THE ROLE OF SPECIAL TAXES IN TAXATION

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ABSTRACT

This study examines the role of special taxes in the Hungarian tax system. The number of special taxes, and the revenue they generate for the budget, is increasing virtually from one year to the next. This can also have harmful consequences, as the cost-cutting ordered by companies in order to make up for the excess burden can lead to the shelving of investments which in turn holds back economic growth. Passing them on to consumers supresses consumer demand, lowering the revenues of taxable persons. The drawbacks are aggravated by the ill-considered, rapid introduction of the taxes, and the uncertainty surrounding the tax system discourages foreign investors. Simply abolishing the special taxes is not the only solution; with the right measures, the system of special taxes can be made sustainable in the long term. A further problem with special taxes is that, although there is a lack of EU harmonisation regulations in this regard, the legislature is bound by the competition-law rules – and breaching these carries the risk that the taxes will be reclassified as prohibited state aid.[1]

JEL codes: E62, F38, H2, K34
Keywords: fiscal policy, international financial policy, financial transactions, tax, taxation, tax law

Special taxes have been an integral part of the Hungarian tax system since the economic and financial crisis. And there is no better proof of their popularity than the fact that their cumulative share of central budget revenues has exceeded that of corporate tax in the past few years.

In the summer of 2013 LeitnerLeitner conducted research aimed at mapping the role of special taxes in Hungary. Two and a half years have passed since then, and the issue of special taxes is perhaps even more topical than ever: their number has grown further, and the tax burden has clearly become greater. And what has not changed, furthermore, is that their introduction is preceded by an insufficiently thought-out legislative process.

1 The first edition of the study was published on 16 March 2016 on the website of Leitner+Leitner Tax Kft. The bulk of the text is published in original form in the journal *Gazdaság és Pénzügy* [Economics and Finance], but the changes made over the eight months that have passed since the first publication are summarised briefly in chapter nine. Status of data sources: March 2016.

In this latest study, we seek answers to the same questions as the previous one:

- How do special taxes fit into the Hungarian tax system?
- What are the benefits and drawbacks of special taxes?
- What is the impact of the introduced special taxes on businesses' appetite for investment?
- Who pays the ferryman, or: can special taxes be passed on to final consumers, the general public?

Although focussing mainly on current issues and the past few years, we have also set out to give a full overview of the system of special taxes, so our study will also be of much benefit to those who have not read the previous edition.

1. WHAT DO WE MEAN BY SPECIAL TAX?

"On paper", that is in terms of their name, at present there are only three taxes that are officially referred to with the expression "special tax". These are the

- special tax on financial organisations,
- special tax on credit institutions, and
- special tax on investment funds and distributors, effective from 2015.

In addition to these, however, in the Hungarian tax system numerous individual sectors, industries or activities are burdened by tax or a tax-like payment obligation or deduction, which we are treating as special taxes for the purpose of the present study. In our approach, all types of tax that differentiate between certain sectors, industries or activities from a taxation perspective can be regarded as special taxes.

Based on the above definition, since 2004 a total of **16 such tax types** have been introduced, of which **13** constitute (or constituted) revenue for the **central budget**, and **3** for the **National Health Insurance Fund**.

Tax types constituting revenue for the central budget (in the order of their introduction)[2]:

- energy tax
- credit institutions' contribution

2 In 2014 a levy referred to as the credit institution contribution was also in effect, but this was account for among corporate tax receipts, and therefore it is not addressed in the present study. See: *Elemzés az államháztartás 2014. I–VI. havi költségvetési folyamatairól* [Analysis on the budgetary processes of January to July 2014, State Audit Office of Hungary] (2014), p. 16

- energy suppliers' income tax ("Robin Hood tax")
- special tax on financial organisations ("bank tax")
- special taxes on certain sectors ("sector-specific special taxes") – discontinued in 2013
- credit institutions' special tax
- telecoms tax ("telephone tax")
- utilities tax
- financial transaction duty
- insurance tax
- advertisement tax
- special tax on investment funds and distributors
- healthcare contribution for tobacco-industry companies ("tobacco-industry healthcare contribution")[3].

Tax types generating revenue for the National Health Insurance Fund:

- taxes on the pharmaceutical industry
- public health product tax[4] ("crisps tax", "hamburger tax"), and
- accident tax.

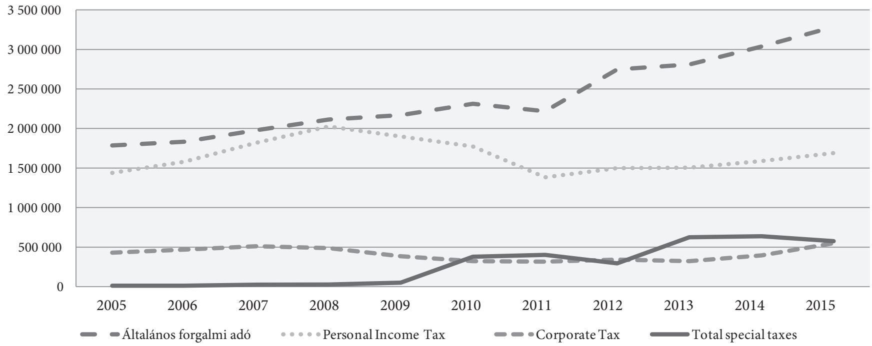
The advertisement tax, however, only partly conforms to the above definition of special tax, because it is only sector-specific insofar as it is primarily levied on entities in the media sector; however, in addition to these taxable persons, anyone could be a taxable person in respect of the potential (secondary) liability incurred by those who place private advertisements. In other words, rather than being a tax on a sector, it is a tax on advertising activity.

Considering that the sector-specific special taxes were abolished in 2013, **at the end of 2015 there were 15 special taxes in the Hungarian tax system**, which is three more than in 2013. Of these, we mainly examine in more detail the tax types that generate revenue for the central budget, and only mention the other tax types in relation to certain specific issues. In our analysis we set out to give a comprehensive overview of the special taxes of the Hungarian tax system, but focus primarily on the changes in the period since publication of the last study (2013-2015). For our detailed analysis, we used the data of the Central Statistical Office (KSH) that was available in February 2016.

3 The tobacco-industry health contribution exists on the boundary between the two groups: although it generates revenue for the central budget, these have to be spent on development of healthcare subsystems.

4 01/09/2011 – 29/11/2011: central budget revenue

Figure 1
Revenues of the central budget (2005–2015)



Note: Data: HUF million
Source: KSH

2. SPECIAL TAXES IN THE TAX SYSTEM

Before examining the individual special taxes in more detail, it is worth comparing them, in terms of their significance, with the three most important taxes in the Hungarian budget, which not only constitute the basis for international comparisons, but also serve as yardsticks of tax competition between countries worldwide. These are

- value added tax,
- personal income tax, and
- corporate tax.

While before 2011 slightly over half of the revenues of the Hungarian central budget came from these "big three" tax types, in the past few years this ratio has fallen to below 50%. Although the amount of tax revenue derived from them have increased constantly in absolute terms since 2011 (2011: HUF 3,919 billion, 2015: HUF 5,523 billion), their percentage share of total revenues, their significance, has decreased. While in 2011 they accounted for 47% of budget revenues, in 2014 this ratio was only 42%. This is partly due an increase in the share of special taxes, which will be discussed in this and the next chapter. This trend appeared to be reversing in 2015, as at this time the three tax types accounted for 46.7% of central budget revenues, which is partly due to the growth in receipts from these taxes, and partly to a decline in special tax receipts.

Meanwhile, the ratios of the "big three" taxes relatively to each other also changed, which can be followed on the chart made by LeitnerLeitner[5] (see: Figure 1). As regards the big three taxes, revenues have shifted towards taxes on consumption (VAT), which is being accompanied by a downward/flat trend in the ratio of taxes on income (personal income tax, corporate tax) This does not mean, however, that the revenues from taxes on income have decreased. The main cause of the change in the ratios is that VAT revenues have grown at an even faster rate.[6] And this trend is not limited to the above three tax types. According to the State Audit Office's analysis of the macroeconomic interactions between budgetary processes, between 2011[7] and 2014 the ratio of central tax receipts related to consumption (e.g. VAT) grew from 54% to 58.6%[8], while payments into the budget by businesses and individuals (e.g. corporate tax, personal income tax) decreased from 46% to 41.4%. An exception to this trend was the year 2015, because the significance of income taxes (due to the steep growth in corporate tax receipts) increased slightly again, as will be discussed more in this chapter. The question is whether this represents a change of trend, or just a temporary strengthening.

VAT revenue during the studied period showed a virtually constant upward trend, which became even more pronounced from 2011. Revenue from VAT amounted to HUF 2,219 billion in 2011, while in 2015 they were almost one and a half times as much, at HUF 3,286 billion. The growth was started by the incremental raising of the VAT rate (to 25% from 1 July 2009, then to 27% from 1 January 2012, making it the highest rate of Value Added Tax in the EU in 2015[9]. Further potential causes of the continuous growth in VAT receipts include the installation of online cash registers[10] and the increasing strictness of tax audits. According to the Budgetary Council's analysis of September 2015, the latter factors, as well as the launch of checks using the Electronic Public Road Trade Control System (EKÁER) from 2015, are helping to whiten the economy, and this is also reflected in the pro-rata fulfilment of the 2015 target.[11]

5 Since we are examining the special taxes within the revenues of the central budget, the diagram does not include the tax types that constitute revenue for the National Health Insurance Fund.

