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**FACULTY OF ECONOMICS**
**THEORY AND PRACTICE OF ECONOMIC PROCESSES**
**DOCTORATE SCHOOL**
**SUBPROGRAM FOR FINANCES**

# COMPARATIVE STUDY OF CORPORATE TAXATION IN THE MIRROR OF HUNGARY'S EU ACCESSION

## THESIS OF DOCTORATE (PhD) DISSERTATION

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**Research Objectives**

The main objective of this research was the investigation on corporate taxation as an aspect in investors' decision-making.

Taxation policy is the most important element of the national economy policy; taxes constitute the basis for the public expenditures and income redistribution. Therefore, the taxation systems have to fulfil a double role: They have to ensure the incomes for the budget while influence the orientation of different economic areas in order to bring them in line with the macro economy endeavours and to influence the different branches of the economy as efficiently as possible.

All actors in the economic and social life will come into contact in one way or another with the taxation system. Considering the issue of taxation from the aspect of the enterprises, it is an important aspect for all enterprises acting in the economy how they use their profits achieved in the given business year: how much they should pay to the budget and what will be the amount that in the end will remain for the enterprise that can be used for realization of its own objectives.

My research focuses on the investment incentives in the corporate taxation as an aspect of the investors' decision-making. My objective is to evaluate the Hungarian regulation and to search for an optimal Hungarian taxation strategy based on the regulations provided by the European Union and the practice of the member states in the line with the regulations of the European Union however, still preserving the competitiveness of Hungary.

On May 1, 2004, Hungary became full member of the European Union. It is obvious that it is important to have an appropriate knowledge on the Community: rights and opportunities as well as obligations.

Both the economic and social processes and the ever strengthening international taxation competition force the taxation regulation makers and enforcers to analyze and evaluate the present taxation regulations.

In the last decades a strong competition emerged among the national economies to seize the direct foreign capital investments. It became typical that the nation-states try to attract into the country the multinational enterprises by economical policy facilitations and discounts using the tax allowances or taxation exemptions as tools.

During the accession negotiations with the European Union it became necessary to review and transform the Hungarian tax allowances and tax exemptions.

In my research I am looking for the answer for the question: why the investors' tax allowances are needed and whether these allowances were needed at all. Was this a correct strategy? What is the regulation of the European Union and what kind of practice is applied in the individual member states? What new regulations would be needed in the taxation and within this, on the area of corporate taxation in order to keep Hungary attractive not only to the foreign investors but to domestic investors as well?

**Precedents and Employed Methods**

The author of the essay, being a tax adviser and tax management officer deals with the issues of taxation for years; this present essay is also a result of her activity. Besides summarizing theoretical knowledge, this present essay has been prepared using practical experiences as well.

In the employed methodology the main part of the research work has been provided by exploring and analyzing the primer resources; here I would like to mention the study – starting from the system changeover – carried out on European Union's legal regulation, Member States practice (based on the data of tax authorities, Ministry of Finance and the Investment Incentive Office. The starting point for analyzing and comparing the Hungarian regulation has been provided by the other 24 European Union Member States' corporate taxation system. Analysing the laws together with independent critical processing of the specialized literature constitute an important part of the work. The review of Hungarian legal regulation and empirical analyzes on flash report data from the Companies' Return Summary – following the investigation on the Member States' practice –serve the purposes of comparison for theoretical approach and practice.

**Innovative Character of this Essay**

The innovative character lies in:

- providing a comprehensive review on the taxation system and state aids in the 24 member states of the European Union,
- examining the Hungarian corporate tax system from the aspect of legal regulation changes since 1988 with the purpose of investment stimulation,
- revealing by analyses the beneficiaries of tax allowances and how these enterprises contribute to the economical performance,
- based on those above the information and proposals can be used for decision-making in economical policy and tax policy.

**Main Statements, Theses, Proposals of the Essay**

1. A new global system is going to be created: the age of **globalisation**, production and trade as well as the age for profit maximization. Governments, enterprises and private individuals (being consumers and employees at the same time) are mutually depending on each other. World economy tendencies will limit the economic decisions of the individual governments.

