

## HUNGARY

|  | 1995        | 2000        | 2001        | 2002        | 2003        | 2004        | 2005        | 2006        | 2006        |                      |                      |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------------|----------------------|
| <b>A. Structure of revenues</b>                      |             |             |             |             |             |             |             |             | % of GDP    | € bn                 | Ranking <sup>1</sup> |
| Indirect taxes                                       | 17.8        | 16.1        | 15.3        | 14.9        | 15.6        | 16.3        | 15.8        | 15.3        | 13.7        | 9                    |                      |
| VAT  | 7.7         | 8.6         | 8.1         | 7.8         | 8.1         | 8.8         | 8.4         | 7.6         | 6.8         | 16                   |                      |
| Excise duties and consumption taxes                  | 4.2         | 3.8         | 3.7         | 3.6         | 3.6         | 3.3         | 3.2         | 3.3         | 3.0         | 10                   |                      |
| Other taxes on products (incl. import duties)        | 5.8         | 3.3         | 3.2         | 3.1         | 3.4         | 3.6         | 3.6         | 3.8         | 3.4         | 1                    |                      |
| Other taxes on production                            | 0.1         | 0.4         | 0.4         | 0.4         | 0.4         | 0.5         | 0.5         | 0.6         | 0.5         | 21                   |                      |
| Direct taxes   | 8.9         | 9.6         | 10.1        | 10.1        | 9.5         | 9.1         | 9.1         | 9.4         | 8.5         | 17                   |                      |
| Personal income                                      | 6.7         | 7.1         | 7.5         | 7.5         | 7.0         | 6.6         | 6.6         | 6.7         | 6.1         | 16                   |                      |
| Corporate income                                     | 1.9         | 2.2         | 2.3         | 2.3         | 2.2         | 2.1         | 2.1         | 2.3         | 2.1         | 24                   |                      |
| Other  | 0.3         | 0.3         | 0.3         | 0.3         | 0.3         | 0.4         | 0.4         | 0.4         | 0.3         | 22                   |                      |
| Social Contributions                                 | 14.9        | 12.8        | 12.8        | 12.8        | 12.5        | 12.2        | 12.5        | 12.5        | 11.3        | 9                    |                      |
| Employers'   | 12.2        | 10.3        | 10.1        | 10.1        | 9.7         | 9.4         | 9.7         | 9.5         | 8.5         | 4                    |                      |
| Employees'   | 2.3         | 2.0         | 2.1         | 2.2         | 2.2         | 2.3         | 2.3         | 2.5         | 2.2         | 16                   |                      |
| Self- and non-employed                               | 0.4         | 0.5         | 0.6         | 0.6         | 0.6         | 0.5         | 0.5         | 0.6         | 0.5         | 17                   |                      |
| <b>B. Structure according to level of government</b> |             |             |             |             |             |             |             |             | % of GDP    |                      |                      |
| Central Government                                   | 25.1        | 22.9        | 22.5        | 22.2        | 21.8        | 21.6        | 21.3        | 21.2        | 19.1        | 17                   |                      |
| State Government <sup>2</sup>                        | n.a.        | n.a.        | n.a.        | n.a.        | n.a.        | n.a.        | n.a.        | n.a.        | n.a.        | n.a.                 |                      |
| Local Government                                     | 2.7         | 3.8         | 4.0         | 4.0         | 4.3         | 4.5         | 4.3         | 4.3         | 3.9         | 10                   |                      |
| Social Security Funds                                | 13.8        | 11.8        | 11.8        | 11.7        | 11.5        | 11.3        | 11.4        | 11.4        | 10.2        | 12                   |                      |
| EU Institutions                                      | n.a.        | n.a.        | n.a.        | n.a.        | n.a.        | 0.2         | 0.3         | 0.3         | 0.3         | 15                   |                      |
| <b>C. Structure according to economic function</b>   |             |             |             |             |             |             |             |             | % of GDP    |                      |                      |
| Consumption  | 17.4        | 15.3        | 14.5        | 14.1        | 14.6        | 15.0        | 14.5        | 13.9        | 12.5        | 5                    |                      |
| Labour   | 20.8        | 19.1        | 19.3        | 19.4        | 18.7        | 18.2        | 18.5        | 18.6        | 16.7        | 11                   |                      |
| Employed   | 20.0        | 18.2        | 18.4        | 18.5        | 17.8        | 17.3        | 17.6        | 17.7        | 15.9        | 10                   |                      |