6 In 2014, for example, 61% of total revenue for the three tax types derived from VAT, while personal income tax and corporate tax only accounted for 39%.

7 Elemzés a 2013. évi költségvetési folyamatok makrogazdasági összefüggéseiről [Analysis of the macroeconomic relations of budgetary processes in 2013], State Audit Office of Hungary (2014), p. 35.

8 Elemzés a 2014. évi költségvetési folyamatok makrogazdasági összefüggéseiről [Analysis of the macroeconomic relations of budgetary processes in 2014], State Audit Office of Hungary (2015), p. 45.

9 Taxation trends in the European Union, Eurostat, 2015 Edition. p. 140.

10 Vincze, János: Középtávú előrejelzés a makrogazdaság és az államháztartás folyamatairól [Medium-term projection of macroeconomic and budgetary processes], MTA (2015), p. 30.

11 A Költségvetési Tanács Véleménye Magyarország 2015. évi központi költségvetése végrehajtásának helyzetéről és az államadósság várható alakulásáról *(az I. félévi folyamatok jellemzői)* [Budgetary Council's Opinion of the status of implementing Hungary's 2015 budget and projections of the deficit (first six months)], Budgetary Council (2015), p. 6.

The rate of increase was lowered slightly by the fact that the 2009 mid-year increase in the general rate was accompanied by the introduction of the special 18% rate, followed in 2010 by the 5% rate. The range of products taxed at these rates has been steadily expanded in recent years (e.g. in 2014-2015 on the sales of certain livestock and carcass meats, then in 2016 the VAT on certain new residential properties was also reduced).

At the same time, we observe that revenues from corporate tax have generally shown a downward or flat tendency since 2008, and although slight growth may be observed in certain periods, this is only temporary. The chart gives a good sense of the drop in revenues from this tax from 2008 right up to 2011. Except for a temporary increase in 2012, we had to wait until 2014 for more substantial growth. One reason for the decrease was that the most favourable, the 10% rate of corporate tax was gradually rolled out: first its conditional use, then from 16 August 2010 its unconditional application – independently from the de minimis system – up to a tax base of HUF 500 million created a progressive corporate tax rate structure in Hungary. Following this, the steadily built-up system of tax allowance (e.g. discounts claimable for sponsorship of popular team sports from 2011), and the availability of new small business taxes as alternatives to corporate tax (kata, kiva) also contributed to preventing any substantial increase in corporate tax receipts. In 2014 and 2015, however, a turning point was reached as revenues from corporate tax once again started to rise considerably, and exceeded the targets. Corporate tax for 2015 (HUF 549 billion), for example, is more than one and a half times the 2011 figure (HUF 317 billion). And this is in spite of the fact that a decrease was forecast for 2015, with some analysts naming the impacts of the law on the settlement of foreign currency loans as a possible reason for this.[12]

This begs the question, however, of whether the exceptionally high 2015 corporate tax receipts included items that were paid to the tax authority NAV by taxpayers, but a part of which was passed on by the tax authority within 15 days, in accordance with the instructions of the taxpayer, to a beneficiary organisation on the basis of the regulations in effect from 1 January 2015[13]. Because if this is the case, then the surge in taxes on income is not as robust as it may seem at first glance, because the increase was partly caused by "revenues" those do not remain in the budget.

12 Vincze, János: *Középtávú előrejelzés a makrogazdaság és az államháztartás folyamatairól* [Medium-term projection of macroeconomic and budgetary processes], MTA (2015), p. 29.

13 The so-called "instruction on the utilisation of tax", since 1 January 2015, has provided a new way of supporting film productions, performing arts organisations and popular team sports. Taxpayers can choose between the "old" form of support (where the taxpayers transfer the sponsorship money directly to the supported organisation and subsequently offset it against corporate tax) and the "new" form of support (where the taxable persons pay their tax to NAV, which then passes on the part of the tax determined by law to the named beneficiaries in accordance with the instructions of the taxable persons).

The taxation of personal income is also typified by a multi-tiered process consisting of parallel steps that often have opposite effects, with the result that personal income tax revenue plummeted steeply between 2008 and 2011, both in terms of their share of overall tax revenue and in terms of their absolute value. One of the causes of this was the lowering of the progressive tax rates, which were replaced in 2011 by a single 16% tax rate[14], but family tax allowances were also introduced in 2011. After this, personal income tax receipts started to grow slowly (2013: HUF 1,505 billion, 2014: HUF 1,589 billion, 2015: HUF 1,689 billion), although they have not reached the pre-2008 level of over HUF 2,000 billion since then. The increase can be attributed partly, for example, to the discontinuation of the tax credit serving to ensure tax exemption for the minimum wage, the constant rise in the minimum wage, and a lower-than-expected rate of tax reclaim (e.g. in 2013)[15], but factors outside the tax system – such as rising employment, salary increases – also exerted a considerable influence[16].

Changes in tax revenue, however, are dependent not only on the tax-law regulations, but on countless other factors as well, such as the compliance of taxable persons, changes in the taxed performance ratio (e.g. sales revenue), or growth in employment.

In parallel with the above processes, the special tax revenues of the central budget showed (almost) continuous growth (e.g. 2011: HUF 402 billion, 2013: HUF 625 billion), which is clearly illustrated in the chart compiled by LeitnerLeitner (see Figure 1). In 2015 a slight drop did occur (2015: HUF 575 billion). This was mainly due to a fall in the revenues from one tax, the financial transaction duty, and was also "thanks" in part to the fact that the European Commission prohibited the use of progressive tax rates in the case of certain tax types. This matter is discussed in more detail in *chapters 3* and *7*.

In most of the recent years, revenues have shifted towards taxes on consumption (VAT), which is being accompanied by a downward/flat trend in the ratio of income taxes (personal income tax, corporate tax).

14 The single-rate personal income tax system is not complete even in its present form, as there are various special types of income to which a different effective tax rate applies.

15 A Költségvetési Tanács Véleménye Magyarország 2013. évi központi költségvetése végrehajtásának helyzetéről és az államadósság várható alakulásáról (az I. félévi folyamatok jellemzői) [The Budgetary Council's Opinion of the status of implementing Hungary's 2013 budget and projections of the deficit (processes of the first six months)], Budgetary Council (2013), p. 8

16 A Költségvetési Tanács Véleménye Magyarország 2014. évi központi költségvetése végrehajtásának helyzetéről és az államadósság várható alakulásáról (az I. félévi folyamatok jellemzői) [The Budgetary Council's Opinion of the status of implementing Hungary's 2014 budget and projections of the deficit (processes of the first six months)], Budgetary Council (2014), p. 7

Concurrently, the special tax revenues of the central budget have grown (almost) continuously.

Examination of the relative proportions of the special taxes and the "big three" taxes reveals that, owing to their small number, until 2009 the special taxes were not a significant source of revenues; but between 2010 and 2012 they accounted for more or less the same share of budget revenues as corporate tax, and from 2013 onwards significantly exceeded this. In 2015 the slight drop in special tax receipts, accompanied by a steep rise in corporate tax receipts, brought the two figures close to each other again.

Although the volume of special taxes is less significant in comparison to VAT or personal income tax, they are nevertheless an important part of the budget. And what is more, they are only generated by certain, selected sectors of the economy, for which they represent a considerable burden.

The cumulative revenues from special taxes have exceeded revenues from cor-porate tax in almost every year since 2010. While each individual special tax, by itself, has a relatively small weight within the revenues of the budget, cumula-tively they represent a substantial source of funds.

There are two reasons why the legislature has focused in particular on special taxes. One is the financial and economic crisis, which fundamentally altered economic processes in Hungary. To make up for the lost revenues, starting from 2010 various, mostly sector-specific special taxes were introduced. Based on the findings of the State Audit Office's audit of the years 2007-2013, which covered several special taxes, this proved to be only partially successful. Although the special taxes contributed substantially to a reduction in the budget deficit, in the year 2009-2011 the target deficit was still not achieved.[17] Their importance, however, is indisputable: the financial transaction duty along reduced the deficit by 20.9% in 2013, while the sector-specific special taxes reduced it by 21.3% in 2012.[18]

The situation is nuanced by the fact that the growth in revenues from special taxes partially coincided with a fall in certain income tax receipts. According to the European Commission's report on 2013, for example, one of the important aspects of the special taxes was that they compensated for the loss of revenues

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18 JELENTÉS – az egyensúlyjavító intézkedések ellenőrzése- Az egyes egyensúlyjavító intézkedések és azok hatása a költségvetés végrehajtására című ellenőrzésről [REPORT – audit of measures to improve balance – On the audit entitled: Individual measures to improve balance and their impact on implementation of the budget], State Audit Office of Hungary (2015), p. 31

caused, for example, by the more widespread use of the reduced corporate tax rate, and the various tax allowances.[19] In other words, the onus of generating revenues for the budget was effectively shifted to sectors that are less dependent on international laws.

