



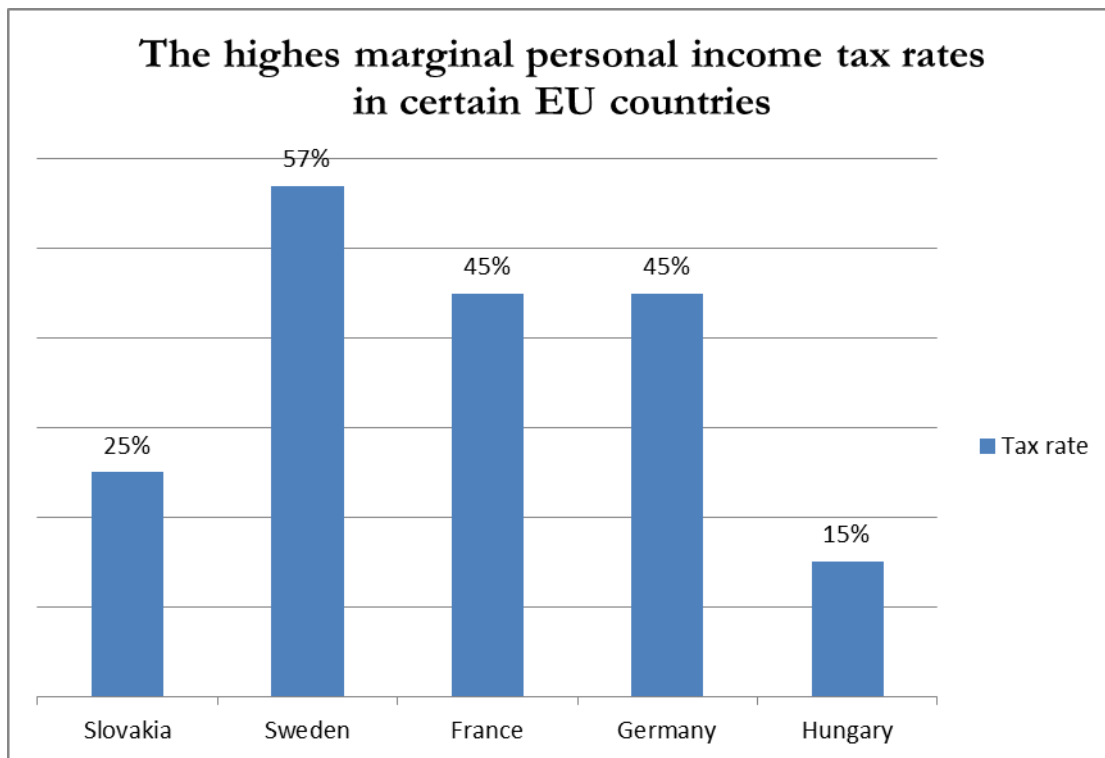
Major changes expected to increase tax competitiveness in Hungary

As of 2016, the rate of personal income tax has been reduced from 16 percent to 15 percent in Hungary. This measure is expected to be another step towards improving the competitiveness of the Hungarian taxation system. According to projections of the Ministry for National Economy, in comparison to 2010 taxpayers will keep more than HUF 850bn extra in the year 2016. The Government endeavours to cut the rate of personal income tax further in this parliamentary term and reach a single-digit figure by 2018.

Favourable changes in the tax regime in 2016

The flat-rate personal income tax regime has been introduced in Hungary as of 1 January 2011. Initially, a uniform tax rate of 16 percent had been introduced, which was recently cut to 15 percent. This has led to substantial improvement in the transparency of the tax system and helped simplify a complex tax regime. Formerly, the personal income tax regime was progressive, with various rates depending on annual incomes. This system adversely affected job offers, discouraged people from working better and forced jobseekers to accept work in the grey economy. In 2010, for example, the tax rate was 17 percent up to a yearly income of HUF 5 million, and 32 percent above that threshold. Prior to 2011, tax credits and later so-called super-grossing further complicated tax returns. In 2010, a tax credit – 17 percent of the wage or maximum HUF 15 100 per month -- could be claimed up to a total annual income of HUF 3 188 000. Under super-grossing, employer contributions were added to the tax base.