| Paid by employers                                    | 12.3        | 10.5        | 10.3        | 10.2        | 9.9         | 9.6         | 9.9         | 9.7         | 8.7         | 6                    |                      |
| Paid by employees                                    | 7.7         | 7.7         | 8.1         | 8.3         | 8.0         | 7.7         | 7.7         | 8.1         | 7.2         | 13                   |                      |
| Non-employed   | 0.8         | 0.9         | 0.9         | 0.9         | 0.9         | 0.8         | 0.8         | 0.9         | 0.8         | 13                   |                      |
| Capital  | 3.5         | 4.1         | 4.4         | 4.4         | 4.4         | 4.4         | 4.4         | 4.7         | 4.2         | 23                   |                      |
| Capital and business income                          | 2.8         | 3.1         | 3.4         | 3.4         | 3.2         | 3.1         | 3.1         | 3.4         | 3.0         | 24                   |                      |
| Income of corporations                               | 1.9         | 2.2         | 2.3         | 2.3         | 2.2         | 2.2         | 2.2         | 2.4         | 2.1         | 24                   |                      |
| Income of households                                 | 0.6         | 0.6         | 0.7         | 0.7         | 0.6         | 0.6         | 0.6         | 0.6         | 0.6         | 15                   |                      |
| Income of self-employed (incl. SSC)                  | 0.3         | 0.3         | 0.4         | 0.4         | 0.4         | 0.4         | 0.3         | 0.4         | 0.3         | 23                   |                      |
| Stocks of capital / wealth                           | 0.7         | 1.0         | 1.0         | 1.0         | 1.2         | 1.3         | 1.3         | 1.3         | 1.2         | 17                   |                      |
| <b>TOTAL</b>   | <b>41.6</b> | <b>38.5</b> | <b>38.3</b> | <b>37.9</b> | <b>37.6</b> | <b>37.6</b> | <b>37.4</b> | <b>37.2</b> | <b>33.5</b> | <b>12</b>            |                      |
|  |             |             |             |             |             |             |             |             | % of GDP    |                      |                      |
| Of which environmental taxes                         | 3.1         | 3.0         | 2.8         | 2.8         | 2.7         | 2.8         | 2.8         | 2.9         | 2.6         | 9                    |                      |
| Energy   | 2.7         | 2.4         | 2.3         | 2.2         | 2.3         | 2.1         | 2.1         | 2.1         | 1.9         | 9                    |                      |
| Transport  | 0.2         | 0.4         | 0.4         | 0.4         | 0.2         | 0.5         | 0.5         | 0.6         | 0.5         | 12                   |                      |
| Pollution/Resources                                  | 0.2         | 0.2         | 0.2         | 0.2         | 0.2         | 0.2         | 0.2         | 0.1         | 0.1         | 10                   |                      |
| <b>D. Implicit tax rates</b>                         |             |             |             |             |             |             |             |             | %           | Ranking <sup>1</sup> |                      |
| Consumption  | 30.8        | 27.5        | 25.6        | 25.4        | 26.0        | 27.6        | 26.4        | 25.8        | 7           |                      |                      |
| Labour employed                                      | 42.6        | 41.8        | 41.0        | 40.6        | 38.8        | 37.7        | 37.8        | 39.0        | 9           |                      |                      |
| Capital  | -           | -           | -           | -           | -           | -           | -           | -           |             |                      |                      |
| Capital and business income                          | -           | -           | -           | -           | -           | -           | -           | -           |             |                      |                      |
| Corporations   | -           | -           | -           | -           | -           | -           | -           | -           |             |                      |                      |
| Households   | -           | -           | -           | -           | -           | -           | -           | -           |             |                      |                      |
| <b>p.m.:</b>   |             |             |             |             |             |             |             |             |             |                      |                      |
| Real GDP growth (annual rate)                        | 1.5         | 5.2         | 4.1         | 4.4         | 4.2         | 4.8         | 4.1         | 3.9         |             |                      |                      |
| Output gap (potential)                               | 1.4         | -0.5        | -0.8        | -0.9        | -0.8        | 0.0         | 0.4         | 1.1         |             |                      |                      |

See ANNEX B for classification of taxes and ANNEX C for explanatory notes.

