MINISTRY
FOR NATIONAL ECONOMY

Taxation system: left behind by the competitors

In Hungary the revenues from indirect taxes are much higher than average

Focus

The key indicator to judge the competitiveness of an economy is the amount of general tax liabilities. If enterprises consider administrative costs too high, they may opt to scale back production and investments or would-be investors may decide not to come to Hungary. As a result of the tax measures implemented during the last couple of months, the tax burden fell to 37%, but it is still more than the average of the Visegrád group members.

Background

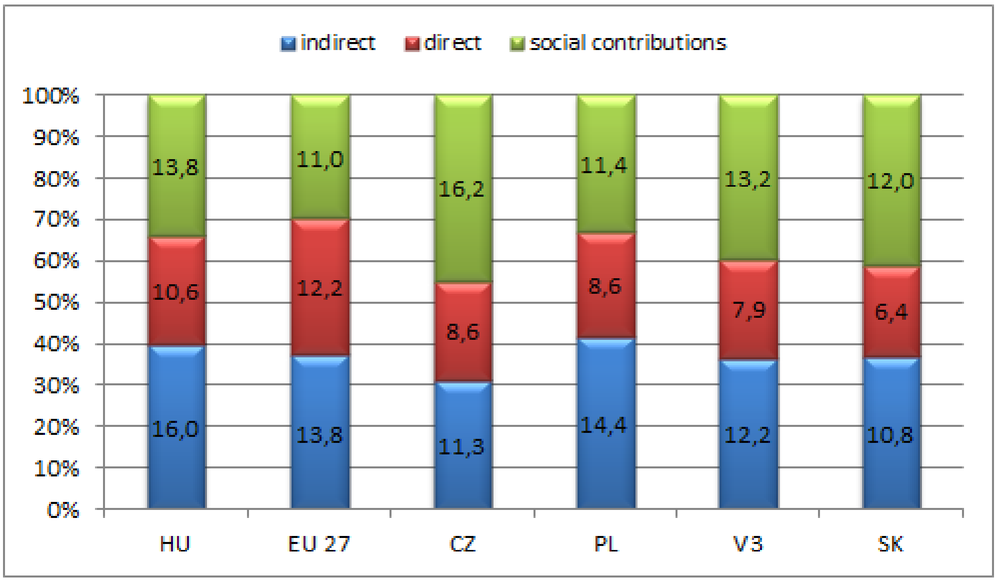
If we compare our data to those of countries' at a similar stage of development, it is apparent that during the last couple of years the tax burden relative to GDP was remarkably high, even higher than the average of the EU-27 or the Euro-zone. The average tax burden of 33% of the Visegrád group members in 2008 was 7 percent lower than the Hungarian indicator of 40%. However, recent changes in the tax system significantly improved the tax situation in Hungary. Due to the cut in corporate taxes which was implemented in July last year, the tax burden was reduced to 37.6%. As a result of the implementation of the flat-rate personal income tax in January 2011, tax liabilities will decrease further to presumably 36.5%.

'Cornerstones'