Multinational enterprises - owing to their foreign capital investments - exert an effect to the states' economic policy and influence it while the frames of activities of multinational enterprises are specified by national regulations. Therefore a **mutual dependency** is created.

2. Taxation plays a decisive role in **competitiveness**, however interpreting competitiveness as a mere tax competition would be an erroneous approach.

Recently, an increasing competition emerged among the states to obtain the foreign direct investments. In investors' decision-making the examination of the taxation system in the given country is considered an important aspect. Tools for attracting capital include the tax allowances provided by the government and the local governments.

3. **Reasons why Hungary has attracted** a prominent amount of **foreign direct investment**:

- political, economy goal, financial stability,
- new market, market share increase, purchasing trademarks,
- a market-type financial, legal and institutional environment and spontaneous privatization already began in 1988-1989, Hungary being the first in this area among the former socialist countries, fast liberalization,
- production transfer owing to lower production costs, lower wage costs, well-trained workforce,
- established infrastructure, yet, a more loose environmental regulation,
- higher proceeds expectations than the western profits,
- further export opportunities through Hungarian companies to other countries of the region,
- economic growth: a fast-growing economy provides better conditions for the return of the invested capital,
- promoting the foreign investors, significant supports, tax allowances.

Foreign investors have been attracted to Hungary primarily by the opportunity of obtaining market share and the trained, yet, relatively cheap workforce.

Owing to the foreign direct investments the Hungarian economy has been integrated into the production and trade system of the world economy.

Attracting the foreign direct investment is becoming more difficult with the increase of competition.

4. The assessment on the foreign capitals' role shows that foreign direct investments in the Hungarian economy brought both positive and negative effects. The modernization and structure change could only be realized with the help of the foreign companies.
Investors were attracted by areas ensuring a relatively fast capital return. The large multinational companies' relatively small investments generated an attraction force for the other investors with large capital strength. These were soon followed by their suppliers, banks and other service providers.

Companies with foreign share have a decisive role in the performance ability of the Hungarian economy. The export-oriented enterprises being in foreign ownership have propelled the Hungarian economy. Without the inflow of foreign direct capital the crisis would have been graver, the unemployment would have been of larger proportion, and the changeover would have been longer and more painful.
The research work proved that the foreign investors were in favoured position during the privatization therefore they succeeded to obtain a decisive part of the Hungarian companies while the green field investments promoted their integration into the multinational global network. As a summary, the foreign enterprises were focusing to more efficient areas of the economy.

5. The long-term economic growth is primarily ensured by export-orientation. If an enterprise endeavours to provide supply only for a given market then it is not interested in the renewal of the technology, increasing the efficiency, in competitive wages, establishment of a production of economical sizes; therefore it doesn't exert positive effects to the other areas of the economy or these effects are minimal.
The contribution of the foreign direct capital to the economic growth is likely to be realized when the recipient country follows a policy that stimulates the foreign company to run a business in which the proportion of the R&D is high, hires high proportion scientific and technical staff, and the innovative character of the product is also important to it.
The foreign direct capital on one hand may help the modernization of the industrial branches; on the other hand, however, product and territorial concentration may also occur. This can be observed in Hungary in the industry of production electrical machines, appliances and vehicles; here a territorial concentration has been formed in Budapest, Pest County and in Western Transdanubia.

6. The objective of the economy policy is to ensure the incomes needed for the performance of the state's duties, stimulating at the same time the economic activities and the efficient utilization of production factors and to keep all these in line with macroeconomical endeavours.
In the states wishing to join the Eurozone the involvement opportunities of the monetary policy are decreasing, which leads to more sophisticated means while the **fiscal policy** and its tool – the tax policy – is likely to become stronger.

**Taxation** endeavours to identify all the performance and to involve them into the sphere of rates and taxes with a proportional load.
Tax allowances have a diverting economic effect: tax subjects – due to the tax regulations – change their behaviour to decrease their tax burden. This, compared to the ideal market will divert the allocation of resources and the aggregate income as well.

