the current gap.

VAT gap

Data are only available for the VAT gap, calculated by a special task force of the European Commission, show that the estimated gap in Hungary was 18% (or EUR 2.1 billion) in 2014.[5] This was down from over 20% in 2014, and represented a respectable showing, better than those of Greece and Italy in the 'old EU' and also outperforming Bulgaria (19.8%), Latvia (23.4%), Lithuania (36.8%), Poland (24.1%), Romania (37.9%) and Slovakia (30%) among the new member states. This is line with the general picture that the efficiency and discipline of tax collection have improved in recent years as Tax Authority control became more efficient in general, and on-line cashing machines improved VAT collection in particular.

PIT gap

There are basically two forms of tax evasion and tax avoidance of Personal Income Tax[6]. The former group contains cases of black and grey forms of employment. Black (undeclared) workers are not registered: they do not pay tax at all. Workers in grey economy are registered and pay taxes on a certain part of their salary (typically at minimum wage) while they receive the other part of their earnings in "envelop" (in cash). Opposite to these cases, tax avoidance is a kind of tax optimization; the groups belonging here do not cheat but only seeks to minimize tax paying by using possibilities of the law (e.g. taxing as an entrepreneur instead of an employee). We will deal here with black and grey work.

Hungarian economists estimated the share of **black** (undeclared) employment to 10-17 percent of total employment between 2001 and 2007. Since then, no new model estimations have been prepared and published.

Several assumptions confirm that this ratio might have declined since then. Firstly, the tax authorities strengthened their control activities mainly at those branches in which the share of undeclared work was the largest (construction industry, retail trade and consumer services). At the same time, amount of the penalty was significantly lifted, that is why it became less and less worth to work illegally.

Secondly, those branches which were mostly infected by black work (construction industry and retail trade) have shrunken in the last 10 years. Construction activity and retail trade turnover started to decrease in Hungary even before the global crisis. The necessity to fiscal consolidation was urgent in 2007, after the government deficit amounted to 8% of GDP in the average of previous 4 years. The global financial and economic crisis has further hit the

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[5] See https://ec.europa.eu/taxation_customs/business/tax-cooperation-control/vat-gap_en

[6] See: Benedek, D.-Elek, P.-Köllő, J (2013). Tax avoidance, tax evasion, black and grey employment. In: The Hungarian Labour Market 2013. Fazekas, K.-Benczúr, P.-Telegdy, Á. (eds.). Centre for Economic and Regional Studies, Hungarian Academy of Sciences & National Employment Non-profit Public Company, Budapest

Hungarian economy and particularly these industries being mostly infected by black work. And although in recent 2 years the Hungarian economy has definitely picked up, this acceleration has merely been attributed to the usage of European Funds. However, the European Funds can be exercised only against an invoice.

All in all, we estimate that at present the illegal work might be at the lower limit of past estimates (10%), or even below this ratio.

The size of **grey** work can be calculated by the number of workers declaring minimum wage. In Hungary, there are two types of minimum wages: the minimum wage for non-skilled workers and the so called guaranteed minimum wages, the latter for skilled labor. Between 2012 and 2015, the number of workers in both groups has substantially risen: the number of minimum wage earners from about 200 to 270 thousand and that of the workers with guaranteed minimum wages from 430 to about 550 thousand. Compared to total employment this is about 15-20% of all employees.

According to previous estimates (Benedek et.al, see footnote 5) the share of the underreporting among workers which are paid minimum wage might be about 45-50%. This share strongly differs by sectors; about 15% among cleaners (who really earns the minimum wage), about 50-60% in construction industry and nearly 100% among university graduates.

Concerning lost revenues of general government, most studies have estimated the effect of hidden tax base of disguised minimum wage earners on fiscal revenues to about 1% of GDP; some others calculated it to well below 1% (0.6-0.7%). Considering the supposed decrease in black work and the increase in the number of minimum wage earners in recent 10 years, the lost state revenues due to undeclared earnings could be slightly below 1% of GDP.

CIT gap:

Corporate income tax evasion is less typical than the evasion of VAT or personal income tax. As we saw in chapter 1, in Hungary the CIT rate is relatively low and is particularly low for small businesses which are basically more prone to tax evasion. The model estimations of the extent of tax evasion is also complicated by the fact that corporate results being the base of taxing, are heavily dependent on economic cycles, as well as a number of tax benefits complicate clarity.