1) The ranking is calculated in descending order. A "1" indicates this is the highest value in the EU-27. No ranking is given if more than 10 % of data points are missing.

2) This level refers to the Länder in AT and DE, the gewesten en gemeenschappen / régions et communautés in BE and comunidades autónomas in ES.

n.a.: not applicable, - : not available

Source: Commission Services

## Overall trends in taxation

### *Structure and development of tax revenues*

As of 2006, with a total-tax-to-GDP ratio of 37.2 % (including social security contributions), Hungary's tax burden is slightly above the EU-27 average (37.1 %). Looking at neighbouring countries, Austria and Slovenia display higher tax ratios (41.8 % and 39.1 % respectively) but both Slovakia's (29.3 %) and Romania's (28.6 %) ratios lie well below the Hungarian value.

Revenues from indirect taxes are substantial, their share accounting for 41 % of the total. VAT revenues however decreased by 0.8 points in 2006, owing to the reduction of the standard rate from 25 % to 20 %. Other taxes on products are the highest in the EU mainly because of local business tax revenues. In contrast, direct taxes are relatively low: at 9.4 % of GDP, they are lower than the EU-27 average by almost one fourth. Despite a marked decline since 1995, social contributions in relation to GDP remain clearly above the European average; the majority of them fall on employers.

Tax revenues are divided between central government, local government and the social security system. While central government remains by far the largest recipient of tax revenue, with over half of the total, local government taxes are, at 4.3 % of GDP, not negligible. Local taxes have grown rapidly until 2004 (70 % increase since 1995), although in 2005 they dropped down slightly to the 2003 level.

The overall tax burden has been generally declining since 1995 and has now reached the EU-27 average level; in 1995, the tax burden in Hungary exceeded the EU-27 average by 4.1 percentage points. The shares of the main categories of taxes evolved differently as the shares of indirect taxes and social contributions declined somewhat from 1995 levels (largely owing to falling other taxes on products) while the share of direct taxes, including personal income taxes, has tended to increase up to 2002, showed a decline in 2003 and 2004 and stabilised at 9.1 % in 2004 and 2005, then in 2006 increased again to 9.4 %, close to the 2003 level.

### *Taxation of consumption, labour and capital; environmental taxation*

The high level of indirect taxation in Hungary leads to a correspondingly elevated ITR on consumption (25.8 % in 2006). This value is the seventh highest in the EU-27. The ITR on consumption shows a general decline up to 2002 in line with the reduction in indirect tax revenue, then bounced back somewhat thereafter.

The ITR on labour amounted to 39 % in 2006. This value is 4.3 points above the EU-27 average. Since 1997, the ITR on labour showed a gradual decline over time until 2004, but increased by 1.3 points in 2006. The revenues from taxes on capital are, at 4.7 % of GDP, the lowest in the EU after the Baltic States, due notably to low business income taxation, but have been increased by 0.2 points in 2006 reflecting the changes in tax policy. Data limitations prevent computation of the ITR on capital.

Environmental taxes represented 2.9 % of GDP. This share is somewhat above the EU-27 average (2.7 %) and has remained roughly stable in the past five years. As in most countries, taxes on energy account for the largest part of environmental tax revenues.

### *Current topics and prospects; policy orientation*

In 2006 the government introduced taxes on interest and capital gains derived from stock exchange activities (rate of 20 %). These taxes increased the proportion of tax revenues from taxes on capital. Labour and personal income taxes, on the other hand are expected to fall in the coming years. This structural modification will maintain the overall tax burden but converge to EU structural trends. There have been some changes in corporate taxation; a solidarity tax has been introduced. The solidarity tax also affects private persons with high income.