And this brings us to the other reason for the introduction of the special taxes, namely the flexibility with which they can be configured – in comparison the "traditional" tax types. The system of value added tax is subject to a high degree of harmonisation in the European Union. Although the VAT Directive does allow the individual member states to set their own detailed regulations within certain narrow constraints, further country specific rules can only be put into effect after being put through a preliminary authorisation system. With respect to taxes on the income of companies and individuals there is a lower level of European harmonisation, but here too, international interactions are regulated by directives, and the OECD-governed principles precluding double taxation also place limitations on legislation. In contrast to the above tax types, generally special taxes can be flexibly configured and introduced at short notice, which boosts their popularity among legislators. This, however, does not mean that legislators are exempt from complying with certain EU (e.g. competition-law) rules (see chapter 7 of this study).

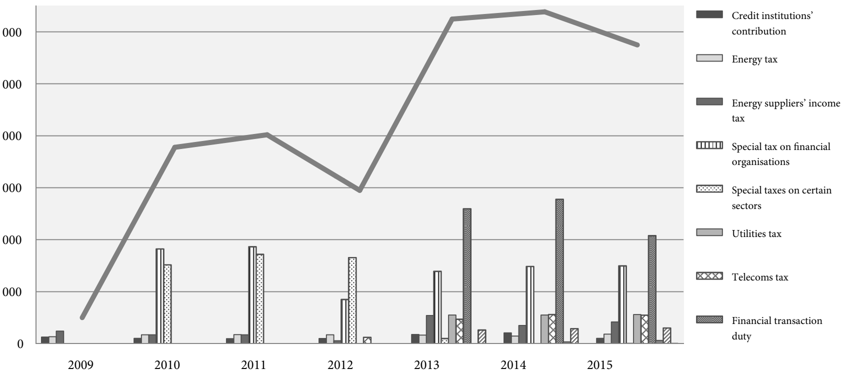
In summary, the introduction of a series of special taxes has helped to push the traditional taxes into the background. While each of the individual special taxes, by itself, has a relatively small weight, overall they represent a substantial source of funds, and approximately 5% of the budget's revenues.

3. ANALYSIS OF THE SPECIAL TAXES

The changes in the central budget revenues from the individual special taxes, both cumulatively and separately, are shown in Figure 2 for the 2009-2015 period. The virtually continuous growth in special tax revenue is clearly visible.

19 Macroeconomic imbalances Hungary 2013, Occasional papers 137, European Commission (2013), p. 24

Figure 2
Special tax revenue of the central budget 2009–2015



Note: Data: HUF million
Source: KSH

One of the greatest increases in the history of special taxes was seen in 2010, when their share of central budget revenues grew from 0.6% to 4.47%. The introduction of the special tax on financial organisations and the sector-specific special taxes played an important role in this. In spite of the temporary dip of 2012, and the phasing out of sector-specific taxes in 2013, the rise of the special taxes later continued. In 2013–2015 these taxes brought in roughly one and a half times the revenue that they used to in 2010.

If we also include the special tax revenues flowing into the National Health Insurance Fund (not shown on the chart), then the aggregate special tax burden of 2009 (HUF 94 billion) had increased almost five-fold by 2010 (HUF 429 billion). The special tax burden of 2014 (HUF 740 billion) is almost eight times that of 2009, and exceeds the 2010 figure by a factor of more than one and a half.

One of the most important causes of the virtually continuous growth in revenues deriving from special taxes is that a growing number of special taxes are present in the Hungarian tax system. Our previous, 2013 study already highlighted that in 2009 there were still only 4 types of special tax in effect (credit institutions' contribution, the energy tax, the energy suppliers' income tax – often referred to as the "Robin Hood tax" – and the taxes levied on the pharmaceutical industry). At least two more tax types were added to this figure in every subsequent year, so in 2010 there were 6 (with the bank tax, sector-specific special taxes added), in 2011 there were 9 (credit institutions' special tax, public health product tax, accident tax), in 2012 there were 10 (telecommunication tax), and in 2013, with the discontinuation of the sector-specific special taxes, but introduction of the utilities tax, insurance tax and financial transaction duty, there were a total of 12 special taxes in effect. In 2014 more changes took place as, mid-year, in lack of adequate preparation, the advertisement tax – which has since undergone countless amendments – has been introduced. With effect from 2015, the tobacco industry is burdened with a new type of healthcare contribution, and a special tax on investment funds and distributors has also been introduced.

The bigger jumps in the cumulative special tax curve (shown in Figure 2) correspond to the introduction of the new special taxes as described above. Clearly visible, for example, is the introduction in 2010 of the bank tax and sector-specific special taxes, which brought revenue growth of HUF 334 billion, as well as the HUF 341 billion increase in revenues resulting from the introduction of the three new tax types in 2013, although this was mitigated by the discontinuation of the sector-specific special taxes, representing an approximately HUF 155 billion drop. In 2014 there was no substantial increase; the introduction of the advertisement tax mid-year did not push revenues up significantly. In 2015 the extent of the cumulative special tax revenue fell for the first time since 2012, despite the fact that two new taxes were introduced in 2015[20], and the advertisement tax from then had to be paid in respect of the whole calendar year. The causes of this – especially those based on the change in the law on financial transaction duty and the investigations of the European Commission – shall be discussed in more detail later in this chapter.

The development of special tax revenues was also influenced by the change in the amounts generated by the individual special tax types. This can be attributed only partly to changes in the law (for example, tax rate increases resulting in revenue growth), because the changes in external, market factors influencing the tax base (e.g. turnover, number of transactions) also played a role. Since these external factors are difficult to calculate, and the impacts of the statutory changes are also not possible to estimate accurately, a discrepancy can often be observed between the revenues actually received and the planned revenues (targets). In many cases the budget overestimated the revenue that would be generated by the special taxes (see also *Figure 3*). In what follows we illustrate this with a few examples.

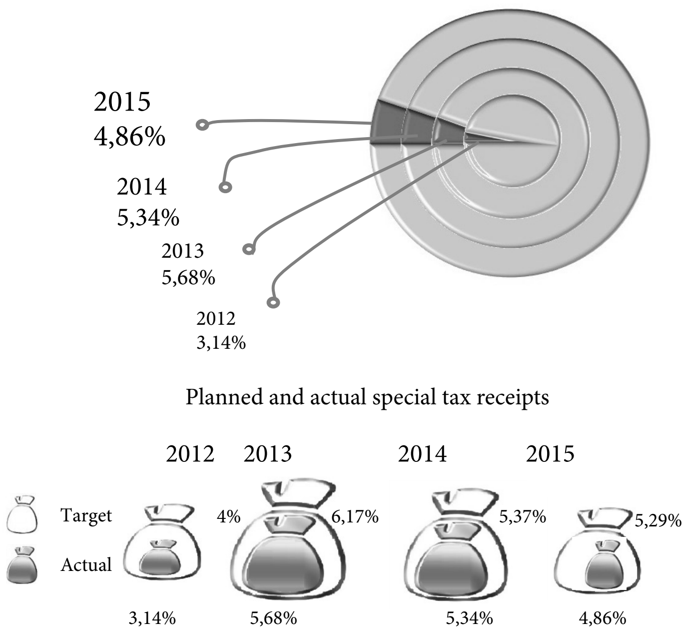
One of the main reasons for the dramatic rise in special tax revenues is that the number of such taxes has risen from year to year. The revenues were also af-fected by the constant amendment of the laws and other external factors (which were often unpredictable and sometimes even led to a reduction).

It has already been established that special tax revenues rose steeply in 2013, although they still fell short of the target by almost HUF 100 billion. The revenues

20 Of these, no target was available for the special tax on investment funds and distributors.

from the income tax on energy suppliers increased by a factor of almost ten in comparison to 2012, as a consequence of the expansion of the range of taxable persons and an increase in the tax rate (from 8% to 31%). The government-ordered reduction in utility fees could be one of the reasons why the revenue still fell significantly short of the target, because this reduced the sector's turnover. But also, from April 2013 the mining contribution became deductible from the tax[21].