Our competitiveness position

1. **Taxation based on the type of the distribution of public burdens**

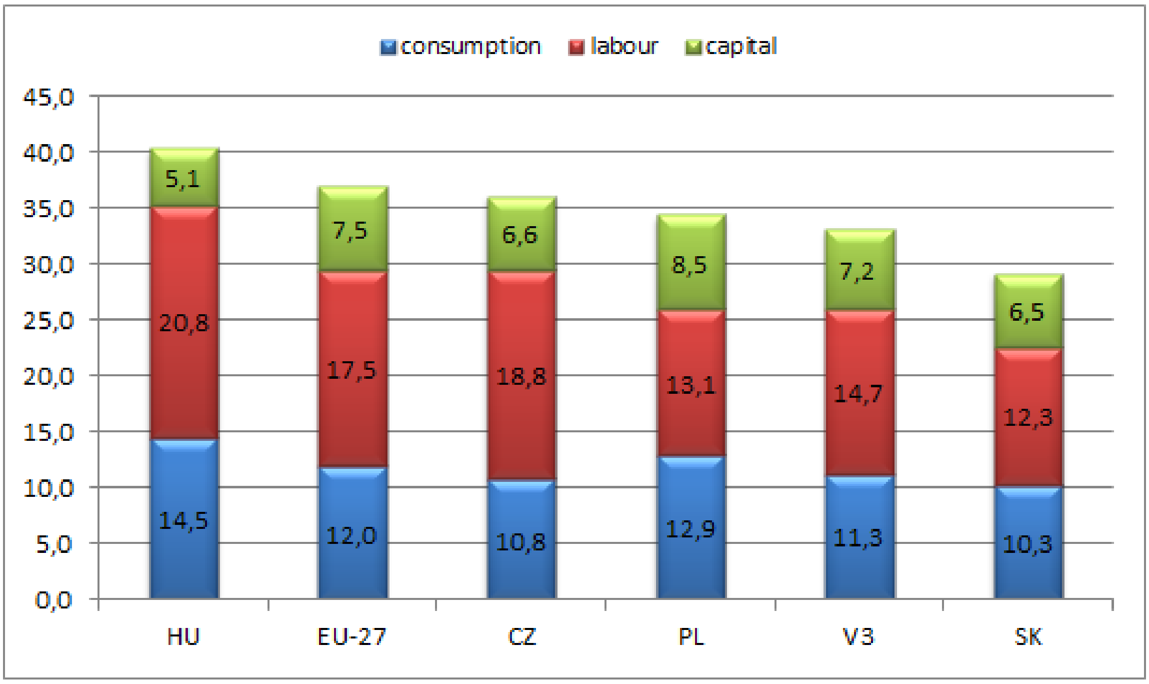
In 2008 indirect taxes in Hungary were high relative to international figures, while direct taxes were almost on par with data from the Visegrád countries – but even these were nearly 3 percent higher. Social contributions were slightly higher relative to the average of both the EU-27 and the Visegrád group members.



Therefore, in Hungary the proportion of revenues from indirect taxes is well above the average in international comparison. The same applies to **social insurance contributions.** However, the proportion of direct taxes as of GDP is well below the EU average but still higher than the average of the Visegrád countries.

