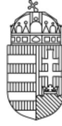


MINISTRY
FOR NATIONAL ECONOMY

Tax reduction and minimum wage increase in Hungary

Fast-paced economic growth and a successful fiscal policy have together created manouvering room for economic stimulus: the current, progressive corporate income tax scheme is to be replaced by a flat-rate tax of 9 percent, and parallel to that, the minimum wage is raised significantly and contributions payable on labour are to be reduced. The new tax scheme turns Hungary into one of the most business-friendly countries in the world, a place where it is worth to invest capital then re-invest returns. The Government expects that raising wages in the lowest category and reducing payroll taxes will together lift the standard of living and average wages in Hungary and that in turn will help narrow the real wage gap with the developed members of the European Union and add additional impetus to economic growth. The Government's predictions show that the introduction of this pro-growth tax package will enable the rate of economic growth to increase from the current 2-3 percent level to the 3-5 percent band as early as in 2017.

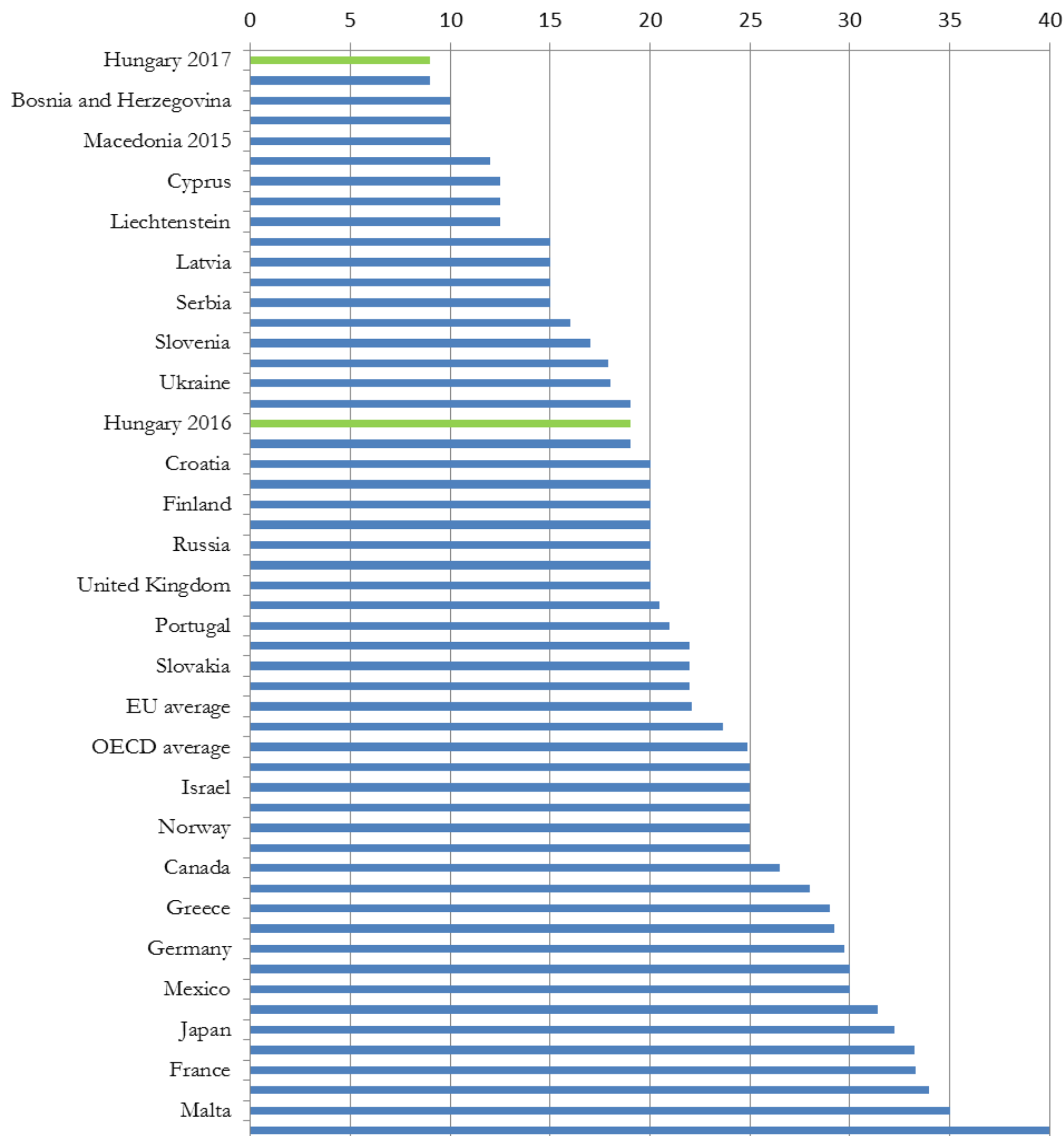
The effective progressive corporate income taxes rates of 10 percent and 19 percent will be replaced by a flat rate of 9 percent. Among the OECD countries, Hungary will thus become the second most competitive country in terms of taxes on corporate turnover, trailing only top-ranked Switzerland. In case every kind of tax levied on the profits of a company is taken into account, Hungary is in an even better position than Switzerland. From a regional perspective, the Hungarian tax rate is competitive in light of the respective rates of 22 percent in Slovakia, 16 percent in Romania and 15 percent in Serbia.