Figure 3
Special tax revenues as a proportion of central budget revenues



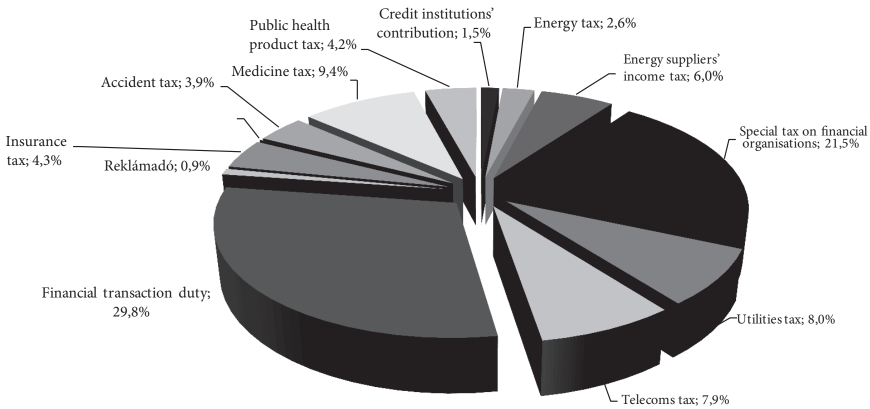
Source: KSH

The change was also considerable, but lower than planned in the case of the credit institutions' contribution, where the 2013 target projected a quadrupling of the 2012 revenue figure, but in the end it "only" doubled. The target is based on the change in the settlement of foreign currency loans under the exchange rate cap system, but fewer people than expected made use of the new system; in other

21 A Költségvetési Tanács Véleménye Magyarország 2013. évi központi költségvetése végrehajtásáról és az államadósság alakulásáról [The Budgetary Council's Opinion of the status of implementing Hungary's 2013 budget and projections of the deficit], Budgetary Council (2014), p. 8 and Elemzés az államháztartás 2013. I-VI. havi költségvetési folyamatairól [Analysis of the budgetary processes of January to July 2013], State Audit Office of Hungary (2013), p. 24

words, fewer borrowers than expected opted to repay their foreign currency loans at a fixed exchange rate[22].

Figure 4
Special tax burden in respect of the special taxes in effect in 2015



Source: KSH

Interestingly, the revenue from financial transaction duty in 2013 (HUF 260 billion) fell HUF 41 billion short of the target[23], despite the fact that the tax rate was raised in August 2013, and a one-off additional payment prescribed, precisely due to the discrepancy.

During the 2014 planning the legislature took into account the fact that the actual data were worse than the planned figures, and for several tax types based its calculations on less revenue than in the case of 2013. With regard to the financial transaction duty, the actual data exceeded the target, but in the case of the energy suppliers' income tax barely more than half of the (reduced) target actually flowed into the budget, which is less than even the 2013 actual data. The State

22 Under the statutory amendment, the settlement of the loss accruing from the exchange rate cap system changed in respect of 2013: the state pays the entire loss, then the banks pay their share, as speicified in the agreement, into the budget in the form of the credit institutions' contribution. See also: A Költségvetési Tanács Véleménye Magyarország 2013. évi központi költségvetése végrehajtásáról és az államadósság alakulásáról [The Budgetary Council's Opinion of the status of implementing Hungary's 2014 budget and projections of the deficit], Budgetary Council (2014), p. 8 and Elemzés az államháztartás 2013. I-VI. havi költségvetési folyamatairól [Analysis of the budgetary processes of January to July 2013], State Audit Office of Hungary (2013), pp. 23–24.

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Audit Office's analysis of the first half-year accounted for the negative impact of the government-ordered reduction in utility bills, but not for a decrease on this scale.[24] It is also thanks to the reduced target that there was no marked difference between the planned and actual data.

As regards 2015, the forecasts were even more pessimistic than those for 2014. The main reason for the reduced target was the planned loss of revenue from the financial transaction duty: it was HUF 71.7 billion (26%) below the 2014 actual data, because this tax no longer has to be paid on transactions launched between treasury accounts[25]. The pessimistic forecasts were borne out by the actual data: the fall in revenues (HUF 70 billion, in line with the forecast) from the financial transaction duty were not offset by the better-performing tax types, and thus the special tax revenues flowing into the central budget plummeted from the HUF 639 billion in 2014 to HUF 575 billion in 2015.

It should be noted that the tobacco-industry healthcare contribution, payable until 30 June 2015, would also have represented additional revenues: based on the target it was expected to bring almost HUF 12 billion. The actual data, however, reveals that barely HUF 540 million was received, which may have been partly due to the fact that the use of progressive tax rates was suspended as part of an investigation by the European Commission (see also: chapter 7).

Although the legislature altered the progressive rates of the advertisement tax (probably again due to the Commission's investigation), this resulted in no great loss of revenue as compared to the target. This is because although the new, 5.3% tax rate is considerably lower than the higher rates of the old progressive tax table (20–50%), at the same time the ceiling for application of the 0% rate plunged from HUF 500 million to HUF 100 million, and thus many more (previously exempt) businesses became liable to pay advertisement tax. Since the majority of Hungarian companies are small and medium-sized enterprises, this resulted in a considerable expansion of the range of taxable persons.

With regard to the weights of the individual special taxes within the tax system, it is worth highlighting that in 2015 the most special tax types that generated the most income were levied on the financial sector. The financial transaction duty and the special tax on financial organisations accounted for half of the cumulative special tax revenue; that is, the revenue flowing into the central budget and the National Health Insurance Fund (see Figure 4[26] and the end of *chapter 6*).

24 Elemzés az államháztartás 2014. I-VI. havi költségvetési folyamatairól [Analysis of the budgetary processes of January to July 2014], State Audit Office of Hungary (2014), p. 20.

25 Elemzés a Költségvetési Tanács részére a 2015. I. félévi költségvetési folyamatokról [Analysis for the Budgetary Council on budgetary processes in the first six months of 2015], State Audit Office of Hungary (2015), p. 20.

26 The special tax on financial organisations also includes the revenue from the special tax on credit institutions. There is no data on the special tax on investment funds and distributors.

Another characteristic of the efforts to fill the holes in the budget is the practice of introducing allowances and increasing tax burdens in parallel, which can also be observed in the case of the changes made within the individual tax types. Entering into force as of 1 January 2013, insurance companies were no longer subject to the bank tax, but from November 2011 they were burdened with the accident tax[27], and from January 2013 with the insurance tax.

With regard to the increase in the number of special taxes it is also worth mentioning that many of the taxes were only introduced for one tax year, then "extended" every subsequent year, thus making the tax burden into a permanent fixture. The most striking example of this is the special tax on financial organisations, the effect of which has been extended in every single tax year since its introduction in 2010, and it has still not been discontinued in spite of the promises made to the sector. The perpetual extensions were brought to an end by the mid-year tax changes of 2015, which (with effect from 2016) removed all references to the specific tax year – this suggests that the tax has become permanent and generally applicable. The situation is complicated further by the fact that the tax liability has (had) to be calculated on the basis of the financial statements for the 2009 tax year. It certainly eases budget planning, and indeed makes it more difficult to pursue tax avoidance strategies, if the tax liability has to be calculated from past data; however it raises the question of how ethical it is to levy burdens on the basis of results achieved in a more successful period of doing business, in a period with more difficulties present.

Another example of an initially temporary tax being made permanent is the tobacco industry healthcare contribution, effective since February 2015, which originally only related to the 2014 tax year, but became a permanent tax burden in the course of the mid-year tax changes.

> **A number of special taxes were only introduced on a temporary basis, then with time – contrary to the government's assurances – became permanent.**

It is also worth noting that although the majority of the special taxes are sector-specific, they are not reinvested in the sector concerned. Their revenues go into the central budget, not a special fund, and these sums are not earmarked for any specified purpose. The European Commission has also objected to this practice in the case of the special tax on the telecommunication sector (see chapter 7). Apart from the tax types that boost the revenues of the National Health Insurance Fund, the only exception is the tobacco industry healthcare contribution, which must be spent on the development of healthcare subsystems.

27 Here, however, the registered keepers of insured vehicles are the actual taxable persons.

Taxable persons attempt to make up for the additional tax burden partly by thinking about cutting costs, and partly by passing the tax on to consumers. We discuss these two strategies and their consequences in *chapters 5* and *6*.

4. FORCED INTRODUCTION AND ILL-CONSIDERED LEGISLATION

Since special taxes place a large burden on the businesses concerned, the amount of time they have to prepare for their introduction is of critical importance.

The old public finance act, until 29 September 2011, prescribed a mandatory 45-day introduction period between the promulgation and commencement of acts relating to payment obligations, the persons subject to the payment obligations and the extent of the payment obligation (except in case of a reduction). The legislators took the bare minimum of time permitted, and indeed, in several cases they did not even comply with this. In the case of the public health product tax introduced in 2011, for example, only 44 days elapsed between promulgation and commencement. Later, probably as a result of this haste, the introduction period was reduced to 30 days[28], and this was exploited to the full, with the speed of legislation increasing.

In the case of the telecommunication tax having been introduced in 2012, the sector only had 32 days to prepare.[29] Similarly short periods elapsed between promulgation and commencement in case of the special tax on investment funds and distributors (36 days) and the utilities tax (39 days). There are exceptions, however: with the accident tax 134 days, in the case of the financial transaction duty 162 days, and with the insurance tax 172 days passed between promulgation and commencement of the law.

