

Bianka Parragh – Dániel Palotai

Towards an Incentive Tax System

Reform of the Tax System and Tax Administration in Hungary

SUMMARY: The secret to successful economic convergence lies in broad-based cooperation between the public and private sectors. The tax system is a priority area, since on the one hand it generates the revenues for the functioning of the state, while on the other hand it regulates the basic conditions of the private economy. In this regard, the tax reform implemented in Hungary after 2010 was a milestone, as it not only changed the tax structure in a growth-friendly manner, but also served to simplify the tax system and reduce tax evasion. The reform of the tax administration was launched in a second round in 2016, with the aim of establishing a cooperative, client-oriented tax authority which encourages taxpayers to adhere to the rules through modern means and appropriate incentives. This study provides an overview of the stages and results of the transformation of the tax system as well as the tax administration to date. By citing successful international examples, we offer suggestions and draw attention to the possibilities of further reform.¹

KEYWORDS: public finances, fiscal policy, tax system, tax administration, institutional system, macroeconomics, the behaviour of economic operators, cooperation

JEL-CODES: H20, H21, H3, H71, H83

Looking back in economic history, the relationship between the state and the market has always affected the performance, success and sustainability of the economy. According to *Kolozsi, Lentner and Parragh* (2017), several models can be identified based on how the public sector and the private sector relate to each other, of which the most successful may be a state which can establish a cooperative relationship with citizens, the corporate sector, banks and other stakeholders. Through its behaviour and attitude, the cooperative state establishes its frameworks and rules in a way

that it encourages its partners to adhere to the rules and to cooperate. An institutional system that uses appropriate incentives builds on mutual benefits between the state and the stakeholders, thus driving the private sector towards cooperation. The successful functioning of the state requires citizens and businesses to become interested in the success of Government's policies and fully endorse the aims of its measures.

By contrast, in a non-cooperative, punitive, sanctioning model, the functioning of the state is characterised by a lack of trust in the stakeholders. The typical regulatory instrument is excessive burden on those who adhere to the rules. In the case of a naive state, the

E-mail address: parragh.bianka@uni-nke.hu
palotai.daniel.titkarsag@mnb.hu

state strives to cooperate, but the other market participants (companies and the people) are still not ready to do so. The theory of the cooperative state matches up with the concept of “good governance” as well. One of the key tasks of a well-run state is to ensure financial and economic stability and sustainability for its institutions, economic agents as well as for its citizens (Domokos et al., 2016).

Since 2010, changes in the direction of a cooperative, more effective state have taken place in several areas of the Hungarian economy. Such changes include the tax reform which stimulated economic activity and employment, and also the resulting fiscal change which ensured the sustainability of public finances. At the same time, the downward path of public debt increased households’ trust in government securities. As a result, it was possible to finance an increasing part of the budget from domestic forint savings. Since 2013, the changing monetary policy has been supporting the recovery from the economic crisis more actively than before, while keeping its focus on the inflation target, and has significantly contributed to sustainable growth. By easing supply-side constraints, the Funding for Growth Scheme (FGS) reactivated the corporate credit market after the *credit crunch*, thus avoiding a creditless recovery. Moreover, the reductions in the central bank base rate reduced interest rates in all economic sectors. The conversion of foreign currency loans, which eliminated one of the most significant economic and social risks, required multilateral cooperation between a particularly large number of participants (Matolcsy, 2015).²

In this study, we seek to answer the question as to how the theory of the cooperative state and Hungarian practice correlate with each other. How have changes in the dimension of taxation helped to achieve the aims of the cooperative state in recent years? The tax system is considered to be cooperative if the

tax rules established by the state are socially acceptable and implementable, resulting in tax revenues which provide adequate contribution to the government budget, if the tax administration supports compliance with the rules as much as possible, while, in view of the above, the private sector accepts, follows and internalises such rules.³ Consequently, the cooperative system of taxation is based on two factors on the part of the state: the rules of the tax system and the practices of tax administration.

The radical reform of the tax system between 2010–2013 not only supported economic growth and fiscal balance, it was also based on cooperation between the parties. The emphasis was shifted from taxes levied on labour to taxes levied on consumption, stimulating employment and reducing the distorting effect of the tax system on economic decisions. By levying crisis taxes, the system strengthened burden-sharing, while the implementation of targeted measures assisted in combating the shadow economy and thus in ensuring fair competition. The aforementioned measures effectively contributed to an upsurge in employment and economic performance, paving the way for additional tax cuts.⁴

The aim of the tax administration reform launched by the National Tax and Customs Administration of Hungary (NTCA) in 2016 was to achieve a total paradigm shift. With the reform, the NTCA wanted to transform the image of the former punitive authority into a cooperative, supportive service-providing organisation that is fair with its clients. The new tax administration reform puts an emphasis on the improvement of the taxpayers’ morale, which is easier to achieve with the support of a client-oriented tax authority (Ambrus and Széles, 2017). Further measures resulting from this paradigm shift may enhance not only the improvement of the taxpayers’ morale, but also the country’s competitiveness (Parragh, 2015b).

REFORM OF THE TAX SYSTEM

Aims of the tax reform

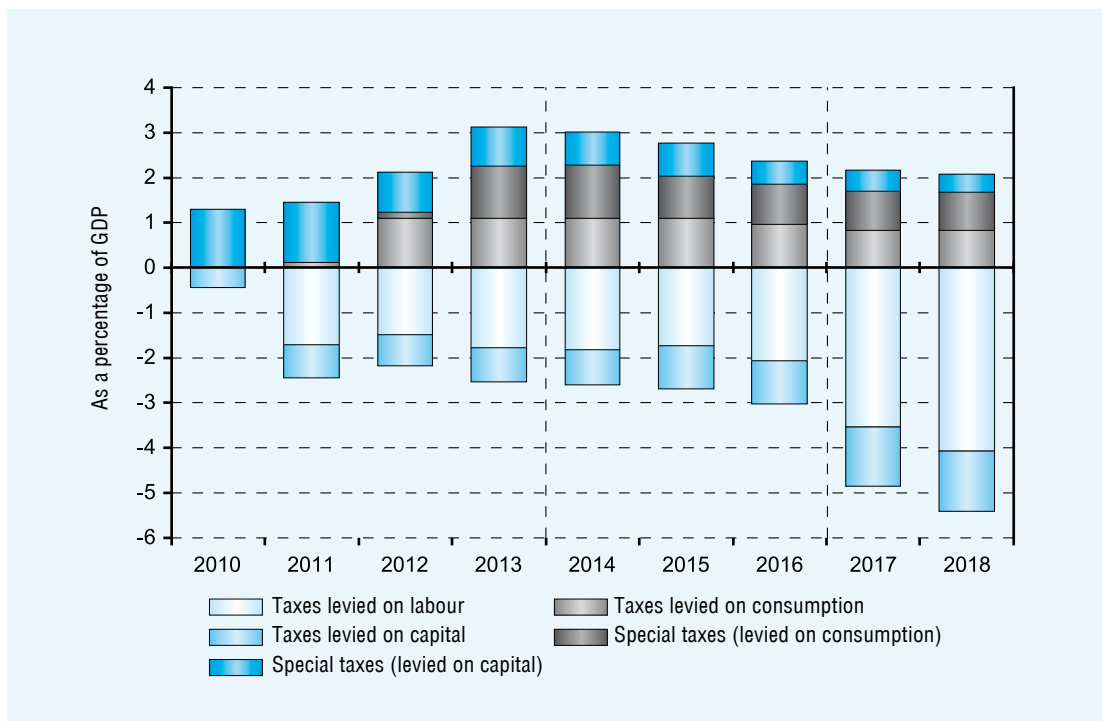
The Hungarian tax system went through a major reform after 2010, with most of the work completed by 2013 (Palotai, 2017). Due to the tax reform, the tax revenue emphasis was shifted from taxes levied on labour and capital to consumption and turnover taxes. As a result of the reform, the burden on labour from taxes and welfare allowances decreased to a significant extent, as did the level of taxes levied on capital. The increase in the rate of consumption taxes and sectoral special taxes provided the financial background for the aforementioned measures. The reform increased the competitiveness of the tax sys-