Hungary can thus join the competition for investment by global economic stakeholders. This move is expected to facilitate the expansion of Hungarian enterprises and the largest possible volumes of re-investment of profits generated.

As Hungary will thus have the lowest corporate income tax rate in Europe, the country will also become one of the most investor-friendly states in the EU. In the post-Brexit period, companies currently headquartered in London may also decide to bring investment and operations to Hungary. Besides the investment effect, the Ministry is also envisaging a technical-statistical impact: encouraged by the favourable tax rate, the number of international companies which opt for booking operating profits in Hungary is also likely to increase. Indirectly, this will have a favourable effect on Hungary's GDP, and in the long term the rising volume of revenues will

compensate for the shortfall caused by the lower tax rate. Business advisors are ready to add that the rate of corporate income tax is albeit a major but not the one-and-only factor in weighing investment options. Tax experts warn that extremely low taxes may put Hungary in the same league with tax havens in the eyes of decision-makers, and that may harm the country's international political and economic relations.

Percentage rate of corporate tax (tax burden of corporate profit)



Source: data from OECD, edited by Ministry for National Economy

The largest impact of the current changes will be on the amount of tax payable by medium-sized and large enterprises, as the 19 percent tax rate is applied to the larger part of their tax base.

Chances are good that these enterprises are going to use funds gained through lower taxes to finance extra investment projects in the midst of a growing economy. Analysts point out that this change mainly benefits large enterprises, and among them those which are just now running out of investment allowances and tax credits. On the other hand, market analysts believe that allowances deductible from taxes are set to fall, and the incentives gained from tax and tax base deductions will decrease in proportion to the reduction of the tax rate. However, it has to be added that the real tax burden has actually been below 19 percent at several large enterprises, and in their case the reduction of the tax rate is likely to have a less sizable impact on profitability. The real, final outcome of lower tax rates will vary from company to company, depending on other corporate incentives.

As the general government budget is concerned, according to the estimate of the Ministry for National Economy, the governmental body responsible for fiscal management, the reduction of the corporate income tax rates to a single rate will cut fiscal revenues by altogether HUF 145bn. The bulk of this amount is set to remain at high-turnover companies which have hitherto applied the higher tax rate. However, substantial reserves have been accumulated within the state budget and these allow the easing of tax conditions and other economic stimulus measures without jeopardizing stable public finances. Hungary's 2017 Budget is projected to cover the shortfall due to lower tax revenues from reserves of HUF 200bn. In the 2016 Budget, full-year revenues from the corporate income tax are estimated at HUF 689.9bn, against the previous year's HUF 548.8bn. The respective estimate for the 2017 Budget, adopted in summer 2016, is HUF 734.7bn. Figures calculated by market analysts are similar to the Government's predictions: the volume of tax base in 2015 was some HUF 4500bn, of which the 10 percent rate was applied on HUF 2900bn and the 19 percent rate was applied to HUF 1630bn. In light of these concrete data, the reduction of the 10 percent rate to 9 percent will result in a shortfall of HUF 28-29bn, while the tax base upon which 19 percent tax was formerly levied is set to cut tax revenues by HUF 163bn, to roughly HUF 192bn. Taking into consideration the system of effective tax incentives, the gap would total – based on 2015 data – some HUF 155bn. Based on estimations for 2017, experts put the overall revenue shortfall resulting from the latest measure at HUF 170bn.

Parallel to reducing the corporate income tax rate, the Government has also decided to introduce a number of measures aimed at increasing wages as of 2017. The lowest official wage -- the minimum wage -- and the guaranteed minimum wage – paid to skilled workers -- are set to rise by 15 percent and 25 percent, respectively. Employer contributions are to be cut by 5

percentage points in 2017. In 2018, the minimum wage and the guaranteed minimum wage are projected to rise by another 8 percent and 12 percent, respectively, while payroll taxes will be reduced by another 2 percentage points. From maintaining jobs the main focus of economic policy has shifted to keeping skilled labour in the economy in a bid to safeguard growth. The main objective of this move was to accelerate the convergence of real wages to that of developed EU member states. Raising lower-end wages is expected to prompt wage hikes all across the board. The lower corporate income tax rate is already a factor for achieving this. Increasing wages are seen to boost consumption and thus become an internal growth engine for the Hungarian economy.

An earlier comprehensive proposal by the National Bank of Hungary, aimed at improving competitiveness, has recommended the reconsideration of the system of tax incentives, as this might facilitate the lowering of some tax rates. **The Government is expecting that the reduction of the corporate income tax rate and a substantial wage hike will concurrently improve competitiveness and help meet wage demand.** The Ministry for National Economy prognosticates that stronger economic growth will compensate for the ensuing shortfall already in 2017. **The introduction of these measures is expected to lift the rate of economic growth from the current 2-3 percent to 3-5 percent per annum.**