All member states within the European Union have an **independent taxation system**. The European Union formulates certain directives by the observance of which the member states can independently establish their taxation policy.

7. The Treaty of Rome, in 1957, set as target the establishment of an economic union. The common market, today being the internal market, assumes the free movement of goods, services, persons (workforce), capital and the similarity of competition conditions for all market actors. To implement this, **tax harmonization** is essential.

The three most important objectives:

- stabilization of Member States' tax incomes,
- smooth operation of the internal market,
- improving the employment.

Community tax harmonization is closely linked to the four freedoms:

- in order to enable the free movement of goods and services the harmonization of indirect taxes and within this, the harmonization of general value added tax systems is needed.
- in capital flow and free company foundation, the corporate tax is determinant,
- free movement of workforce requires the harmonization of the personal income tax systems and the social insurance contribution systems.

The community tax policy sets a ranking as well: the objective is to realize primarily the Customs Union then the harmonization of indirect taxes , then the corporate tax and lastly, the harmonization of personal income taxes and social insurance contributions .

8. From the aspect of economical efficiency the tax systems should be “neutral”, that is, different economical decisions should not be allowed to be influenced by taxation considerations on the Single Market. This, however, is not so in the EU Member States since the taxation systems are more or less different. This is the basis for investments and investment incentives.

The objective of the most recent steps of general tax policy was to prevent the prevalence of the diverse effects of the taxation competition, that is, to prevent companies to transfer their headquarters and sites to another member state having a more advantageous taxation system since this would distort the taxation structures as well.

The Member States are not interested in the harmonization of the taxation: **tax competition** constitutes a part of their capital attraction force and **competitiveness**.

It acts in the favour of the **tax competition** and against the tax harmonization:

- the several-decade history of the European tax harmonization shows that taxation is a sensible area from the aspect of the politics, the right of taxation is the basic element of the financial sovereignty and there is no member state that would willingly hand it over to another organization ,
- based on the Treaty of Rome an unanimous consent decision is needed in all taxation issues and any member state’s veto may prevent it,
- in member states the tax policy is one of the main elements of their fiscal policy ,
- the role of the taxation systems is differing in the individual member states,
- tax harmonization also influences the income side of the national budget.

There is no joint political will or economic constraint.

9. When analyzing the **tax burden**, and comparing it on international level, it could be demonstrated that the tax burden is high in those European Union member states that have a high level welfare system such as Sweden, Denmark, Finland and in those states where the state undertakes a higher level of obligations such as Austria or France .

The tax burden is average (corresponding to the average of the EU) in countries having a strong economy but undertaking an average level of obligations such as Germany or Italy.
In a part of the countries having a low tax burden the level of state obligations is also lower, such member states are Great Britain or Ireland, while the other group includes those countries, where the economy is less developed and the standards of state services are also lower such as Spain, Portugal, Greece and the majority of the new member states.
The average tax burden of the ten new member states is 37.3% , this being 3.1% lower than the average of the EU-25 .

Hungary's tax burden - this being 38.8% – is nearly similar to the average of the European Union (40.4%), however, it is higher than the average of the ten new member states.

Sweden, having the highest tax burden has an index of 1.77 compared to Ireland having the lowest index. The proportion of the direct taxes compared to the GDP is also the highest in Sweden, this value being greater by 1.59 times then the Czech value, this latter being the lowest. The proportion of the direct taxes compared to the GDP is the highest in Denmark, this being four times greater than in Poland which has the lowest value. The proportion of social insurance contributions compared to the GDP is the highest in Germany and is lowest in Denmark, the difference being tenfold. These differences indicate at the same time the depth of the tax harmonization as well in the case of the individual taxes.

The tax burdens are transferred from the capital incomes to the remaining taxable incomes, that is, the work and the consumption. Increasing tax burden on the work incomes may have a negative effect on the employment.

Taxation in the member states of the European Union is transferred from the production to the consumption.