tem, as consumption and turnover taxes are typically less distorting. Such taxes also have a less significant influence on the international competitiveness of Hungarian products, and therefore they are less harmful to growth and employment than taxes on income and employment. Moreover, measures taken to prevent tax evasion were also important elements of the tax reform. In addition to providing additional revenue for the budget, they also contributed to the establishment of fairer competition. (Figure 1)

The tax reform was needed due to the coexistence of several adverse factors. Until 2010, the Hungarian tax system did not support the growth of the real economy, and at the same time, it was one of the main sources of structural problems. The level of taxes on labour

Figure 1

THE CUMULATIVE BUDGETARY EFFECT OF TAX MEASURES IMPLEMENTED SINCE 2010 (BASED ON A STATIC APPROACH)



Source: Palotai (2017)

was significantly higher in Hungary in 2010 than in Hungary's competitors in the region, which was a serious drag on employment and dampened growth (Matolcsy, 2014). In 2010, Hungary had the lowest employment rate in the EU. Consequently, the need for economic growth and fiscal balance arose simultaneously in economic policy. The most important element of the change was the reform of the tax system (Parragh, 2015a).

Tax reform to stimulate employment

Taxes on labour were decreased and restructured between 2011 and 2013. In the framework of the tax reform the progressive, two-bracket income tax system was replaced by a flat-rate tax, the family tax allowance was considerably expanded, supergrossing and tax credit schemes were abolished, the social contribution cap was phased out and targeted allowances of the Job Protection Action Plan were introduced. Due to the aforementioned changes, the system of taxes on labour has become a true flat-rate tax system.

The aims of reducing taxes on labour can be distinguished depending on whether we examine groups with stronger ties to the labour market and higher activity rate or disadvantaged groups in the labour market. In the first case, the aim of the tax reform was to encourage employees to work more and perform better, which was also further motivated by the decrease in marginal tax wedges. Before 2010, the tax on a unit of additional revenue (marginal tax wedge) was between 60–80%, in contrast with 35–50% in neighbouring countries. Such a high tax level punished those who worked more and owing to the adjustment of labour supply on the intensive margin, hindered investment in human capital, studying and training, and led to people hiding their incomes. With the phasing out the flat-rate

tax and the tax credit, the marginal tax wedge dropped to the level of other countries in the Visegrád Group, while people could now keep most of the income from additional work.

In the case of the other group, the aim was to increase labour market activity and employment, which was encouraged by targeted allowances introduced in the framework of the Job Protection Action Plan. Such allowances were aimed at groups with low activity rate (employees under the age of 25 or over the age of 55, mothers returning from maternity leave, permanent jobseekers and unskilled employees), who were more sensitive to financial incentives when making decisions on entering the labour market.

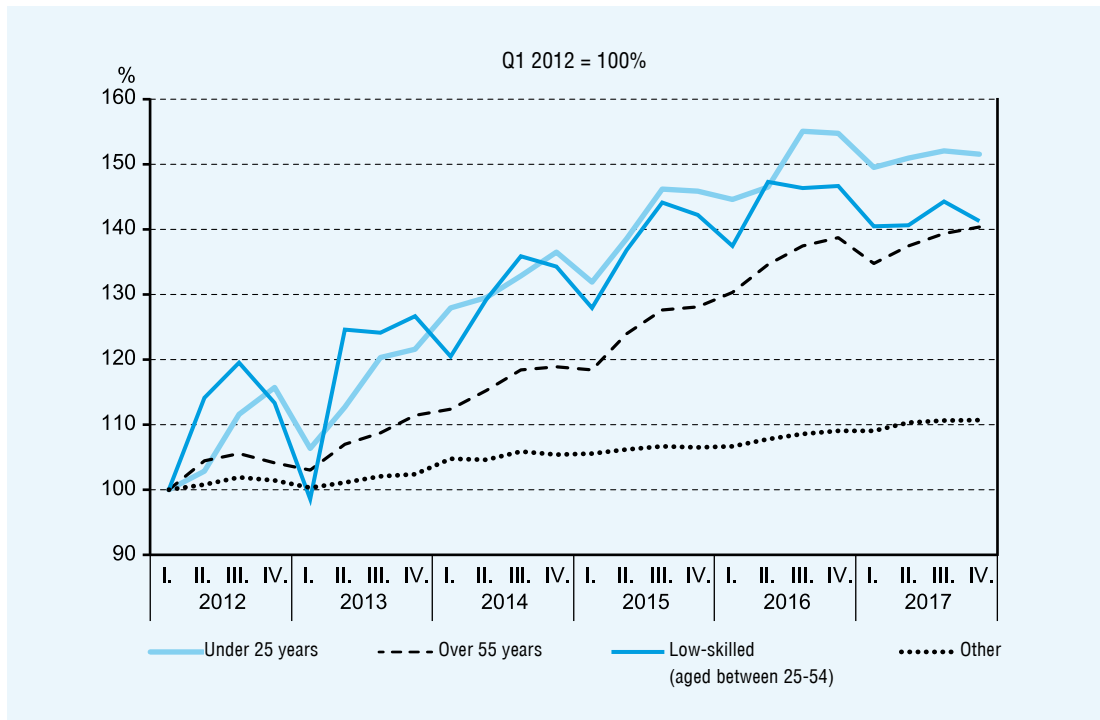
The significant extension of the family tax allowance, which mainly serves social policy purposes, was a key element of the tax system reform. One of the main purposes of the Government was to stop or possibly revert adverse demographic development by increasing the birth rates. The family tax allowance helps people in creating a family by contributing to the financial burden of raising children.

The tax reform achieved its aims in the field of employment policy. Since the start of the tax reform in 2010, the number of employees has increased by 750,000, two-thirds of whom have been able to find a job in the business sector. In line with the expansion of employment and activity, the level of unemployment dropped below 4% by the end of 2017, while the employment rate reached almost 60%, which is the EU average.

Due to the success of the Job Protection Action Plan, employment grew at an above-average rate, rising by 40–50% in the target groups (*Figure 2*). As the flexibility on the extensive side (the likelihood of starting work) was the highest in the case of the groups of beneficiaries among all employees in the national economy, the targeted allowances were effective.