What is more, in many cases the rapidly introduced taxes were not sufficiently well thought-through. According to the aforementioned audit by the State Audit Office in relation to the years 2007–2013, in the case of 3 special taxes (credit institutions' contribution, sector-specific special taxes, financial transaction duty), there had been no preliminary assessment whatsoever of the impacts of their introduction on the competitiveness of those concerned, employment and the budget, and nor had the likely benefits, drawbacks and risks been taken into account.[30]

28 Article 10 of Act XXXVIII of 1992 and Article 32 of Act CXCIV of 2011

29 We should also point out that the law itself granted a further 2 months for preparation after commencement.

30 JELENTÉS – az egyensúlyjavító intézkedések ellenőrzése- Az egyes egyensúlyjavító intézkedések és azok hatása a költségvetés végrehajtására című ellenőrzésről [REPORT – audit of measures to improve balance – On the audit entitled: Individual measures to improve balance and their impact on implementation of the budget], State Audit Office of Hungary (2015), p. 25

The situation is similar in the case of statutory amendments. Impact study sheets were made for only 4 of the investigated (non-technical) amendments, although this would have been necessary on 28 occasions according to the statutory requirements.[31] Although a retrospective impact study was performed in relation to the telecommunication tax, this would have been warranted in the case of many more tax types.[32]

One of the most important consequences of lack of preliminary research was that countless problems arose in the course of industry consultations and practical implementation, which they attempted to remedy through constant amendments. The best example of this is the advertisement tax, the first version of which was published in the official journal *Magyar Közlöny* on 17 June 2014, and should have commenced on 18 July 2014. The act was amended by parliament between these two dates, and the amendment was promulgated on 15 July. This postponed the final date of commencement to 15 August 2014. Irrespectively of this, the first tax advance declaration and payment obligation had to be fulfilled by 20 August 2014. Despite the amendment, countless problems of interpretation and questions arose, which the tax and customs authority, NAV, attempted to address in the form of an information leaflet and presentations for professionals. The "gaps" in the regulations, and the difficulties arising in practice, were corrected in subsequent statutory amendments (for example those that commenced in January and July 2015).

The impacts described above considerably raised the level of uncertainty among businesses, because it suddenly presented them with unexpected financing difficulties, which in turn damaged their financial planning ability. Moreover the situation was only aggravated by difficulties in interpreting the laws and the legislative "gaps" that they contained.

5. SPECIAL TAXES AND INVESTMENTS

As highlighted in our 2013 study, the introduction of special taxes can also be blamed for the decline in willingness to invest, the long-term impacts of which on the economy are uncertain for the time being.[33] Several other research studies

31 It should be noted that the Audit Office's report also covered tax types that are not discussed in this study.

32 JELENTÉS – az egyensúlyjavító intézkedések ellenőrzése- Az egyes egyensúlyjavító intézkedések és azok hatása a költségvetés végrehajtására című ellenőrzésről [REPORT – audit of measures to improve balance – On the audit entitled: Individual measures to improve balance and their impact on implementation of the budget], State Audit Office of Hungary (2015), pp. 17, 23 and 29

33 Vincze, János: *Középtávú előrejelzés a makrogazdaság és az államháztartás folyamatairól* [Medium-term projection of macroeconomic and budgetary processes], MTA (2015), p. 6

also support our finding in this regard. We would like to cite, as an example, the European Commission's annual macroeconomic analysis concerning Hungary. Both the analysis published in April 2013[34] and the one published in June 2015[35] highlight that the levying of taxes on certain sectors only could have contributed to the drop in investments. According to the analyses the possible reasons for this include, for example, a decrease in the companies (after-tax) profit, representing a reduction in the amount available to spend on investments, or the uncertain economic environment resulting from the changes (frequent changes in the law, sudden increase in the number of special taxes, which are subsequently made permanent). Moreover, the additional tax burden could discourage foreign investments, because it makes Hungary a less attractive investment location. In addition, the fact that the special taxes are only levied on certain sectors means that the effect they have on investments also distorts competition[36]. The 2013 analysis cites the above causes as part of the explanation for the fall in the investment rate to an all-time low, mainly in the sectors affected by the special taxes. As a consequence of this, Hungary plummeted 12 places (from 48th to 60th place) relative to the previous examined year, in the ranking of the Global Competitiveness Report 2012-2013 produced by the World Economic Forum[37].

The special tax burden, as a drain on the funds of the companies concerned, has a negative impact on investments irrespective of whether companies pay the new tax burdens from their own pocket (at the price of cost cutting) or pass them on to the consumers (which, by pushing up prices, can reduce demand and thus also the company's revenues). (See also the next chapter.)

According to the European Commission's analysis, the taxes levied on certain sectors have contributed to the decline in investments. Reasons for this include, for example, their negative impact on companies' (after-tax) profit and Hun-gary's attractiveness as an investment destination, as well the fact that they are partly responsible for the uncertain economic environment.

The Commission's position that special taxes cause uncertainty among (in many cases foreign) investors is corroborated by the annual economic reports of the German-Hungarian Chamber of Industry and Commerce (DUIHK). Several re-

34 Macroeconomic imbalances Hungary 2013, Occasional papers 137, European Commission (2013), pp. 23 and 25

35 Macroeconomic imbalances - Country Report Hungary 2015, Occasional papers 220, European Commission (2015), pp. 17, 44 and 54

36 Macroeconomic imbalances - Country Report Hungary 2015, Occasional papers 220, European Commission (2015), p. 44

37 Global Competitiveness Report 2012-2013, World Economic Forum (2013), p. 194

ports (for example the 2012 and 2015 reports) highlight that businesses which are less satisfied with Hungary, as an investment location, are less willing to invest in our country that those who are satisfied[38]. According to the 2015 report, 65% of companies that are satisfied with the tax system and tax administration plan to increase their investments, and only 6% would like to reduce them. In contrast, only 23% of dissatisfied companies wish to step up their investments, while 28% certainly want to cut back on them.[39] The significance of these statistics is increased by the fact that, according to the 2009-2015 reports, "tax burdens", as well as the "tax system and tax authority" are among the most criticised factors in the Hungarian investment environment.[40] Besides the strictness of tax authority audits a big role in this, according to the 2013 report, is played by the introduction of lots of new small tax types (special taxes), with the result that the tax system has not been simplified and the tax burdens have grown.[41]

The negative impact of special taxes on the perception of Hungary, as an investment location, is not only typical of the sectors directly hit by the special taxes, because the fear of introduction of a new special tax, or Hungary's reputation for having an unpredictable taxation environment, can also have an effect on potential investors in other sectors.

A potential decline in investments, however, has also placed one of the government objectives of introducing the special taxes – reduction of the budget deficit – in jeopardy. The investments shelved as a result of new or increased taxes hold back growth, and thus the revenues expected from the taxes can fall short of expectations. The European Commission's tax-themed report of 2014 states, for example with respect to the energy suppliers' income tax, that the Hungarian energy sector is effectively burdened with a 50% corporate tax rate[42]. It is probably also due to the negative impacts listed above that the Commission, in its 2015 analysis cited above, highly recommends that Hungary discontinues the sector-specific taxes[43].

38 *Konjunkturbericht Ungarn* 2012, DUIHK (2012), p. 23; and *Konjunkturbericht Ungarn* 2015, DUIHK (2015), p. 33

39 *Konjunkturbericht Ungarn* 2015, DUIHK (2015), p. 33

40 *Konjunkturbericht Ungarn* 2015, DUIHK (2015), p. 43

41 *Konjunkturbericht Ungarn* 2013, DUIHK (2013), p. 21

42 Taxation trends in the European Union, Eurostat, 2014 Edition. p. 96

43 Macroeconomic imbalances - Country Report Hungary 2015, Occasional papers 220, European Commission (2015), p. 62

6. WHO BEARS THE BURDENS?

In several cases the government's communication highlighted that certain special taxes are tools for taxing the banks and prospering economic players (for example, the "multinationals"). It is worth examining how successful this taxation strategy has been, and whether the burdens of special taxes really are borne by the actual taxable persons.

Among the special taxes discussed here, it is only true of the accident tax that the corporations (insurance companies) are only required to collect the tax, which is actually levied on the registered keepers of insured vehicles, who may also be private individuals. In the case of all the other tax types, the taxable persons are mostly or exclusively companies and businesses. It is safe to assume, however, that the latter – as a part of their market strategy – incorporate the additional burdens of the special taxes into the prices of the goods they sell and the services they provide, and at the end of the day these too are paid, at least in part, by the consumer.

A study[44] of the terms and conditions of 24 Hungarian banks in 2010 found that the introduction of the bank tax coincided with a greater-than-usual increase in the handling charges and disbursement fees for loans, and in account management and transfer fees.