Examining the tax structure, the proportion of the **indirect taxes** compared to the GDP and the tax incomes has increased in almost all countries. Within the GDP the proportion of the indirect taxes is the lowest in the Czech Republic, while this is the highest in Denmark and Sweden, the Hungarian value having the rank of 8. The proportion of the indirect taxes is higher in the new Member States. This can be also explained by the fact that in the new member states having a weaker taxation moral, collection of indirect taxes is easier than of direct taxes.

Incomes originating from **direct taxes** vary within a wide range. It is the highest in Denmark and Great Britain while it is below the average in Portugal, Greece, and Germany and in the majority of the new member states including Hungary.

The proportion of corporate tax compared to the total tax income is higher in the ten new member states of the European Union than in the fifteen former member states. Its proportion, compared to the total tax income, is low in Germany, Latvia, however it is fundamental in Luxembourg, Czech Republic, Ireland, Cyprus and Malta.

10. In contrast with the indirect taxes – where the subject of the taxation, that is, the individual transactions can be more easily identified than the returns needed for **corporate taxation** – on the area of the corporate taxes the harmonisation of the national tax rates and especially the establishment of the **tax basis** are facing difficulties.

Tax legislation has to be closely linked to the harmonization of the accounting rules. The first step in the harmonization of the corporate tax systems would be to establish a consolidated tax basis.

Different versions:

- Tax regulations of the country of the mother company could be authoritative for the branch companies as well, mutually acknowledging the regulations.
- in case of accepting the parallel system the companies could employ voluntarily a brand new harmonized EU regulation.
- a part (or all) of the incomes flowing in from the possible European corporate taxes would be added to the budget of the European Union , this tax would appear beside the national tax regulations as an alternative ,
- “traditional”, mandatory harmonization.

It serves the establishment of the unified tax basis that companies registered with the stock exchanges of the European Union are required to compile their summarized (consolidated) annual report according to the international accounting standards (IAS) starting from 2005 – in some cases from 2007 .

11. In the case of **group taxation** the enterprises belonging to the same owner would pay taxes for the consolidated tax basis; the objective is to prevent the disadvantages that would arise from running their business in separate enterprises. Tax reduction is realized by transferring the losses and profits among the members of the group of the companies. Group taxation is connected in almost all member states to the full ownership interlacement.

12. Today the tax rates of the 25 member states of the European Union can not be compared to each other since they do not mean anything until the basis for the comparison is not common. The effective tax burden is expressed by the effective tax rate therefore the nominal tax rate does not provide a clear picture on that.

However, it can be stated that corporate tax rates vary on a wide scale within the European Union, the general tendency being the reduction of the corporate tax rates.

Similar to the regulations relating to the general value-added taxes, the thought of introducing a minimal tax rate has emerged on the area of corporate taxation as well.

In several member states the progressive tax rate is applied for example in Belgium, France, and the Netherlands or in Great Britain.

Even loss-making enterprises have to pay a minimal tax in several member states such as Austria and France therefore the budgetary incomes become more predictable and the company may deduct it from the tax basis in the next year or years when it becomes profitable.

13. The capital is flowing into the direction where the tax burdens are lower. Germany has lost a serious amount of foreign direct investment because of its high tax burdens, while one of the beneficiaries beyond the ten new member states was Ireland.

14. **Investment incentives have** become spectacular in every country. Investments are allocated in a targeted manner on one hand to the regional developments, on the other hand to the attraction of investments representing the developed technology. Workplace creation and training has gained a prominent role.
The amount limit of the investments to be supported is relatively low making possible that not only large enterprises can become the beneficiaries of the state supports.

Among the items decreasing the tax basis, the fast write-down connected to the amortization is a general practice in almost all member states. A fast amortization is allowed in general in computer technology, software, environmental protection, research and development tools, that is, on the areas that typically belong to the horizontal supports.
Equipment procurement in lump sum means a simplification of the tax administration and a fast amortization procedure.