Figure 2

INCREASE IN THE EMPLOYMENT RATE OF GROUPS INVOLVED IN THE JOB PROTECTION ACTION PLAN COMPARED TO Q1 2012



Source: Eurostat

Note: The three priority labour market groups above cover 87% of the allowances paid within the framework of the Job Protection Action Plan on average as well as 91% of the beneficiaries. The category "Other" includes all other employees working in the national economy, not including the three priority groups.

In addition to the reduction in taxes on labour, taxes on capital have decreased as well, namely the taxes and social charges paid by companies, principally by small and medium-sized enterprises. Since the middle of 2010, the corporate income tax rate for SMEs has dropped to 10%, while the upper limit of corporate income tax has risen from HUF 50 million to HUF 500 million. Due to the restriction on write-offs and changes in tax-type expenditures, the tax base has been broadened and the system of allowances has been changed as well. The tax burdens of SMEs have been significantly reduced by various small corporate taxes (small taxpayers' itemised lump sum tax – KATA, small

enterprise tax – KIVA), which replaced several other tax and contribution types. While only a modest number of taxpayers have chosen KIVA over the years, the number of enterprises choosing KATA has been increasing. By the second half of 2017, it exceeded 230,000 taxpayers.

Budgetary revenues lost due to the reduction in taxes on capital and labour have been recovered from different sources. The two most important new revenue sources were generated by raising the share of consumption taxes and levying additional sector-specific taxes. Additional taxes were paid by sectors with above-average revenue-generating ability, contributing to the more balanced distribu-

tion of public revenues. The highest rate of the value added tax was increased from 25% to 27% in 2012, which – along with the increase in various excise taxes (tobacco products, fuels) – contributed to a permanent increase in the share of consumption taxes within tax revenues. Within consumption and turnover taxes, the share of additional taxes is significant. Such taxes account for almost half of the revenue increase.

Results of the tax reform are visible

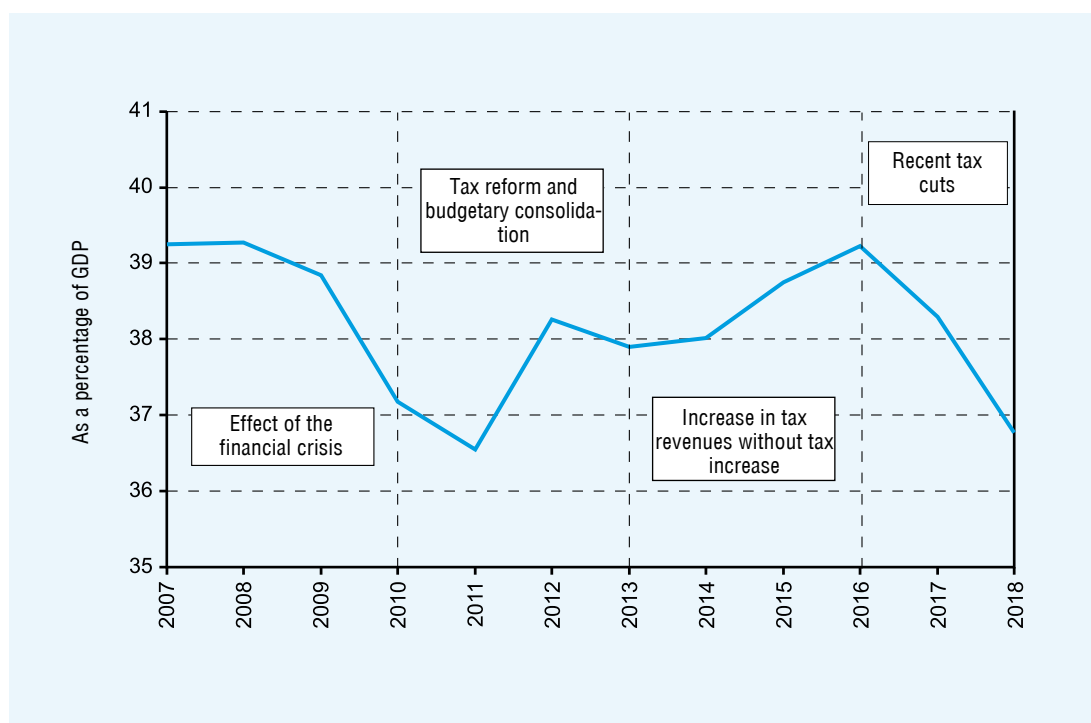
The results of the 2013 tax reform can be seen in employment growth, an increase in economic performance and tax revenues as well as a decrease in tax evasion, which later ena-

bled the further cuts in certain tax types (social contribution tax, corporate income tax, targeted VAT rates).

Employment growth also gave a boost to economic growth, thereby increasing tax revenues. Between 2013 and 2016, tax revenues increased by almost 1.5% of GDP, while tax rates remained unchanged (Palotai, 2017). The rate of increase in the tax revenues-to-GDP ratio, which does not require tax-increasing measures, shows the beneficial long-term effects of tax and transfer changes from previous years. *Figure 3* illustrates the change in the tax revenues-to-GDP ratio. Based on a recent study by the Magyar Nemzeti Bank (Szoboszalai et al., 2018), measures implemented since 2010 may increase economic growth by 6% of GDP over the long run. Consequent-

Figure 3

CHANGE IN TAX REVENUES TO GDP RATIO (TAX CENTRALISATION) IN HUNGARY



Source: Palotai (2017)

ly, tax cuts have become partly self-financing over the medium term.

The effective use of various measures aimed at combating the shadow economy has contributed to the increase in revenues. Between 2011 and 2012, the Ministry for National Economy reviewed and assessed the best international examples, looking for possibilities of restricting the shadow economy. As a result of this review, based on successful Bulgarian and Swedish examples, the planning and preparation of the introduction of online cash registers was launched. The Government decided to introduce them in October 2012.⁵ A new instrument, the Electronic Trade and Transport Control System (EKAER, hereinafter: electronic road toll system) was implemented in 2015. The effect of the online cash registers and the electronic road toll system was reflected in the increase in VAT revenues and the shrinking shadow economy. By reducing the informal sector, it was possible to permanently increase tax revenues without raising tax rates. Initially, the European Commission was sceptical about the effects of online cash registers on the economy, and therefore it took the revenue surplus only to a lesser extent into account than the Government, which contributed to the fact that, in 2013, the European Commission forecasted a budget deficit exceeding 3% for 2014. However, subsequently, the European Commission acknowledged the effectiveness of the measures to fight the shadow economy. Tax evasion is most frequently measured by the so-called VAT gap, i.e. the difference between theoretically collectible VAT revenue and actually collected VAT revenue. This index dropped by 7 percentage points in Hungary between 2013 and 2015 (Poniatowski et al., 2017). In light of the above, due to the decline in tax evasion, VAT revenues increased by HUF 280 billion on an annual basis by 2015, while VAT rates remained the same (*Figure 4*).

The considerable increase in revenues without a tax increase ensured the proper budgetary background for further significant tax cuts in 2017. In line with the economic policy launched in 2010, employer's contributions have declined gradually and significantly starting from 2017. Due to the reduction in the flat-rate corporate income tax, the weight of taxes on labour and capital has further decreased. The previous increase in the share of consumption taxes has been partly compensated by targeted VAT cuts (on poultry, pork, fish, egg, fresh milk, internet services, restaurant services) over the past few years, which have been enabled by the positive results of the tax reform and the simultaneous reduction of the shadow economy.