> **In many cases companies incorporate the additional burdens caused by the spe-cial taxes into the prices of the goods they sell and the services they provide, so at the end of the day these too are paid, at least in part, by the consumer.**

The introduction of the financial transaction duty had similar consequences. According to an analysis[45] published in the March 2014 review of the National Bank of Hungary (MNB), the 11 largest credit institutions passed the transaction duty on to customers in several steps, both at the time of introduction of the special tax and at the time of subsequent increase in the rates. This took place partly through the raising of the charges for transactions (cash withdrawal, transfer, bank card payment), and partly through an increase in bank card fees. Indeed, in the period concerned from December 2012 to October 2013, the extent of the fee hikes at certain banks exceeded the justifiable level of the transaction duty, with this mainly affecting natural persons – the amount passed on to corporate customers did not

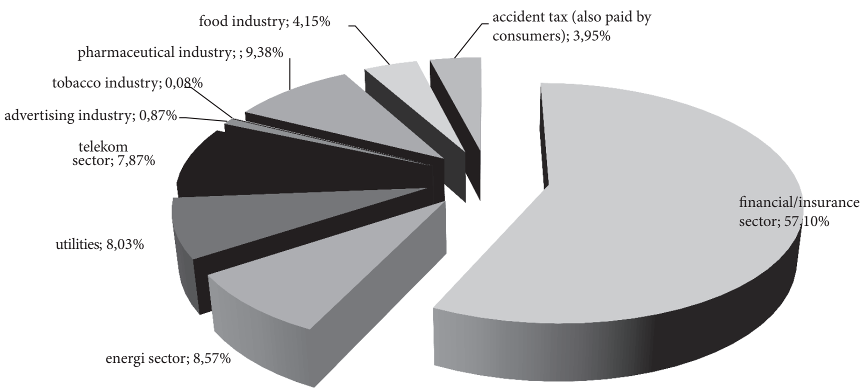
44 *Világgazdaság Online:* "Díjemeléssel reagáltak a bankok a különadóra" [Banks raise fees in response to special taxes], 28/10/2010

45 Tamás Ilyés – Kristóf Takács – Lóránt Varga: *A pénzforgalmi szolgáltatások díjainak és a pénzforgalom szerkezetének alakulása a pénzügyi tranzakciós illeték bevezetését követően* [Transformation of the structure of payment service fees and payment services in the wake of introducing transaction duty], MNB (2014), pp. 40-41

exceed the extent of the duty[46]. This passing on of the duty, which in many cases was unlawful, did not stay unsanctioned. A spokesman for the Hungarian Financial Supervisory Authority (PSZÁF) pointed out in an interview that, by August 2013, several banks had had to repay a total of HUF 300 million to customers, but also emphasised that, within the constraints of the law,[47] passing on the duty is a legitimate practice.[48]

Above factors may also have played a part in the fact that the legislature, in 2013, passed a law compelling financial institutions to provide their customers (if they made a declaration requesting it) with two free-of-charge cash withdrawals a month, up to a total amount of HUF 150,000[49].

Figure 5
Special tax burden on the individual sectors in respect of the special taxes in effect in 2015



Source: KSH

A potential consequence of the price increase resulting from the passing on of taxes is a drop in consumption. In case of the transaction duty this meant that, af-

46 Tamás Ilyés – Kristóf Takács – Lóránt Varga: *A pénzforgalmi szolgáltatások díjainak és a pénzforgalom szerkezetének alakulása a pénzügyi tranzakciós illeték bevezetését követően* [Transformation of the structure of payment service fees and payment services in the wake of introducing transaction duty], MNB (2014), p. 41

47 According to the rules, news fees may not be introduced and the method for calculating the fees may not be changed due to an increase in the transaction duty, and the rules on notification must also be complied with: customers must be notified of the increase at least 60 days in advance, and the extent of the increase must also be stated at least 15 days in advance.

48 *Adó Online*: "PSZÁF: jogtalanul hárították át a tranzakciós illetéket" [Hungarian Financial Supervisory Authority: passing on transaction duty is illegal], 29/08/2013

49 Article 36/A of Act LXXXV of 2009

ter its introduction the number of retail bank accounts decreased by 340,000, to a four-year low as of September 2014.[50] These problems do not only affect Hungary. In July 2014 the results of an investigation carried out by the European Commission on the (non-harmonised) taxes (special taxes) levied on the food industry were published, which concluded that the additional tax burdens change consumer habits and may have a negative impact on the competitiveness of the sector concerned.[51]

The price increases resulting from special taxes is not only bad news for consumers, as the drop in consumption, the deterioration of turnover in the given sector, ultimately leads to a shrinking of the economy. A consequence of the "price hike" by banks could be a fall in the extent of loans taken out, the effects of which may be felt in sectors which are not burdened by a special tax. The aforementioned 2013 macroeconomic analysis by the European Commission also highlights that the special taxes levied on the financial sector have contributed to a tightening of lending terms and the resultant decline in corporate loans.[52] This in turn has an impact on the appetite for investments (see previous chapter).

Not taking into consideration the examples given above, it is quite hard to prove that special taxes are being built into consumer prices, as they do not appear as a separate item on invoices. One of the requirements of the public health product tax is that the sellers (e.g. discount stores) must indicate on every invoice or receipt that the tax liability is borne by the seller. This does not mean, however, that those liable for the tax have not (at least partially) built the additional costs resulting from the tax burden into the prices of the products concerned. We should point out here that an increase in prices (or removal of discounts) is not in itself sufficient proof, as there may be countless other possible reasons for this.

It is also worth examining, with regard to the group of taxable persons, which sectors pay special taxes. In our 2013 study, too, we pointed out that the brunt of the sector-specific taxes is borne by the banking and insurance sector and the energy sector. Our present research shows that this continues to be the case, as only these sectors are burdened with more than one type of special tax. The special tax burdens of the sectors in 2015 are summarised in Figure 5 and, in more detail, in the table below:

50 *Adó Online:* "Több százezer bankszámla tűnt el" [Hundreds of thousands of bank accounts disappeared], 06/01/2015

51 European Commission: Food taxes and their impact on competitiveness in the agri-food sector, a study, 16/07/2014

52 Macroeconomic imbalances Hungary 2013, Occasional papers 137, European Commission (2013), pp. 17 and 23

Table 1
Special tax burdens of the individual sectors in 2015

Sector	Number of special taxes	Special tax burden (HUF billion)	Special tax burden (%)
finance/insurance sector	6	397.4	57.1%
energy sector	2	59.7	8.6%
utilities	1	55.9	8.0%
telecommunication sector	1	54.8	7.9%
advertising industry	1	6.1	0.9%
tobacco industry	1	0.5	0.08%
pharmaceutical industry	1	65.2	9.4%
food industry (hamburger tax)	1	28.9	4.1%
accident tax[1]	1	27.5	4.0%
Total	**15**	**696**	**100%**

Source: KSH

Overburdening the financial and insurance sector is not only reflected in the disproportionately high number of special taxes (6 out of 15). In 2015 some 57% of the total (that is, not only taxes paid into the central budget) special tax bill (HUF 696 billion) was paid by this sector, while in second place – far behind – are the energy sector, the telecommunication sector and the pharmaceutical industry, with "only" 7–9% of the burden.

7. SPECIAL TAXES UNDER FIRE FROM THE EU

The European Commission has investigated whether the individual special taxes conflict with EU law several times in recent years.

In our 2013 study we highlighted that in March 2011 the Commission launched an infringement procedure against Hungary in connection with the **sector-specific**

special tax levied on the telecommunication sector.[53] Based on the Commission's reasoning, the special tax runs contrary to EU regulations (the Authorisation Directive 2002/20/CE), which state that revenue from a special tax levied on the telecommunication sector may only be used for specified purposes (e.g. to cover administrative and regulatory costs related to the telecoms sector). The issue was eventually resolved by the discontinuation of sector-specific special taxes.

The other procedures and investigations launched by the Commission can be divided into two main groups. The first includes the procedure in which the Commission criticised discrimination against foreign businesses in favour of their Hungarian competitors. In the 2012 procedure[54] **relating to the sector-specific special tax on telecoms activity** and **shop-based retail trade**, it was emphasised that in the Hungarian market Hungarian businesses are typically smaller than their foreign-owned competitors. In this way the latter – due to their higher sales revenue – were penalised with a disproportionately high special tax burden due to the progressive taxation rates. Consequently, the Commission called upon Hungary to amend the law within two months. This issue, too, was eventually resolved by the discontinuation of sector-specific special taxes.

The other package of inspections by the Commission includes cases where the focus of attention is not on discrimination against foreign businesses, but on the presence of selective competitive advantages granted to certain market players. Two detailed investigations launched in 2015 – and still not closed – pose the question of whether the special characteristics of the sectors concerned warrant the use of a progressive tax rate, in connection with the **food chain supervision fee** and the **healthcare contribution for tobacco-industry companies**.[55] While the progressive tax rate of the inspection fee, effective from January 2015, only affects certain taxable persons (shops that sell durable consumer goods), the progressive rate structure of the tobacco-industry companies' healthcare contribution, effective from 2015 applies to all taxable persons. The Commission is concerned that companies with lower turnover gain an advantage over the competitors, in breach of the rules. Until the investigations are completed, and Hungary provides satisfactory justification, the Commission has prohibited the use of the progressive tax rate in both cases[56]. National economy minister Mihály Varga said that

53 European Commission: Digital Agenda: Commission opens infringement procedure against Hungary over 'telecoms tax', Brussels, 14/03/2011

54 European Commission: Memo – November infringements package: main decisions, Brussels, 21/11/2012

55 European Commission: Press release – State aid: Commission opens two in-depth investigations into Hungary's food chain supervision fee and tax on tobacco sales, Brussels, 15/07/2015

56 *Adó Online:* "Nem kell progresszív ehot fizetni" [Progressive 'eho' tax rate not required] 11/08/2015

the decision will result in a HUF 35-40 billion loss for the budget[57]. The actual data show that the loss amounts to HUF 11 billion in the case of the tobacco industry healthcare contribution alone (see also Chapter 3).