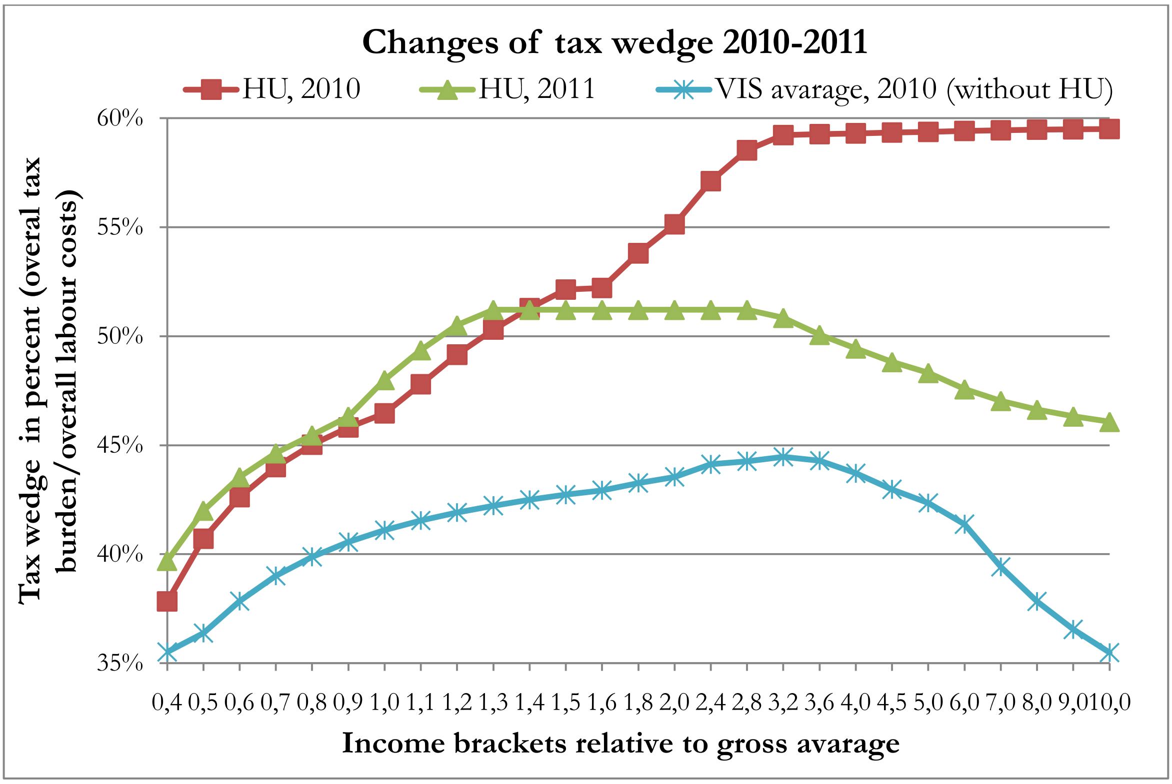
2. Taxation based on economic functions

The proportion of revenues to GDP from **taxes on consumption** was outstanding in Hungary in 2008: we ranked fourth among the EU member states. Hungary's proportion of 14.5% was 2.5% higher than the EU average of 12%, and it was also higher than the 11.3% average of the Visegrád group members (V3).