4. Methods used to combat tax avoidance

In past years, the Hungarian government successfully fought tax avoidance. Efficiency of the Tax Authority has been increased by additional equipment and personnel, by conducting more stringent monitoring of businesses, as well as by using new monitoring techniques.

A major step in decreasing the tax gap was the usage of so called on-line cash machines that are directly wired to the Tax Authorities monitoring system, enhancing VAT revenues. The introduction of online cash registers connected to the tax office has helped whiten the economy, with a sudden increase in VAT reported by traders.

Another major step against tax avoidance was the introduction of the Electronic Public Road Trade Control System (EKÁER) which was launched from 1 January 2015**.** The objective of the system is to strengthen the market positions of compliant economic operators, to make circulation of goods more transparent, to eliminate fraud related to **food products** often endangering human health and; last but not least, to eliminate tax evaders. By using EKÁER the actual route of the goods can be tracked because transport related data (name and quantity of goods, consignee, consignor, registration number of vehicle, etc.) have to be registered in a central electronic system before starting the transport.

Some of these data (product weight, value, registration number of vehicle) can be modified up until the arrival of the cargo and can be registered in the system on the first working day after the time of arrival to the address of receipt (unloading). Stating the registration number of the vehicle is not a precondition to determining the EKAER number but it has to be registered up until the start of transport.

Although there were several technical and administrative problems at the beginning of introduction of the new system, it is now functioning smoothly. According to the statements of producers, as a result of the introduction of the EKÁER, registered vegetables and fruit trade grew significantly. The positive feedback from businesses proves the positive impact of the system on cleaning of the market. According to the National Agency for Food Safety (NÉBIH) some surveys proved that about 80 percent of the black market in Hungary was linked to the food industry. Although there are no exact calculations on the whitening effect of EKÁER, the strict control could eliminate a significant part of black trade.

Staff of the National Tax Authority has been increased and the annual budget of the Authority has been expanded. High profile investigations have taken place against border guards responsible for custom fraud committed by smuggling tobacco into Hungary.

At the same time, the reduction of the marginal rate of personal income tax on high incomes, i.e. the introduction of the flat PIT system reduced tax avoidance as incentives for non-declaration and for self-employment decreased. In addition, avoidance of Social tax contribution has decreased as well, resulting in growing revenues of social security funds.

A generally more active and diligent Tax Authority has probably also reduced tax avoidance among both companies and private persons. Relatedly, simplification of the corporate tax code, already initiated before 2010, has been also playing an instrumental role in pushing back on tax avoidance among corporations. However, firms belong to the clientele of the government may well enjoy somewhat less stringent tax monitoring.

5. Conclusions

Hungary operates a tax system that corresponds to that of most EU countries. Corporate tax, Social contribution tax VAT, Excise tax and Personal income tax all play an instrumental role in ensuring budgetary revenues. In addition, Social tax contributions, sectorial surtaxes, including the bank tax, as well as a special tax on financial transactions considerably extended tax revenues. Generally speaking, the tax system appears working instrumentally, providing a degree of stability and predictability to the Central Budget. Yet, special taxes at the same time were perceived arbitrary and enabling unfair government intervention, sometimes on behalf of government cronies. In a number of cases the EU Commission condemned them and requested that the Hungarian government adjust their tax policies to be in line with EU principles. This way, enhanced tax collection through surtaxes undermined trust in and predictability of government policies. Nevertheless, tax avoidance appears to having decreased in past years and according to data published by the European Commission, Hungary can be regarded as an outperformer of a number of Central and Eastern European countries with respect to the tax gap on VAT.

After a relative dip in 2013, Hungary in past years has successfully increased tax centralization and, most probably, also the efficiency of taxation. Since 2013, a salient increase in revenues from VAT and corporate tax has been observed, making the performance of the Central Budget more predictable and stable. This was primarily the result of an altered incentive structure and a more stringent Tax Authority. Technological innovation, such as the introduction of on-line cash machines has also played an instrumental role.