The government reacted in various ways to Brussels' clampdown. Firstly, in October 2015, it petitioned the Court of Justice of the European Union to overturn the Commission's injunctions[58]. In addition to this – as an alternative to the criticised tobacco industry healthcare contribution – it mooted the introduction of a special tax on the tobacco industry, against which the Commission raised no substantive objection.[59] As regards the statutory regulations, with effect from 27 December 2015 the progressive rates of the inspection fee were discontinued, which also lifted the exemption for shops with a tax base of less than HUF 500 million. In the case of the tobacco-industry healthcare contribution, the progressive taxation structure remains effective to this day, but is not enforced.

It should be noted that the same criticisms were voiced in a detailed investigation into the **advertisement tax**[60], which was launched in March 2015. It is perhaps due in part to the Commission's investigation, that the rates applicable to the primary payers of the advertisement tax changed with effect from July 2015[61]. The legislature significantly modified the progressive tax rate structure, exempting businesses for the part of the tax base up to HUF 100 million, and levying a 5.3% advertisement tax on the part of the tax base in excess of this. The legislature also allowed the retroactive application of the new tax rates, in respect of 2014.

The European Commission has investigated whether the individual special taxes conflict with EU law several times in recent years. As a result of this, the use of the progressive tax rates is currently prohibited in the case of two tax types.

We wish to point out that, in the above cases, the Commission never criticised the existence of the special tax in question, Hungary's right to tax certain sectors, or the extent of the maximum tax rate. It merely investigated (is investigating) whether the special tax in question breaches any EU rule (under competition law or in connection with state aid) by placing certain businesses under a disproportionately greater tax burden with no objective reasons for doing so.

57 *Adó Online:* "Varga védi a különadókat" [Varga defends special taxes], 17/07/2015

58 *Adó Online:* "Bíróságon védené meg adóit a magyar állam" [Hungarian state seeks to defend special taxes in court], 19/10/2015

59 Magyar Idők Online: "Elbuktak a dohánycégek a kormánnyal szemben" [Tobacco companies lose against government], 02/12/2015

60 European Commission: Press release – State aid: Commission opens in-depth investigation into Hungarian advertisement tax, Brussels, 12/03/2015

61 The rates applicable to the secondary payers were also reduced, from 20% to 5%, but the EU's investigation was not concerned with this.

8. THE EUROPEAN PERSPECTIVE

In Chapter 2 of our study we highlight that in recent years – with the exception of 2015 – taxes on consumption have increasingly taken over from taxes on income. Based on our latest study, in terms of the European Union average, this trend was slightly different to the one in Hungary. The European Commission's 2014 report processes the statistics of Eurostat up to and including 2012. According to this, the (weighted) average of consumption-based tax revenues, relative to total tax revenue, grew slowly in the twenty-eight EU member states in recent years, although a small decrease was observed in 2012 (2009: 28%, 2011: 28.9%, 2012: 28.5%). At this time, Hungary "boasted" the fifth highest ratio in the EU.[62]

Eurostat's latest statistics, using a slightly different structure, now include the 2013 data as well, and these figures also support our conclusions. This shows that the weighted average of taxes on production and imports (which comprise VAT and other taxes on consumption) started to decrease slightly relative to total tax revenue in 2013 (2009: 32.6%, 2011: 33.6%, 2013-ban 33.5%). The question is whether this is a temporary dip or a lasting trend reversal.

The cause of the initial upward tendency could be, for example, the rise in VAT rates, the broadening of the tax bases, or the growing internal demand. VAT rate increases in accordance with the main rule were carried out by 20 member states between 2008 and 2014[63]. As a result of these, the EU's average VAT rate rose from 19.5% in 2008 to 21.6% in 2015.[64]

Where taxes on income are concerned, the opposite trend can be observed. The share of these taxes within total tax revenue decreased as a consequence of the crisis, but since 2010-2011 it has again shown uninterrupted growth, although it has not yet returned to the pre-crisis level (2010: 29.5%, 2011: 29.6%, 2013: 30%). Interestingly, this has been especially pronounced in the case of taxes on personal income in recent years, while since 2011 a slight drop has been observed in the revenues of income taxes levied on companies. One reason for this could be that most of the member states are reducing their corporate tax rates in order to improve their position in the tax competition between states. The EU's average corporate tax rate fell from 23.8% in 2008 to 22.8% in 2015.[65]

Having said that, the share of the individual tax types within overall revenue depends on countless factors: it is highly dependent on the peculiarities of the tax system of the country concerned, and a high percentage share could just as easily be due to a high tax rate as to a broad base of taxable persons.

62 Taxation trends in the European Union, Eurostat, 2014 Edition. p. 214
63 Taxation trends in the European Union, Eurostat, 2014 Edition. p. 25
64 Taxation trends in the European Union, Eurostat, 2015 Edition. p. 141
65 Taxation trends in the European Union, Eurostat, 2015 Edition. p. 145

As regards the individual special taxes, the other EU member states – similarly to Hungary – also introduced a number of special taxes in response to the crisis, or raised the rates of existing special taxes in certain sectors. In view of the fact that in Hungary the special taxes mainly burdened the finance/insurance sector, we mainly concentrate on these in our present research. Although Hungary was at the forefront of introducing bank taxes, we were not the first. According to Levente Kovács's 2012 study[66], a total of 17 EU member states had introduced a bank tax (mostly between 2010 and 2012), and in several countries special taxes on banks had existed long before the crisis: taxes and/or duties levied only on the banking sector were introduced in Belgium in 1997, in the United Kingdom in 1984, and in Greece in 1975.

A major difference shows, however, in the implementation of the "bank tax" at any given time. A total of 15 countries calculated the special tax based on balance sheet items, 3 member states levied such taxes on the basis of the financial institutions' earnings and bonuses paid, while in 3 countries a form of transaction tax is applied. There were also member states that introduced more than one of these, and in France all three types are applied. It is noteworthy that 3 member states (France, Netherlands, Italy) introduced special taxes in 2010, or after, that were levied on high bonuses paid in the financial sector.

A comparison of the tax regimes in the financial sector is further nuanced by the question of whether the tax payments constitute revenue for the central budget or are ring-fenced for special purposes. While in Hungary, in line with the European trends, the taxes levied on the banking sector are added to the central budget, in 2012 certain bank taxes in Germany, Italy, Sweden, Cyprus, Slovenia, Slovakia and Latvia flowed, either in full or in part, into a special financial stability fund. The revenue from the French bonus tax contributed to a special fund to assist bank innovation[67].

Other EU member states have also introduced various types of special taxes in response to the crisis, but in a few countries special taxes existed long before the crisis.

Bank tax, however, is not only a concept that appears at local, member state level; the issue has also been on the agenda of the European Commission. In September 2011 the Commission published a draft EU directive on the introduction of a

66 Levente Kovács: "Banki különadók az Európai Unióban" [Special bank taxes in the EU]. In: *Pénzügyi Szemle* 2012/3. pp. 360-362

67 Levente Kovács: "Banki különadók az Európai Unióban" [Special bank taxes in the EU]. In: *Pénzügyi Szemle* 2012/3. pp. 360-362

transaction tax[68]. The original plans presented a tax that extended to every member state with a uniform rate, and urged its enactment in national legislation by the end of 2013. This, however, divided – and continues to divide – the opinions of member states on a number of levels, including the impacts of the new tax type and countless practical issues (e.g. whether the "EU bank tax" were to be paid into the EU budget).[69]

The deadline for its possible introduction has been kept being delayed, and is currently still in the negotiation phase. In September 2015 the finance ministers of 11 member states debated the matter, and according to plans the introduction of the tax will definitely not take place earlier than in 2017.[70]

In addition to the banking sector, we can also find other examples of taxes levied on the energy sector. As a weighted average of the 28 EU members in 2012, taxes on energy ("environmental taxes – energy") accounted for 4.6% of overall tax revenue.[71] One such tax is the German nuclear special tax, which is levied on the operators of atomic power stations on the basis of their use of fissile materials, with the revenues intended to cover the costs to the German central budget of the rehabilitation of a mining facility to be used as a nuclear waste disposal site.[72] Latter tax was also investigated by the Court of Justice of the European Union, but in June 2015 was found to not run counter to the EU regulations.[73]

There are also some sector-specific taxes that are not present in the Hungarian tax system. One example of these is the British Air Passenger Duty[74], which is levied on passenger flights departing from airports in the United Kingdom, on the basis of the number of passengers.