## Main features of the tax system

### *Personal income tax*

Personal income tax is applied at central government level. In the last years, Hungary has introduced a number of reforms in personal income taxation. The three-bracket system utilized since 1999 has been replaced, from 1 January 2005, with a two-bracket system. As from 2007 income up to HUF 1.7 million (€6 800) is taxed at an 18 % rate, whereas above that threshold the rate is 36 %. This highest rate decreased 2 percentage points in 2006 from the previous 38 %. However from 2007 onwards private persons with a combined annual income of more than HUF 7 137 000 (approx. €28 000) must pay solidarity tax. The tax base is the portion of the income over HUF 7 137 000, the tax rate is 4 %.

There is no basic allowance. In Hungary deductions are applied as tax credits: the most important ones are the employment credit (18 % of wage income with limitations), insurance premiums (20 % of the premium) and charitable contributions (30 %). The maximum amount of tax credits is HUF 100 000 (€400); and no credits are available for those who have annual income above HUF 3.9 million (€15 320). The only exception is the family tax credit which applies to households with 3 or more children and the amount is HUF 4 000 (€15)/month/child.

A 25 % withholding tax is imposed on the dividends from resident companies paid to individuals, up to 30 % of the value of equity's portion attributable to the individual's shareholding. The remaining 70 % is taxed at a rate of 35 %. Foreign source dividends are taxed at 25 % rate for the whole amount. Capital gains are also taxed at 25 %.

In order to secure a more equitable distribution of the tax burden between work and capital income, a tax on interest and a tax on stock exchange transaction were introduced on 1 September 2006. The rate of these taxes is set at 20 %. No portion of these incomes is exempted from tax. The tax on interest is withheld by the payer, and the tax on capital gains in stock exchange deals is declared and paid by the private individual in their tax return.

### *Corporate taxation*

In recent years there has been a strong tendency to reduce corporate tax rates, particularly in new Member States. In this context Hungary has an established position as a low-tax country, given that it introduced a corporate tax rate of 18 % already in 1995, further reduced to 16 % as of 2004. Under certain conditions the tax payer may use a tax rate of 10 % for the tax base of HUF 50 million (€200 000).

The solidarity tax was introduced on 1 September 2006. The tax rate is 4 % on the adjusted pre-tax profit. R&D expenditure is deducted from the tax base.

The rate of the simplified corporate tax (EVA) has increased from 15 % to 25 % effective from 1 October 2006. Besides the corporate income tax, municipalities may levy a local business tax. From 2004 onwards companies are also required to pay an innovation tax, in 2007 at the rate of 0.3 %. Innovation tax is levied on the same base as that of the local business tax, but an amount equal to R&D expenditure carried out directly by the firm is deducted from the tax.

Since 2004, companies may carry the amount of trading losses forward indefinitely, but subject to limitations; carry back of losses is not allowed.

Capital gains are generally included in the company's total ordinary income. However, 50 % of capital gains on transactions on a recognized stock exchange by a company other than an insurance or financial institution are exempt, subject to limitations. Capital gains of foreign companies without a permanent establishment in Hungary

are exempt from Hungarian tax. Dividends paid to Hungarian companies are generally deductible from the corporate tax base.

### **VAT**

In 2005 and 2006 the VAT system changed significantly. For almost all goods, the standard VAT rate was cut to 20 % from 25 % from 1 January 2006, but the 15 % reduced rate has increased to 20 % from 1 September 2006. The 5 % reduced rate applies only to a few products (such as specific medicines and medical materials, books, newspapers, etc).

### **Other taxes**

From 2007 banks have to pay a surtax on interest revenue from loans related to state subsidies at a 5 % rate.

Municipalities may levy a real estate tax on building and land. The maximum tax is either a fixed amount (HUF 900 per year per square metre for buildings, HUF 200 per year per square metre for land) or 3 % of the market value.

### **Social contributions**

Social security contributions consist of pension insurance contributions and health insurance contributions. In the case of pension contributions paid by employees, a ceiling applies. Additionally, health care charges are payable.

Social security contributions include employers' social security contributions of 29 % and employees' social security contributions of 15.5 % (health contribution 7 % plus pension contribution 8.5 %; in the case of private pension fund members the health contribution is 7 %, the pension contribution is 0.5 % and they pay 8 % to private pension funds). The health care tax charge of 11 % is generally assessed on those items of income that are not subject to the social security contributions, but are included in the aggregate taxable base.

On 1 September 2006 the rate of the employees' contribution increased from 1 % to 1.5 %.