In Europe, the average rate of personal income tax well exceeds 30 percent; therefore Hungary is in a very favourable situation. Bulgaria has the lowest personal income tax rate within the EU, followed by Hungary and Lithuania, while it is the highest in Sweden. The below chart aptly demonstrates that the rate of personal income tax is lower in Hungary even when compared to neighbouring Slovakia.



Source: http://europa.eu/youreurope/citizens/work/taxes/income-taxes-abroad/index_en.htm

Another advantage of the Hungarian tax regime is that since 2011 it has been supporting families through the family tax allowance. Family tax allowance is an incentive deductible from the tax base; its amount depends on the number of dependants in a family. The amount of the family tax allowance is HUF 10 000 per dependant for one dependant, HUF 12 500 per dependant for two dependant and 33 000 per dependant for three or more dependants. Supporting couples to have children through the tax regime serves a strategic objective of the Government that aims to reverse the multi-decade trend of falling birth rates in the country. Falling birth rates lead to an aging population, which increases burdens on welfare systems and may result in labour shortages. The extreme aging of a society – due mainly to the inevitable rise in retirement age – may also cause the deterioration of the average work efficiency of the labour force. The new housing programme, which aims to assist families with children in purchasing a home, also encourages couples to have children.

The Hungarian Government wants to shift the focus of taxation from indirect to direct levies. This is also in line with international trends, as direct taxes have the major advantage of being more transparent and less susceptible to tax evasion. Accordingly, consumption-type taxes are



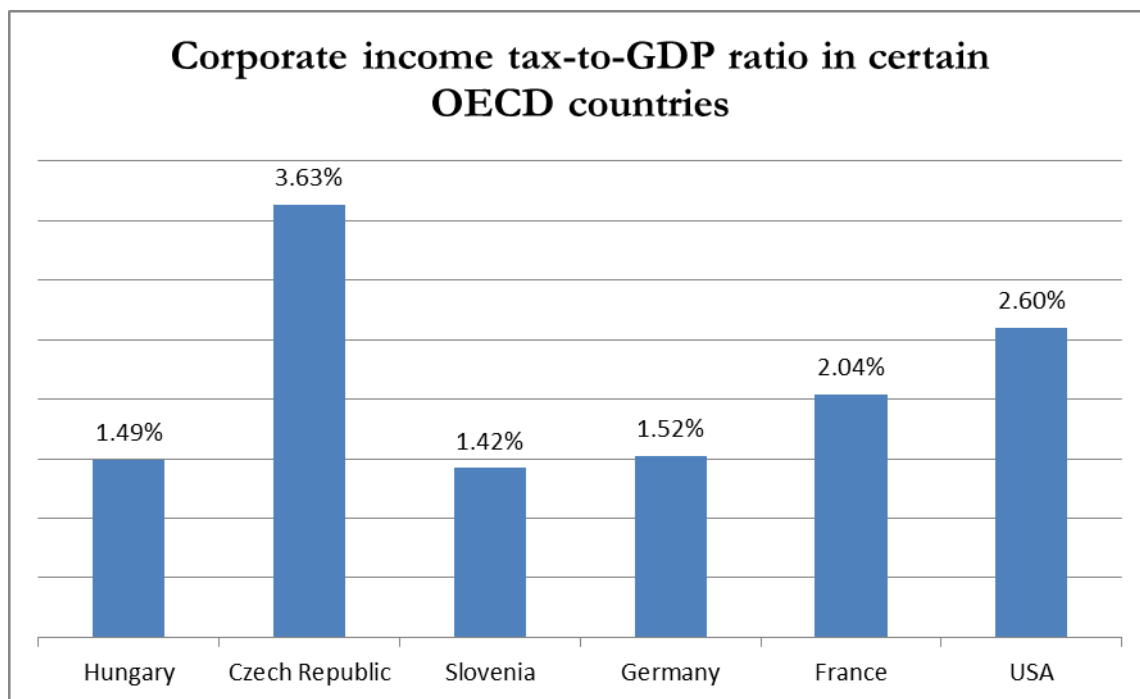
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coming more and more to the foreground. Minister for National Economy Mihály Varga also pointed out in an interview that an increasing number of European countries were reducing taxes for private persons. This also confirms the adequacy of the decision five years ago to cut the personal income tax.

