MINISTRY
FOR NATIONAL ECONOMY

Hungary's flat-rate personal income tax

Focus

From 1 January 2011, Hungary will have a flat rate personal income tax system with a 16 percent flat-rate personal income tax. The change is aimed at improving the competitiveness of the Hungarian tax system, and is a crucial step towards the creation of a new economic system in the country. However, the new personal income tax system is not only new because it applies a flat tax: it will also create family-friendly taxation with tax credits for each child, reducing the tax liabilities of families with children. The new system also makes taxation much less complicated. We are witnessing the creation of the simplest tax system in the European Union and its acceptance will be yet another Hungarian speciality, a 'new Hungaricum'.

Background

The Hungarian personal income tax system **introduced in 1988** has been very complicated, **over-regulated and non-transparent**. In addition, in Hungary the tax burden is too heavy in general, especially the taxes on employment. There are two tax rates applicable to wages, but there are some forms of income which are subject to different tax rates. Until now, taxpayers have tended to declare their incomes as subject to the lowest possible tax rates or they have not declared some of them at all. **We would like to put an end to this practice.**

Hungary must adapt: the current rate of Hungarian personal income tax is far too high, especially when compared to that of our immediate competitors. Nowadays, the most successful countries apply a flat-rate tax, and with the appearance and rapid spread of this system, a "new wave" of European taxation, the tax competition between countries has grown fiercer.

There are a number of advantages to the introduction of a flat-rate tax:

- The complicated personal income taxation system is **simplified**, because every type of income is subject to the same tax rate.
- A lower tax rate encourages **higher performance**

- People will have more disposable income, resulting in a **higher level of both consumption and savings**
- Tax declaration, monitoring and tax administration will be **less complicated** and more **transparent**
- The positive impact on economic competitiveness makes it attractive for domestic and foreign **investors** alike
- In spite of an initial fall in tax revenues, the new system may eventually result in an increase in tax revenues for the central administration, as more and more people evading tax will declare their income and **become legal taxpayers**
- With the transformation of the personal income tax system and the introduction of a proportionate flat-rate tax, employees will have more disposable income and the **costs of employment will fall**
- The effects of a reduced tax burden will become apparent from 2012, and our calculations indicate that this will help **create around 40,000 new jobs** annually.

Cornerstones

- As one of the cornerstones of the draft legislation prepared by the Ministry for National Economy aimed at transforming liabilities on personal income to create **proportionate and uncomplicated taxation**, there will be a uniform, flat-rate tax imposed on every type of income.
- The draft legislation helps do away with the over taxation of employment and fix the problem of a disproportionate tax burden. The new system will bring about a **substantial change**; everyone in work will enjoy the advantages of these measures.
- There will be no change in the current regulation on the definition of **tax base** in 2011. This means that the tax base will be equal to 127% of income.
- Further simplification of the tax system will involve the phasing out of the tax base supplement: in 2012 this will be cut to 13.5% (i.e. by half) and from 2013 will no longer exist.
- Personal income tax will be reduced for all income, not only for salaries: **the tax rate will be 16 percent** on all income requiring the payment of personal income tax. On the sale of real estate, dividends and interest, most cases will see a reduction of 9%, a substantial change.

The tax credits system will be retained. During the planning of proportionate taxation particular attention was given to low-income groups**.** Up to now, those earning around the minimum wage level have not had to pay personal income tax, and even those on an average salary have benefitted in the form of tax credits resulting in a very low tax liability. The new flat tax rate system, however, will apply to everyone across the board regardless of their salary.

To avoid a situation where people have to deal with unexpected payments, the tax credit system (i.e. the method used to reduce the amount of liabilities) will be retained. For next year, the projected tax credit is 16% of the salary but a maximum of HUF 12,100 per month. In other words, the tax credit system can be fully exploited if the annual salary is no more than HUF 2,750,000, when the total tax credit available is HUF 12,100 per month for 12 months. For those in the HUF 2,750,000–3,960,000 a year income bracket, there is a lower rate of tax credit, and for those earning more than HUF 3,960,000, no tax credit is available. The calculations are done in the following way: HUF 2,750,000 is deducted from the total annual income and 12% of the remainder is calculated. This amount is then deducted from the maximum available tax credit, i.e. HUF 145,200 (HUF 12,100 x 12 months).

There will also be some **tax credit options** to lower the overall tax liability, for example voluntary contributions to private pension funds will be tax deductible. In 2010 the proportion of the deductible part of such a contribution was modified to 20%.

To help families, we are creating a personal income tax system to support couples wanting to start a family, and eligibility will no longer depend on how much the parents earn.

There will be a **family tax credit system** for families with children. Families with one or two children will be able to reduce their tax base by HUF 62,500 a month for each child, and for families with three children this will increase to HUF 206,250 a month per child. By claiming these tax credits, a tax saving of HUF 10,000 per month for each of the first two children, and HUF 33,000 for parents with three or more children can be made.

A solution that **may help ease the country's demographic problems** is that from 2011, for families with three or more children, any monthly income up to HUF 487,206 gross will be exempt from personal income tax, and, since the family discount can be divided between the parents, both of them may be exempted from paying it. In contrast to this, in 2010 a parent with three children could claim such a tax credit on up to HUF 55,580 of his/her total income.

Furthermore, **some other forms of income will become tax free**. Although **pension benefit, child care allowance, scholarships** and **employer's housing subsidy** have been tax free until now, **they had to be added to salaries** and tax had to be paid on the basis of this increased amount. As a consequence, a scholarship could move someone's income into a higher tax bracket or make them ineligible for tax credit. In a flat-rate system, this current rule would become meaningless, so **it will be abolished from 1 January 2011**.

Conclusion

So we expect the once-glorious competitor who has been lagging far behind finally to break through to a leading position in Europe. With its soon-to-be introduced tax system, Hungary aims to become the **most competitive country in Europe**. The proportionate, transparent, family-friendly personal income tax system will serve this end.

Budapest, 16 November 2010

Ministry for National Economy