On the whole, in line with the goals set, the tax system has shifted from the taxation of labour to the taxation of consumption. Regarding taxes and contributions on labour and capital, the cumulative static budgetary effect of the measures amounted to more than 5% of GDP between 2010–2018, which is compensated by measures related to consumption and sectoral taxes with about 2% of GDP (Palotai, 2017). This represents a considerable tax reduction, along with a shift towards a healthier structure of the tax system that is more supportive to economic growth. The tax reform facilitated fiscal stabilisation on the one hand, while on the other hand it laid the foundation for the establishment of a growth-friendly tax system with a healthier structure (Lentner, 2017). Tax cuts result in revenue loss in the short run. At the same time, such losses can be recovered from favourable effects stimulating the economy in the long run, mainly through rising employment and the boost to consumption and investment.

Based on the key question of our study, the tax reform is characterised by the features of the cooperative state approach. The reduction of taxes on labour and capital reduces the dis-

Figure 4

CHANGE IN THE DIFFERENCE BETWEEN THE COLLECTED AND POTENTIALLY COLLECTIBLE VAT REVENUES (VAT GAP) IN HUNGARY BETWEEN 2011 AND 2015



Source: European Commission

torting effect the whole tax system has on the economy. Combating the shadow economy supports fair trade, while lower tax rates and simpler regulations facilitate compliance with tax rules. The growth-supporting tax system cannot be successful on its own. Compliance with and control of tax rules requires a well-organised tax administration cooperating with taxpayers.

TAX ADMINISTRATION REFORM

Comprehensive reform of the tax system had to be followed by a reform of the tax administration as well, as a tax reform cannot be complete without the appropriate attitude, performance and efficiency of the tax authority. The

concept above was in line with the review of the functioning of the state as a whole, the aim of which was to establish a system of public administration that was more modern and efficient than the previous system. The reform of the tax administration started with the reorganisation of the NTCA in 2016 and then continued with the adoption of the NTCA's Strategic Reform Programme 2.0 and the Action Plan in 2017.⁶ According to *Norbert Izer*, Deputy State Secretary responsible for tax regulation and accounting, the reorganised NTCA aims to establish a modern, transparent, efficient, service-providing and client-oriented tax authority that can collect budgetary revenues more effectively than the current tax authority.⁷ In the following section, the main elements of the tax reform which has been

launched are described, and subsequently international examples which may be useful in the development of the Hungarian tax administration are presented.

Organisational reform to establish an efficiently operating tax authority

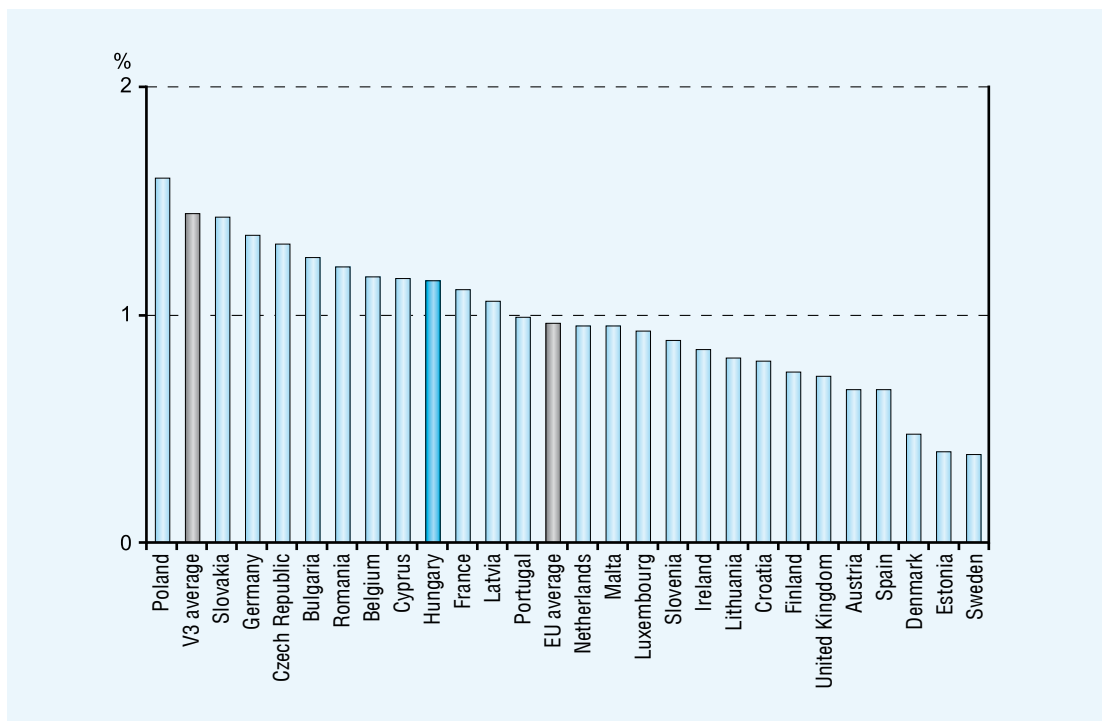
The efficiency of the tax authority can be considered as improved if the tax authority provides the same quality using less resources or provides better quality by using the same resources. According to the study on tax administration by the European Commission (2012), there is no relationship between the number of employees working for a country's tax authority and the size of the shadow econ-

omy. The cost of tax administration per collected tax revenues indicates how efficiently a tax authority works. According to the OECD study (2015), operating costs related to tax administration made up 1.15% of tax revenues in Hungary. (See Figure 5) This figure is the lowest among the countries of the Visegrád Group, but is above the EU average.

Before 2016, the operation of the NTCA as an organisation was characterised by higher fragmentation and parallel functions. Prior to the reorganisation in 2015, the system consisted of three levels (central management, regional Directorate Generals and county directorates). The independent professional management of its activity as a second instance authority was not part of central management. Consequently, regional Directorates

Figure 5

TAX ADMINISTRATION COST IN PROPORTION TO TAX REVENUES



Source: OECD 2015

Generals (DGs) had the power to perform complex professional management activities covering the area of three counties each. In addition to tasks related to professional coordination, the NTCA's activity as a second instance authority belonged to the regional level as well. In conclusion, it can be stated that the management of first and second instance bodies is concentrated at regional DGs. Based on the information received from *András Tállai*, Secretary of State for Parliamentary Affairs and Taxation, DGs often applied different practices and interpreted the law in different ways, without a central coordination.⁸

Since 2016, the organisational structure of the tax authority was fundamentally changed.⁹ After the dissolution of the regional DGs, the three-level system was replaced with a two-tier system, which consists of an executive level (country directorates) and the central management. The NTCA's Appeal Directorate with an independent jurisdiction function was established as of 1 January 2016. The Appeal Directorate is responsible for conducting a review that supports the uniform practices related to the interpretation and application of the law, making use of its experience in case law. Due to the aforementioned reorganisation, the operational rules and non-uniform review practices of the tax and customs (7+7) DGs were abolished. In the new organisational structure, uniform organisational and professional rules of procedure were introduced. As a result of the reorganisation of the NTCA, today the organisational unit with second instance power performs its tasks independently from the first instance bodies, regarding its organisation and competence.¹⁰

The legal, official and supervisory activity of the NTCA are key to Central Management in a professional sense. By preparing codification, supervising the legitimate operation of the organisation and defining complex professional requirements for decisions with legal

effects, the NTCA seeks to ensure a uniform legal practice and interpretation of the law for the whole organisation while closely cooperating with the professional areas. As far as administrative decisions are concerned, nowadays decisions issued by the NTCA are expected to be well-constructed, comprehensible and to express the authority's point of view in a clear and concise manner. If taxpayers are faced with logically structured, clearly worded decisions, they are more likely to behave in a law-abiding way, as they have a clear understanding of their rights and obligations specified by the relevant laws.