In accordance with the MoU concluded with the EBRD, the rate of bank tax is reduced this year and that is expected to boost lending. The upper rate is cut, while the lower remains unchanged. The adjusted balance sheet value of a given bank in 2009 constitutes the tax base for the bank tax, and the upper rate falls from the former 0.53 percent to 0.24 percent. The lower rate remains unchanged, at 0.15 percent up to HUF 50bn. The bank tax is set to be reduced further as of 2017. This is a highly favourable development from the aspect of Hungarian lenders, as the falling lending trend in the post-crisis period showed signs of a U-turn only in 2014, as a result mainly of the MNB's Funding for Growth Scheme.

Lending is also expected to be fuelled by financial instruments used within the framework of EU funding schemes, which may help enterprises obtain funds that would otherwise be unable to get them. The revival of lending may boost economic growth both in the short and the long term through the realization of investment projects, as investment growth generates extra demand within the economy which in turn increases output at companies.

Taxes on corporate profits are also highly favourable in Hungary, as according to an OECD study the only country where enterprises had a lower corporate income tax-to-GDP ratio in 2014 than they did in Hungary was Slovenia. This bolsters the attractiveness of Hungary for foreign investors as well. The below chart presents the findings of the OECD study on corporate income taxes.



Source: OECD

Improving the efficiency of tax collection

Another key indicator of the competency of a country's taxation system is the efficiency of tax collection. The Hungarian Government has been making strenuous efforts to improve tax transparency through increasing the efficiency tax collection. As one of the steps taken in this direction, Hungary's National Tax and Customs Administration (NAV) became as of 2016 a two-tier institution brought under the sphere of competence of the Ministry for National Economy. Under the new system, citizens who dispute a decision by the first instance tax authority may turn to a Directorate of Appeals. The reform of NAV's organizational structure will lead to significant streamlining through uniting formerly highly segmented units. In order to reduce bureaucracy and accelerate processes, the number of organizational levels must be cut and several of them must be abolished. Measures, such as the introduction of on-line cash registers connected to a central database at the taxation authority and the Electronic Trade and Transport Control System (EKÁER), have been assisting the monitoring of payments. These two systems have added a massive amount of extra revenues to the state budget and resulted in substantial improvement of economic transparency.



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The introduction of reverse-charge VAT for certain agricultural products has also contributed to the efficiency of tax collection. Under reverse-charge taxation, producers sell products at net prices, without charging VAT, which is reported and paid later by the buyer. The law on reverse-charge VAT boosts the efficiency of tax control through formulating new data reporting requirements which must be fulfilled by both the sellers and buyers of products under the scope of reverse-charge VAT. This helps combat VAT fraud in the agricultural sector.

The effective fight against tax fraud is not only important because of increasing fiscal revenues. Reducing tax fraud has a positive impact on market operations, as the varying degree of complying with tax regulations distorts competition. In addition, improving compliance with taxpaying requirements facilitates the lowering of tax rates. The improvement of taxpayer morale would also help reduce spending on tax controls. The Government is preparing further anti-fraud measures, such as the launching of an e-bill system and the introduction of on-line cash registers in certain services sub sectors dominated by the black economy.

In short, the Hungarian taxation system is focusing on fostering economic growth and – to this end – it supports jobseekers and encourages private people and enterprises to earn higher incomes.