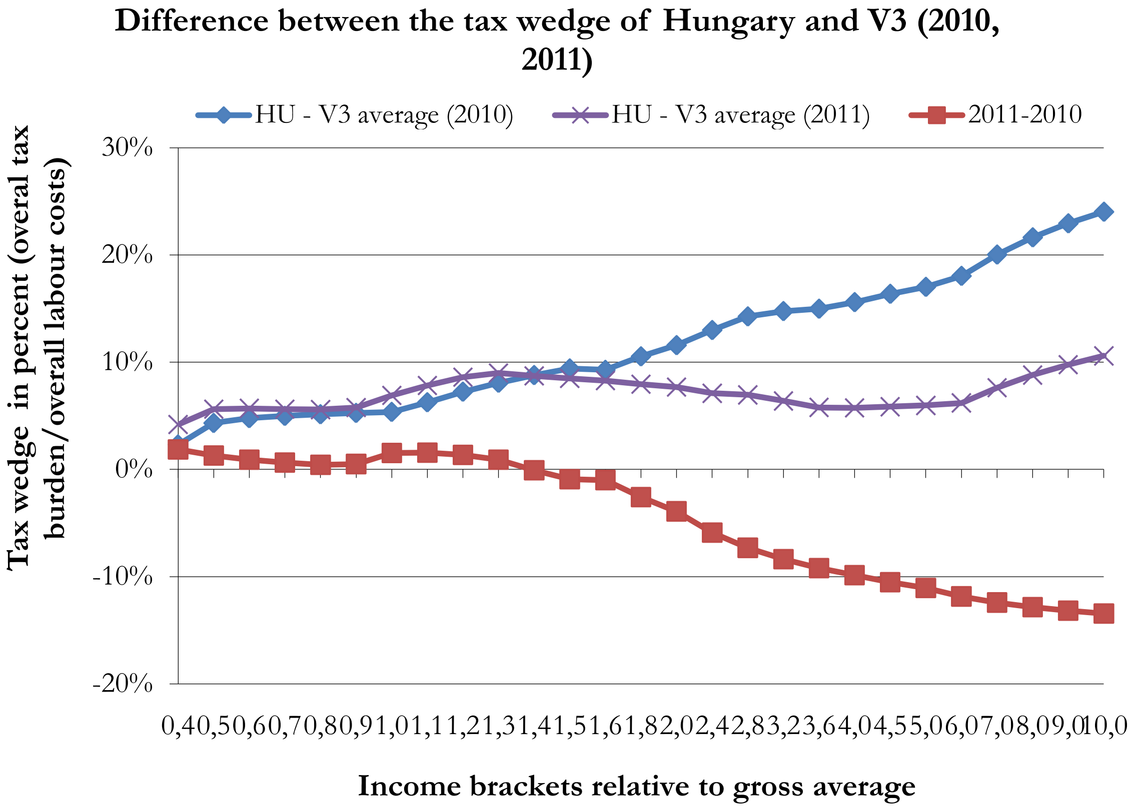


The proportion of revenues to GDP from **taxes on labour** was also higher than the international average. While the aforementioned indicator was 17.5% in the EU member states in 2008 and only 14.7% for the Visegrád countries, in Hungary it was close to 21%. The reason for the higher tax liabilities on labour is primarily the amount of social insurance contributions. Another key element is of course the personal income tax, but this has decreased substantially due to recent reforms which reduced and moved the Hungarian tax wedge closer to the average of the Visegrád countries.

The below tax wedge chart shows how the 2011 tax changes affected the Hungarian tax wedge depending on the proportion of liabilities payable to the state as taxes and contributions (compared to the overall labour costs, including the liabilities of both the employer and the employee).



It is obvious from the chart that the tax wedge which kept rising steadily in 2010 until it stabilized at a level which was about three times the amount of the average wage, and by 2011 it shifted in the direction of a downward parabolic path which is also typical of the Visegrád countries. The tax wedge decreased by a great extent above the level of 1.4 times the average wage and it increased slightly below that. All in all, however, the average proportion of liabilities from taxes and contributions relative to the overall costs on labour decreased by 4.6%, albeit deviations from the standard have been significant.



In 2010 the average difference between the tax wedge of Hungary and the Visegrád trio was 11.7%, but in 2011 this figure decreased to 7.1%. In the higher income brackets (above four times the average wage) this figure decreased by 10 percent or more. As a result, the deviations from the standard between the tax wedges of Hungary and the V3 were reduced to the one-fourth of the data before and therefore a personal income tax system was created which is fairer and can stimulate more people to get employed. While in 2010 the differences between the Hungarian and the V3 tax wedge were in a range between 2.3% and 24%, as a result of the 2011 measures this range narrowed to between 4.2% and 10.6%. This means that we still have a gap to close as far as the V3 and the tax wedge is concerned, the spread of this difference, however, is already much more even across the various income brackets.

In case of **capital tax** liabilities, tendencies have been different. In 2008 there were only four such EU members states (the Baltic states and Slovenia) where the proportion of revenues to GDP from capital taxes was lower than the figure in Hungary: the average was 7.5% in the EU-27, 7.2% in the Visegrád countries and only 5.1% in Hungary. The Hungarian tax burden on assets was especially low, but it is a less crucial figure from the viewpoint of competitiveness.

Lately, the examination and improvement of taxes in connection with **environmental protection ("ecotaxes")** has been a priority area for the international tax policies. The proportion of revenues to GDP from ecotaxes have been low worldwide, it was 2.6% on average in the EU member states in 2008. The Hungarian figure (2.7%) is almost identical with the international average and it is slightly higher than the figure of the Visegrád countries. The proportion to GDP of such type of tax liabilities is albeit high, but it is still low compared to the overall tax burden. Therefore, the entire tax structure could be reformed by reducing the taxes on labour and increasing ecotaxes in order to create a structure which would better stimulate employment.

3. Taxation based on tax issuance rights

In 2008 the 61.3% of overall tax revenues were received by the state budget and 31.4% by the social insurance funds in Hungary. Municipalities received 6.4% from it and the EU budget 0.9%. The share of the municipalities from overall tax revenues is almost one-and-a-half times more in the EU (10.4%) and twice as much in the Visegrád group members than in Hungary. **In other words, tax centralization is high in Hungary**.

Conclusion

In Hungary the proportion of revenues from indirect taxes and social insurance contributions is higher than the average, and the proportion from direct tax liabilities is less than the average.

The tax burden on consumption and labour is higher than the international average, whereas capital taxes (ex. on corporate income or assets) are below it in Hungary.

The share of municipalities of the overall tax revenues is substantially lower than the EU or the regional average, but while the proportion of ecotaxes relative to GDP is low worldwide, the Hungarian figure is above the EU or regional average.

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Budapest, 21 February 2011.

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