Role of the client-oriented tax authority in improving taxpayers' morale

The aim of the client-oriented tax authority is to support taxpayers in their adherence to the rules in a forward-looking manner, instead of penalising infringement retrospectively. In order to achieve this goal, rules should be clearly communicated on the one hand, and on the other hand, compliance with the rules should be supported and their observance should be rewarded. All this encourages and helps taxpayers to comply with tax rules voluntarily, thereby improving taxpayers' morale. In our opinion, a higher level of tax compliance can be achieved with lower expenses in this manner.

The counselling services of the tax authority speed up taxpaying processes and can support the operation of enterprises by offering advice in business/taxation related situations. A good example of this is the British government's website, which is deeply interconnected with the website of the tax authority; thus it provides comprehensive information, advice and support in business planning to enterprises.¹¹ The website has a logical structure, describes services in a clear manner, adjusted to the life and business situations of users.

The NTCA is planning to launch its mentoring service in 2018 to support companies (Section 257 of Act CL of 2017 on the Rules of Taxation, hereinafter referred to as the Tax Act). Based on Hungarian experience, economic operators are often not exactly familiar with the expectations of the law and those of the tax authority, and this often leads to fines. As András Tállai said, the NTCA will support more than 80,000 newly established companies, organise free lectures and provide written or oral information on the tax liabilities of such enterprises. After establishing contact, companies will have the opportunity to receive customised support.¹²

In order to implement the client-oriented approach, a new legal institution was introduced in 2017 to protect the interests of taxpayers. The so-called “support procedure” provides an opportunity for taxpayers who do not act in full compliance with the law to correct their errors and avoid sanctions (Section 139 of the Tax Act).¹³ In the course of the support procedure, the tax authority assesses the documents related to the performance of tax liability (tax returns submitted by the taxpayer, data reports, data received from courts, other authorities or taxpayers). If the tax authority identifies any errors that can be corrected by the taxpayer, it calls upon the taxpayer to conduct a self-audit before imposing sanctions. The aim of the support procedure is to remedy the detected error and deficiencies with the professional support of the tax authority. The NTCA does not impose any fines for any infringements arising in the course of the procedure. If the errors cannot be corrected by the taxpayer or the taxpayer is not willing to conduct a self-audit, the tax authority launches an audit in the framework of a stricter procedure, and in case of a criminal offence, the tax authority informs the investigating authority.

The “tax speed camera” introduced in 2017

also fits into the preventive, supportive concept of the tax authority. The tax speed camera published on the website of the tax authority indicates sectors in which targeted tax audits are to be expected.¹⁴ By announcing tax audits in advance, the tax authority supports and encourages enterprises to abide by the rules in order to avoid negative legal consequences. However, the tax authority may also conduct audits in places other than those announced.

As a reward instrument, a rating system was introduced in Hungary in 2016 (Sections 153–162 of the Tax Act), according to which reliable taxpayers are entitled to receive benefits based on the principle of cooperation.¹⁵ Enterprises are rated ‘good’ if they duly complied with all their tax liabilities in the previous five years. By contrast, businesses that are proven to have infringed tax rules with their activities, are rated ‘risky’. Taxpayers that are not categorised either good or risky are classified as general. Reclaimed VAT is reimbursed by the tax authority to reliable taxpayers within a shorter deadline (30–45 days), and such taxpayers will have to pay only 50% of certain fines in accordance with the general rules, tax audits conducted at such companies will last for no more than 180 days (in the case of a general procedure, maximum 365 days) and in the case of a less considerable amount of unpaid tax, they receive automatic payment assistance with no surcharge payable once a year. If a taxpayer is rated ‘risky’, such rating involves a longer VAT reimbursement period (75 days), stricter supervision by the tax authority (in their case, audit deadlines are extended by 60 days), more administration and more frequent audits. Taxpayers can get out of the ‘risky’ category each quarterly, provided their tax delinquency has been paid and all other conditions are fulfilled. The introduction of the rating system has also contributed to the shift of the tax authority into a cooperative direction.

Within the system of self-assessment, solutions supporting voluntary performance related to official measures are new elements in the rules of procedure. With regard to the fact that 90% of tax revenues comes from self-assessment, special emphasis had to be put on the promotion of self-assessment and voluntary performance by raising the awareness of taxpayers through the authority. The reform of the sanctions system encourages voluntary compliance, as the conditional tax fine acts against prolonged procedures. Pursuant to the legal instrument of “conditional tax fine” (Section 216 of the Tax Act), if the taxpayer waives the right to appeal against the decision on the findings of the tax audit and pays the required tax difference by the due date, they shall be exempt from the payment of 50% of

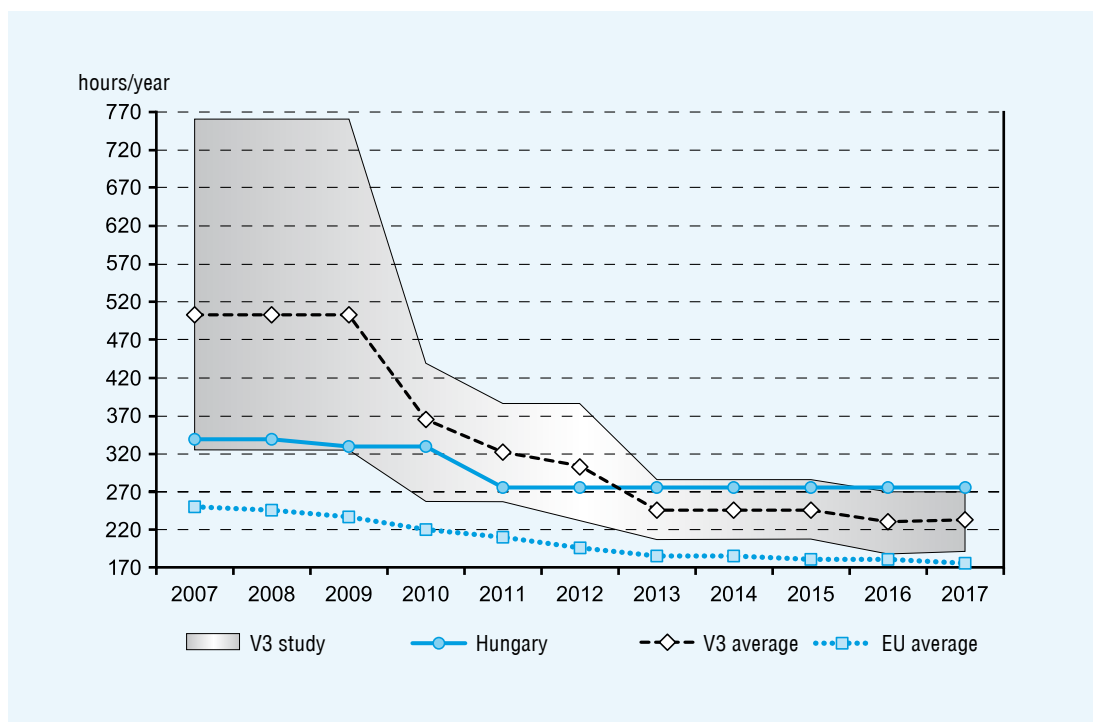
the imposed tax fine. As a result, the number of appeals lodged for the deferment of the payment obligation is expected to decrease as well. Other positive effects of self-assessment include lower maintenance costs of the authority owing to the reduction of bureaucracy.