Special taxes have also been introduced outside Europe: taxes similar to the Hungarian sector-specific tax on telecoms operators exist in several US states, such as Illinois[75] or Tennessee[76], although the latter is also levied on television broadcasters. India has also introduced a special tax on advertising agencies, which is comparable to the Hungarian advertisement tax.[77]

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68 Levente Kovács: "Banki különadók az Európai Unióban" [Special bank taxes in the EU]. In: *Pénzügyi Szemle* 2012/3. p. 356

69 Levente Kovács: "Banki különadók az Európai Unióban" [Special bank taxes in the EU]. In: *Pénzügyi Szemle* 2012/3. p. 357

70 *Adó Online:* "Uniós tranzakciós adó: egy lépéssel közelebb" [EU transaction duty: a step closer], 14/09/2015

71 Taxation trends in the European Union, Eurostat, 2014 Edition. p. 242

72 *Magyar Nemzet Online:* "A szennyező fizet: jogszerű a német nukleáris különadó" [The polluter pays: German nuclear special tax legitimate], 04/06/2015

73 *World Nuclear News:* Nuclear fuel tax case reverts to German courts, 10/06/2015

74 House of Commons Library: Air passenger duty: introduction, 19/09/2012

75 Illinois Revenue database: Telecommunications Tax.

76 Tennessee State Government: Television and telecoms tax page

77 Central Board of Excise and Customs, Government of India: Service tax page

In summary it can be said that other EU member states have also introduced various types of special tax in response to the crisis, and in several countries special taxes existed long before the crisis – some outside of Europe. Although no detailed comparative analyses are available, it is perhaps no exaggeration to say that, when it comes to special taxes, the Hungarian tax system presents one of the most varied pictures in Europe.

9. OUTLOOK – NOVEMBER 2016

Since the study was first published (March 2016), several relevant changes have come to light: from January 2017 the number of special taxes will decrease – for the first time in a long period – with the planned phasing-out of the credit institutions' contribution from the Hungarian tax system. This tax accounted for barely 1.5% of special tax revenues in 2015, so it is not a significant change.

It would be premature, however, to talk about a dismantling of the system of special taxes. According to the present pans, from 1 January 2018 a so called tourism development contribution will be introduced, which will be payable at a rate of 4% on the net price of restaurant catering services (served foods and non-alcoholic beverages prepared on the premises). Concurrently with this, however, the applicable VAT rate will drop to 18% from 2017 and 5% from 2018; in other words, the aforementioned practice of simultaneously introducing new allowances and new tax burdens seems to continue.

As regards the investigations of the European Commission, in July 2016 the Commission established[78] that both the food chain supervision fee and the progressive rates of the tobacco industry healthcare contribution provide a selective advantage for businesses with lower turnover, and as such they breach the EU's rules on state aid. Hungary was unable to prove that the objectives of the two tax types justified the use of a progressive rate structure (for example, by demonstrating that the cost of food chain safety inspections were higher in case of larger companies, or that the harmful effects of using tobacco products increases proportionately with sales revenue). Because the use of the progressive tax rate was suspended in 2015, the state does not incur a repayment obligation towards the businesses concerned. The progressive tax rate of the food chain supervision fee has not been effective since 27 December 2015, but in case of the tobacco-industry healthcare contribution the law has not yet been changed.

78 European Commission: Press release – State aid: Commission finds Hungary's food chain supervision fee and tax on tobacco sales in breach of EU rules, Brussels, 04/07/2016

The investigation into the advertisement tax was concluded in November 2016 with a similar result[79], to the effect that the progressive rate of the tax provides certain companies with a selective advantage that is not warranted by the objectives of the tax. As mentioned before, the rates applied for primary payers of the advertisement tax changed with effect from July 2015. The Commission's press release, however, reveals that Hungary did not consult with the Commission in this regard, and the progressive tax rate structure comprising the two tax rates currently in effect (0% and 5.3%) still discriminates between taxable persons without justification. As a consequence, the Commission has ordered Hungary to eliminate the unjustified discrimination (the progressive tax rate structure of the advertisement tax), and determine the tax payable retrospectively by the individual companies (as "state aid" to which they were not entitled).

Both investigations highlighted that Hungary is entitled to determine its own taxation rules, as well as the objectives of certain tax types, but cannot breach EU law, including the rules governing state aid. As Margrethe Vestager, Commissioner for Competition policy put it[80]: "Hungary is in the full right to finance the cost of its food inspection activities and to levy a tax on tobacco products to finance its health system. However, Hungary should make sure that all companies are treated alike so that the contributions are levied on non-discriminatory terms."

As an additional observation, we also note that with effect from 2017 the legislators are correcting an anomaly in the Hungarian tax system that has long been controversial (not least an ethics standpoint): at last, the special tax on financial organisations will not have to be assessed by the taxable persons on the basis of the 2009 financial report, but on the basis of the second tax year preceding the tax year in question.

It is clear from the above, also, that at present (November 2016) we do not know of any events that will have any truly substantial effect on the system of special taxes in Hungary. The result of the two EU Commission investigations mentioned above, however, have made it clear (once again) that despite the absence of EU harmonisation, special taxes are not a source of revenue that can be shaped by the Hungarian legislature freely at will.

79 European Commission: Press release – State aid: Commission finds Hungarian advertisement tax in breach of EU rules, Brussels, 04/11/2016

80 European Commission: Press release – State aid: Commission finds Hungary's food chain supervision fee and tax on tobacco sales in breach of EU rules, Brussels, 04/07/2016

10 SUMMARY

To sum up, we can ascertain that the spread of special taxes has continued in recent years, and they have become increasingly integral to the Hungarian tax system. The number of these taxes has risen from year to year, and the revenues deriving from them have grown in almost every year, exceeding in total the revenues from corporate tax in almost every year (with one exception) since 2010. Their popularity is best illustrated by the fact that several taxes were originally intended to be temporary or to only remain in effect for a few years, but have since become permanent features of the Hungarian tax system. The main cause of the dramatic revenue growth has been the continuous increase in the number of special taxes. The impact of statutory amendments and external, market factors on the revenues from such taxes is also by no means insignificant.

The year 2015 was exception to the general trend of the spread of special taxes, and this was mainly due to the decrease in financial transaction duty based on a change of law. A similar braking effect was exerted by the investigations of the European Commission, which prohibited the use of a progressive rate structure in the case of several tax types. It would be premature, however, to draw any conclusions as to whether this is the precursor of a lasting downward trend, or only a temporary dip.

The special taxes represent a "convenient" alternative to the "traditional" tax types, because their introduction does not breach such powerful EU harmonisation obligations and controls as, for example, the directive-level regulations governing VAT. Nevertheless, the Hungarian legislature still has to take certain EU provisions into account, or there is a danger that the European Commission will launch an infringement procedure on grounds of a breach of EU competition-law rules, or will investigate whether the tax-law regulations in question could be reclassified as prohibited state aid.

The increasing prevalence of special taxes, however, also raises a number of serious problems. For the taxable persons concerned it represents an additional burden, for which they have to apportion funds. The cost cutting measures used to achieve this can lead to a drop in investments, to the detriment of their economic growth and thus to their future revenues. This, however, also has an impact on the extent of the (income) taxes that they pay. Another possible strategy for taxable persons is to pass the special taxes on to consumers. Although this (seemingly) solves the problem, it holds back consumption and, ultimately, can reduce the companies' profits and the competitiveness of the sector in the same way as if they had borne the burden of the special tax themselves. Whether the taxable persons opt to absorb the special taxes or pass them on, there is a danger that their growth will be negatively impacted by them.

This phenomenon is not only observed in the sectors that are directly affected by the special taxes, but in other sectors too, due to spillover effects. This is only exacerbated by the sense of unpredictability resulting from their rapid introduction, and the unplanned financing problems and difficulties of interpretation arising as a consequence of ill-considered legislation. The reputation of an uncertain tax system can also scare off foreign investors, which could cause damage that is difficult to quantify in terms of the country's competitiveness. Due to the above factors, the government's revenues can increase in the short term, but in the long term special taxes may even have harmful consequences.

Assuming that the government insists on the additional revenues derived from the special taxes in spite of such problematic aspects[81], and does not wish to discontinue these tax types (or at least not all of them), then it is advisable to consider how the system of special taxes could be made sustainable in the longer term. One such method could be reducing the difference in the special tax burden between the sectors, the more consistent distribution of the burdens, since multiple tax burdens on companies (e.g. financial and energy sector) can cause serious damage in the long term. The most important step to prevent an uncertain economic environment that discourages investors could be to hold preliminary and regular consultations with the stakeholders, and to perform a thorough investigation (review) of the impacts associated with the given tax type. With regard to the introduction or discontinuation of a new special tax, it is advisable to give careful consideration to the long-term direct and indirect consequences, the economic and social spillover effects, and how the given tax type fits into the tax system. Given that certain member states of the EU have also introduced various types of special taxes (partly in response to the crisis), it would be useful to analyse the findings gathered in those countries, and consider following such "best practices" in Hungary, too.

81 *Mandiner Blog:* "Lázár: Maradnak a különadók" [Lázár: special taxes here to stay], 10/02/2015

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