Despite the fact that Hungary has a high normal VAT rate at 27%, VAT revenues have been rising impressively in the past three financial years. CIT, PIT and social security contribution receipts have been also increasing, demonstrating effects of a more efficient tax administration. Yet, all this was partially the result of a low basis: the rise in tax revenues without any dramatic economic upturn suggests that tax collection before must had been less than sufficient.

As to the applicability of Hungarian tax measures in other countries, the technological innovation of on-line cash machines can be recommended elsewhere. However, it should be noted that such a significant measure has to be carefully prepared and allow more time for retailers to adapt to the new system.

ANNEX 1: RULES OF CORPORATE TAXATION

Hungarian corporate taxation is in line with EU principles and Hungary essentially operates a regular corporate tax system. Some specificities, however, can be recognized and will be elaborated in the followings.

1. Taxable corporate income

Incomes deriving either from Hungary or abroad of resident taxable persons shall be subject to tax. Pre-tax profit, adjusted by increasing and decreasing items of the tax base constitute the corporate tax base. Importantly, the National Tax Authority can qualify contracts and transactions whether they reflect realistic valuation or serve tax optimization purposes. As a bottom line, no costs and expenses can qualify as costs and expenses if they are apparently used for obtaining tax advantages.

2. Items adjusting the tax base

The tax base must be increased with costs and expenses incurred as a result of legislation, including fines, penalties, late payment penalty interests due to delay in the payment of taxes.

3. Depreciation

The entire purchase value or cost of production can be written off the tax base in the course of several years.

4. Development reserve

A portion of retained earnings committed to future capital investments, also know as development reserve, can be treated as accelerated depreciation and deducted as a lump sum from pre-tax profit. Such a deduction can be implemented over the course of four tax years in accordance with the costs arising from the implemented capital investment. The entire amount of development reserve cannot be more than half of pre-tax profit or HUF 500 million per tax year.

5. Provisions

The tax base must be increased with the amount of the provisions for expected liabilities and future costs regarded as expenses. On the other hand, the amount recognized as a revenue resulting from the utilization of such provisions should be treated as a tax-base decreasing item.

6. Losses

Deferred losses of previous tax years (negative tax bases), can be deducted from the tax base in an amount of the taxpayer's choice over the forthcoming five tax years up to 50% of the tax base calculated without losses. The deferred but not yet deducted loss may be rolled on within the five year period.

7. Dividend

Income from dividends is deducted from the tax base when corporate tax liability is determined. Nevertheless, dividends received from a controlled foreign company cannot be deducted from the tax base.

8. Transfer pricing

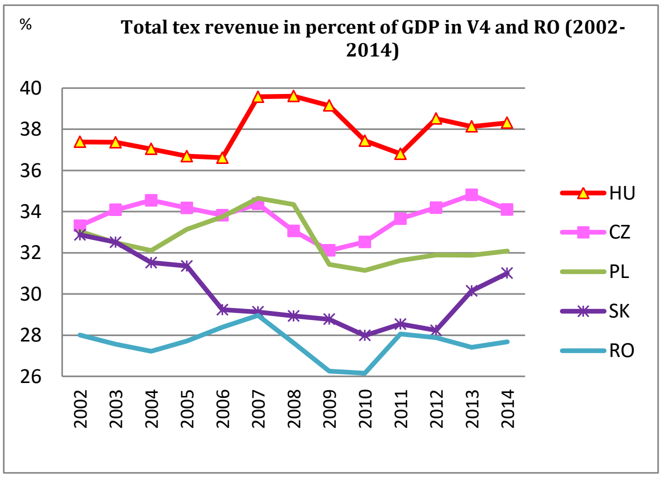
Transfer price regulations are based on OECD guidelines. If prices applied in related-party transactions differ from arm's length prices applied by unrelated parties, the company may decrease its pre-tax profit by the difference under specified conditions.