Possibilities of reducing the administrative burden related to taxation

An important condition for an efficient tax system is that it should provide tax revenues to the state at low costs. When assessing the efficiency of the tax system in this respect, the change in social costs should not be ignored, as on the taxpayer’s side, they also include the time of the private sector spend on taxation

Figure 6

THE NUMBER OF HOURS COMPANIES SPEND ON FILING THEIR TAX RETURN A YEAR



Source: World Bank-Doing Business, PWC

(Nagy, 2017). *Figure 6* summarises the number of hours companies spend on completing their tax returns. The time spent on tax administration restrains the productivity of economic agents. On the one hand, it can be limited by the spread of electronic tax returns with the help of more widespread digitalisation. On the other hand, it can also be reduced by the active involvement of the tax authority in the completion of tax returns (Ambrus and Széles, 2017). Such measures not only reduce the administrative burden related to taxation, but also help meeting social expectations. The time companies spend on the payment of taxes is fairly high in Hungary (277 hours/year), which can be reduced by simplifying the rules and by the takeover of some of the taxpayers' tasks by the tax authority.

Tax administration can also be reduced via more comprehensive automation of taxation processes, including making the completion of tax returns and the payment of taxes easier and simpler. The time spent on filling tax returns is shortened by the use of *pre-filled* tax returns containing the taxpayers' data, issued by the tax authority. The Danish tax authority was a pioneer in the area of pre-filled tax returns, as they already applied this procedure in 1988 (European Commission, 2012). Using a fully automated method, the most developed tax systems fill the personal income tax return for the majority of taxpayers in electronic and/or printed form (Denmark 84%, Finland 94%, Sweden 60%). The system of pre-filled tax returns is popular in other European countries (e.g. Belgium, Estonia, France, Lithuania, the Netherlands, Slovenia, Portugal and Spain) as well.

Hungary has made significant progress when the NTCA undertook the completion of income tax returns for the first time in the 2016 tax year. By launching the new e-personal income tax system, 3.8 million private individuals were given the opportunity to

view, amend and approve their draft tax returns. The NTCA prepares the draft based on the available control data, using the taxpayer's personal income tax returns submitted in previous years and the data available on the basis of monthly contribution returns submitted in the tax year concerned.

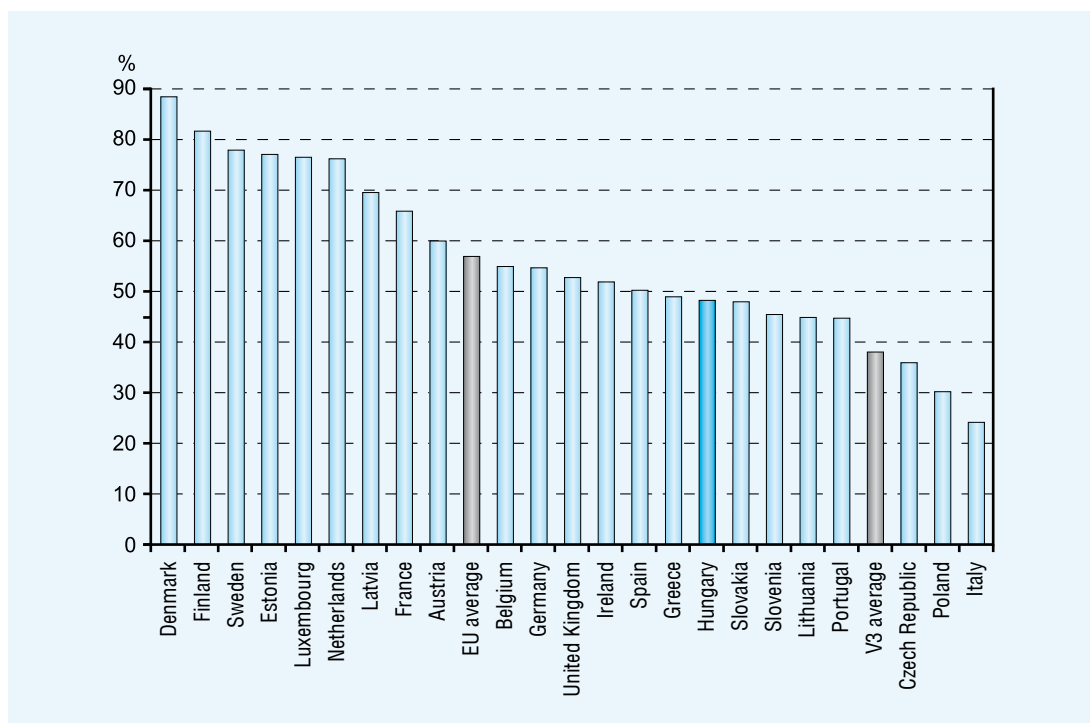
In an international context, in addition to the area of income tax returns, more and more initiatives for the introduction of a draft return appear related to value added tax (European Commission, 2012). In the future, it may be practical to establish an electronic return system for several tax types in Hungary. András Tállai announced, that as of 2018, the NTCA will also prepare the excise tax return, which might be followed by the draft VAT return.¹⁶

On the one hand digitalisation decreases the administrative burdens for clients, while on the other hand it reduces the expenses of the tax authority. Furthermore, it can shorten the time procedures take and is essential for automation in several areas. The digitalisation of public administration and tax administration procedures (e-administration) may significantly simplify the daily administration of enterprises. Online public administration is an important competitiveness and efficiency related issue both for people and companies. In Hungary, online administration exceeds the regional average, but it is slightly below the EU average. According to the Minister for National Economy, in Estonia, e-public administration was launched already in 1996; therefore, official administrative procedures have become practically paperless by now. By contrast, in Hungary only a limited number of business and official issues can be fully arranged online.¹⁷ (*Figure 7*)

The spread of mobile applications speeds up and simplifies the process of taxation and supports the activity of economic agents (OECD, 2017). In Chile, in addition to elec-

Figure 7

**ONLINE PUBLIC ADMINISTRATION
(2016)**



Source: OECD

tronic administration, a mobile application (SII) introduced in 2017 is also used to submit VAT and income tax returns. In South Korea, the tax authority allows enterprises to submit their filled tax returns through a mobile application. Using the mobile interface, enterprises can view their electronic invoices, find information on their business partners, while private individuals can initiate tax credits. The mobile application of the Danish tax authority allows taxpayers to submit their VAT returns and pay the required VAT. The application also includes a tax calculator.

The burden related to tax administration can also be decreased by connecting data and information stored in different systems and databases. A good example for the concept presented above is the report-free Austrian

family support system (*Antragslose Familienbeihilfe*),¹⁸ in the framework of which the tax authority automatically pays the family allowance to families after each new-born baby. Data from the Austrian registry office are automatically forwarded to the system of the tax authority, and therefore citizens do not need to fill any forms or take part in the administrative procedure at the tax office in order to claim family allowance and tax allowance.

Measures to combat the shadow economy

In most developed countries, reducing the extent of tax evasion and the shadow economy is among the high priority economic policy goals which may be facilitated by the activ-

ity of tax authorities (Csomós and Kreiszné, 2015). Tax evasion distorts competition, as it puts legally operating enterprises at a competitive disadvantage, and decreases budgetary revenues, as a result of which taxpayers pursuing declared activities have to bear a higher tax burden. In addition, it also distorts economic statistics, which makes decision-making more difficult. Non-declared employment decreases the social, legal and financial security of employees. There may be several reasons why people resort to tax evasion: high taxes burdening the economy, the amount of fines, the effectiveness of the audits conducted by the tax authority and the opinion about the level of services provided by public institutions.

Overregulation on the part of the state (e.g. stricter labour market rules) may drive eco-

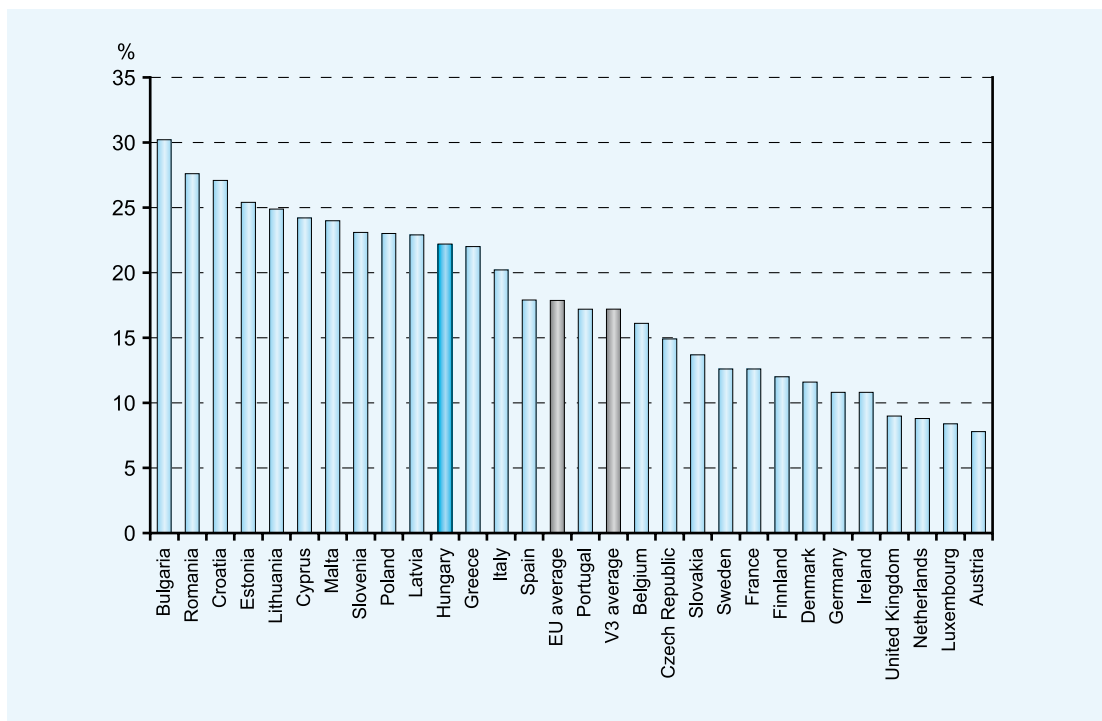
nomic agents towards the shadow economy, as it increases business costs in the formal economy compared to those in the informal economy. In addition, the degree of tax evasion is also influenced by the operational efficiency of the state. (Figure 8)

In Hungary, one of the key focal points of the tax reform launched in 2010 was to improve the “fairness” of the tax system. In order to achieve this, the previous system of taxes levied on labour, which was characterised by high tax rates, was reduced and became linear as described above. Sectors which had been less affected by the crisis were included in equitable taxation, and direct, targeted measures were taken to reduce tax evasion (Varga, 2017).

The Government decided to introduce on-

Figure 8

**ESTIMATED SIZE OF THE SHADOW ECONOMY IN THE EU,
PERCENTAGE OF GDP (2016)**



Source: Schneider, 2016

line cash registers in October 2012, in line with the goal laid down in the Széll Kálmán Plan to increase the efficiency of tax collection. The first online cash registers were installed in September 2013, and today, in addition to other sectors, they are now used throughout the retail sector. The use of online cash registers strengthens voluntary compliance with the law and significantly supports the auditing activity of the NTCA as, based on the detailed data provided by the online cash registers, audits can focus on issues where they are the most needed. In addition to other measures aimed at combating the shadow economy, the positive effect of the introduction of online cash registers is clearly detectable in the favourable change in VAT revenues (see: the change of the VAT gap described above).

The introduction of the electronic road toll system charging tolls proportionate to the distance covered was also part of the Széll Kálmán Plan. The electronic road toll system launched in 2015 was also based on this road toll system. The aim of the introduction of the electronic road toll system was to strengthen the position of law-abiding economic operators, monitor freight shipments, prevent abuse related to food products harmful to human health and filter out tax evaders. Through the electronic system, the tax authority can track the actual route of freight, as all transport-related data are recorded in a central system prior to transportation. The most frequent and most harmful method of VAT fraud, VAT fraud at freight shipments can be easily identified with the help of data provided by cameras controlling the payment of tolls and by axle-weight measuring stations. This way suspicious participants in the transportation of goods are promptly identified, which allows authorities to start immediate action. The launch of the electronic road toll system also resulted in the reduction of fictitious goods transport and tax fraud in the food in-

dustry. Due to the electronic road toll system, the percentage of the shadow economy has dropped from 40% to 20% in the fruit & vegetable sector. *Tibor Mélykuti*, President of the Hungarian Dairy Product Council, said that 85% of the ultra-high temperature processed (UHT) milk on the shelves of Hungarian retail stores used to be imported from abroad, presumably through the shadow economy.¹⁹ Now, partly with the help of the electronic road toll system, this proportion has changed. In 2016, 83% of UHT milk came from Hungarian producers.

In July 2018, a new instrument for combating the shadow economy is to be launched: electronic invoice data reporting (e-invoicing), based on which the NTCA will be able to identify anyone who issues fictitious invoices in real time, by controlling the data of invoice turnover worth HUF 50 thousand billion per year.²⁰ E-invoicing will significantly reduce the administrative burden of enterprises and allow the NTCA to partly fill their VAT return.

In the future, the extension of the system of online cash registers and the electronic road toll system, the extension of the scope of reverse VAT and the support of the spread of POS terminals may further assist in reducing the shadow economy.