9. Rules of income/profit minimum

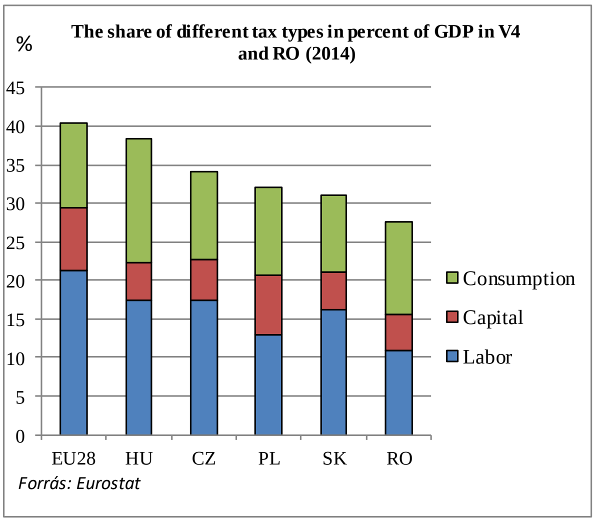
If pre-tax profit or the tax base, whichever is higher, is smaller than 2% of the company's adjusted total income, the company must either pay tax on 2% of the adjusted total income, or make a statement for the National Tax Authority.

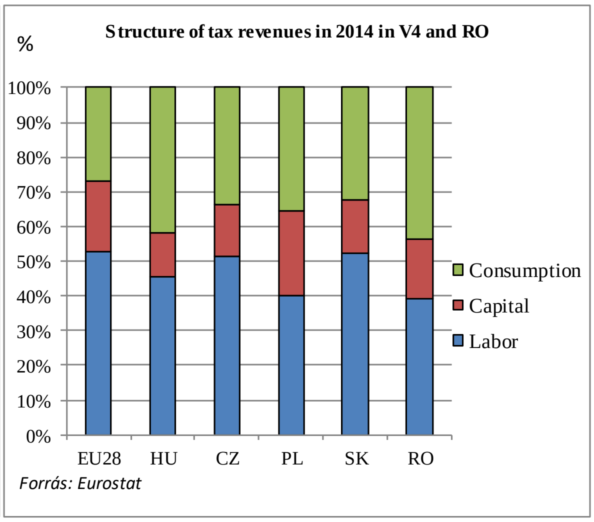
ANNEX 2: Graphs on tax collection

Graph 1.

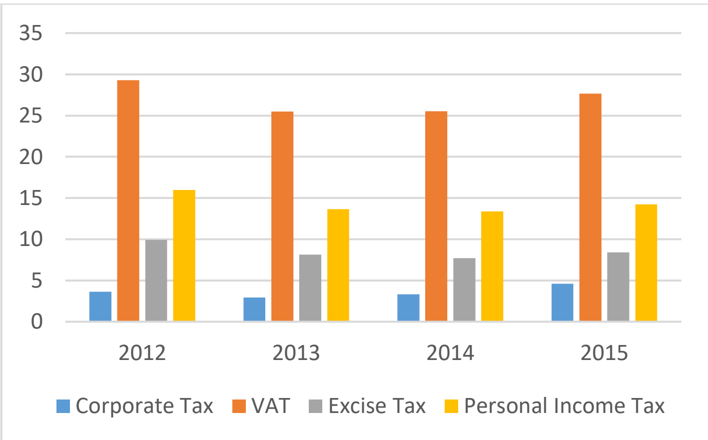


Graph 2:



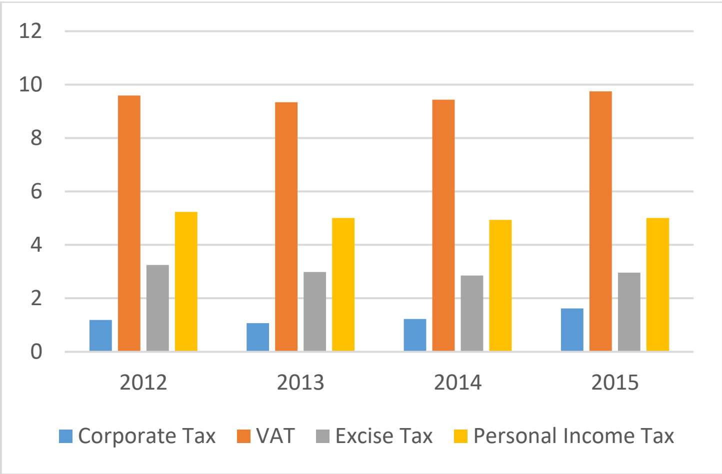


Graph 3: Major tax revenues in percent of Central Budget revenues



Source: Hungarian State Treasury

Graph 4. Major tax revenues in percent of GDP



Source: Hungarian State Treasury and Central Statistical Office