The introduction of online cash registers and the electronic road toll system contributed to a reduction in the informal economy and considerably improved the position of the government budget. As a result of the measures listed above, the estimated value of tax evasion dropped from 23.3% to 22.2% between 2010 and 2016 (Schneider, 2016).

SUMMARY

At the beginning of our study, we asked the question whether the changes in the Hungarian tax system and tax administration over the

past few years were in line with the theory of the cooperative state. In our view, after reviewing the details, the tax system has clearly become more cooperative due to significant tax reforms. As far as tax administration is concerned, the initial important steps have been taken in this direction since 2016.

The main reforms affecting the tax system took place between 2010 and 2013 in Hungary. The measures not only contributed to a considerable growth in employment, but also boosted economic growth. Moreover, they provided an ideal budgetary background for further tax cuts over the past few years. An efficient tax system can generate fiscal revenues by distorting the distribution of economic resources to the least possible extent. At the same time, it should possibly promote economic growth. Due to the tax reform launched in 2010, the Hungarian tax system has moved in this direction. The previously high level of taxes levied on labour has decreased, while the most tax revenues have been collected from consumption taxes. The introduction of instruments aimed at combating the shadow economy strengthened the positive effects of the tax reform. Most of the universal tax allowances were replaced by allowances effectively serving specific social and labour market purposes. The success of such allowances is indicated by the fact that employment growth was higher in groups involved in the Job Protection Action Plan than in the national economy as a whole.

Measures implemented in tax administration may guarantee more transparent and efficient operation of the tax system. The aim of the tax administration reform launched in 2016 is to establish a more efficient institution by reorganising the NTCA and to achieve that the tax authority contributes to the reduction in taxes levied on taxpayers and the improvement of taxpayers' morale in a cooperative, supportive manner. Due to the paradigm shift in tax administration, several new measures have been introduced, such as the rating system of taxpayers, the support procedure, mentoring, the tax speed camera or the conditional tax fine. In order to reduce tax-related administration and accelerate the taxation process, the NTCA has taken over the preparation of personal income tax returns since the 2016 tax year. In addition to the introduction of the e-personal income tax system, the NTCA will also prepare the excise tax return as of 2018, which then may be followed by the draft VAT return. Meanwhile, the introduction of online cash registers and the electronic road toll system has successfully contributed to restricting the shadow economy. The improvement in client-oriented approach, the reduction of the amount of fines and the promotion of counselling services are expected to contribute to the further improvement in taxpayers' morale. The achievement of the aforementioned purposes can be supported by the adoption of further successful international practices, many of which are presented in our study.

NOTES

¹ The authors thank for György Matolcsy, László Parragh, András Tállai, Zsuzsanna Szelecki, Kornél Kalocsai, Gergely Baksay, Balázs Csomós, Péter Domonkos and Gábor Meizer for their contributions to the study.

² The Curia's decision ensuring uniformity passed on 16 June 2014 established the legal grounds for the full conversion of foreign currency loans to Hungarian forints. In addition to the required government decisions, the Central Bank of Hun-

gary also played a key role in the implementation of the conversion, providing foreign exchange liquidity worth EUR 9 billion for commercial banks. The foreign exchange tenders organised by the central bank took place between the autumn of 2014 and September 2015; therefore almost all foreign currency loans were phased out from the balance sheet of Hungarian households by the end of 2015.

³ In our interpretation, the adoption of a behavioural rule leads to a change in attitude as well, because the cooperating parties do not follow and accept the rules on one occasion, but their behaviour, approach and way of thinking change permanently.

⁴ The social welfare system that was too loose before 2010 prevented an increase in activity and employment. Several forms of aids and allowances (permanent unemployment benefit, high number of disability pensioners) acted against employment. At that time, people received a benefit comparable to the minimum wage on a permanent basis even without employment, which undoubtedly discouraged people from working.

⁵ Report on the measures taken to implement the proposal issued by the Economic and Finance Ministers' Council in the framework of an excessive deficit procedure on 13 March 2012

⁶ Government Decision No. 1306/2017. (VI. 8.) and Government Decision No. 1567/2017. (VIII. 28.)

⁷ SZAK-ma.hu – We are making 21st century tax rules An interview with Norbert Izer, Deputy State Secretary responsible for tax regulation and accounting. <http://szak-ma.hu/ado/a-xxi-szazadnak-megfelelo-adoszabalyozast-keszitunk-interju-izer-norbert-adoszabalyozasert-es-szamviteleert-felelos-helyettes-allamtitkarral-101181>

⁸ Kormany.hu – The Tax Authority is modernised by the Government. <http://www.kormany.hu/>

[hu/nemzetgazdasagi-miniszterium/parlament-allamtitkarsag/hirek/tallai-xxi-szazadi-modern-adohatosagot-szeretnenk](http://nemzetgazdasagi-miniszterium/parlament-allamtitkarsag/hirek/tallai-xxi-szazadi-modern-adohatosagot-szeretnenk)

⁹ Bill No. T/7918 of 2015 on the amendment of certain laws related to the reorganisation of the National Tax and Customs Administration of Hungary, budgetary planning and management <http://www.parlament.hu/irom40/07918/07918.pdf>

¹⁰ Operational and Organisational Rules of the National Tax and Customs Administration of Hungary: https://www.nav.gov.hu/nav/kozerdeku_adatok/altalanos_kozzeteteli_lista/nav_feladat_es_hataskore_1366633265651/szmsz/nav_szmsz

¹¹ <https://www.gov.uk/>

¹² SZAK-ma.hu – 2018 opens a new chapter in taxation – AN INTERVIEW WITH ANDRÁS TÁLLAI. <http://szak-ma.hu/ado/2018-uj-fejezet-nyit-az-adozasban-101538>

¹³ Tax Online (Adó Online) – The support procedure of the NTCA. <https://ado.hu/rovatok/ado/a-nav-tamogato-eljarasa>

¹⁴ <https://www.nav.gov.hu/nav/adotraffipax>

¹⁵ NTCA – Information on the rating of taxpayers (2016). https://www.nav.gov.hu/data/cms404510/71._sz_fuzet_Az_adozoi_min_sitessel_kapcsolatos_tudnivalok_20160504.pdf.

¹⁶ Hirado.hu – The NTCA also helps with completing the excise tax return. <https://www.hirado.hu/belfold/kozelet/cikk/2018/01/18/a-jovedeki-adobevallas-elkesziteseben-is-segit-a-nav/>

¹⁷ Portfolio.hu – Mr. Varga has announced an enormous plan. <https://www.portfolio.hu/gazdasag/adozas/varga-hatalmas-tervet-jelentett-be.270339.html?k=3&i=270339>

¹⁸ European Public Sector Award 2015 – ALF (Child Benefit without Application). http://www.epsa2015.eu/files/Exec._summary_ALF-AT.pdf

¹⁹ Hungarian Times (Magyar Idők) – A breath of fresh air for producers (Levegőhöz jutottak a termelők). <http://magyaridok.hu/gazdasag/levegohoz-jutottak-termelok-2567659/>

²⁰ Draft decree on the amendment of Decree No. 23/2014. (VI. 30.) of the Minister of National Economy on the tax administration identification of invoices and receipts, and the verification of electronically stored invoices by the tax authority. https://www.nav.gov.hu/nav/onlineszamla/jogszabalyok/A_nemzetgazdasagi_min20180117.html

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