15. The most frequent investment stimulating tool is to **provide tax allowances**.
Tax allowance is qualified as state support since provides advantages to the beneficiary, exempting it from certain obligations. When providing allowance the state will lose budget income. Tax allowance also influences the competition and trade among the member states. Allowance is of a specific and selective character, since certain enterprises and certain goods are placed in the focus.

16. Investigating the structure of the tax income structure it can be stated that in Hungary the **tax burden** is nearly similar to the average of the European Union. However, when compared to the economical development of **Hungary** this tax burden is high. In Hungary, the proportion of the direct taxes is below the EU average. Personal income taxes are low while the proportion of the indirect taxes is high within the total of the tax incomes. The lower proportion of the corporate tax incomes can be explained by the lower tax rates and the wider sphere of the text allowances and tax exemptions.

17. **Legal regulation** is continuously changing, law interpretation disputes are frequent. Legal regulation is too sophisticated, it is difficult to obey and to have obeyed and control is weak. Legal regulations are not normative, there are many exceptions. Employed allowances often serve non-appropriate objectives. Tax administration is expensive. A more simple administration for the smaller enterprises appears only at the EVA (simplified entrepreneurial tax).

18. **Investigating the Hungarian corporate taxation** the following problems and deficiencies can be stated: tax basis corrections are sophisticated, it is difficult to control the tax, the corporate income is taxed irrespective of the target the income is devoted to, therefore the reinvested income is also taxed, hindering the investments.

The most important factors determining the tax burden of companies on the area of corporate taxation:

- items decreasing profit before taxation – at the establishment of the taxation basis,
- amortization tax policy – at the establishment of tax basis,
- tax rate,
- investment tax allowances – for decreasing calculated tax.

19. In the beginning of 1990s it was of key importance for the Hungarian economy to engage the foreign capital therefore ensuring **tax allowances** for the foreign investors was justified. However, even then, introduction of a similar tax allowances for domestic enterprises would have been needed in order to keep the neutrality of market competition.

The Act on corporate profit tax in 1988 provided a significant tax allowance for the foreign investors. It belongs to the deficiencies of the regulation that the allowances are ensured for an unlimited period, and the fact that supported specifically the foreign investors and certain industrial branches. Besides the proportion of the foreign capital, it did not contain regulation for such important questions as the development of the implements or preserving the workplaces, environmental protection regulations, technological standards.

The new corporate tax Act of 1996 was in line with competition neutrality principle, however, mostly the foreign enterprises could make use of the new tax allowances that were introduced. The capital strength of the domestic enterprises did not allow financing 1, 3 or 10 thousand million forint-worth investments.

Within the Hungarian tax system, certain invested sums (3 thousand million Forints in the underdeveloped regions, 10 thousand million in the other regions) are entitled for exemption from the corporate tax for a period of ten years. So it became possible that certain companies during these ten years were given a larger sum in the form of tax incentive than the amount these companies originally invested.

According to the standpoint of the European Union, the incentive must be smaller than the invested sum. This allowance affected 48 large enterprises and 4000 thousand million forint-worth investment in Hungary in 2002. The regulation had to be transformed; as a transitional regulation, some tax allowances will remain in force up to 2011 for the sake of legal certainty.

New investment stimulating EU-conform tax allowance has been introduced: the development tax allowance which, however, could only be employed by a few companies because of the strict conditions of the starting period. Following the amendments it still provided stimulating effect to the large investors. The advantage of the present tax allowances is that the foreign and domestic investors are judged by similar criteria.

20. The low corporate **tax rate** is an important factor in competitiveness. Corporate tax rates decreased from 18% in 2003 to 16% in 2004, this measure also targeted the improvement of competitiveness. Low tax rates and the even lower effective tax rate is an important tool for the Hungarian economy policy in attracting the foreign direct investment. Today, however at tendency of reduction of tax rates can be observed in the other member states as well; therefore the competitiveness of Hungary on the area of taxation is gradually diminishing. The overall tax burden is increasing, the reason for this is that the period set for a part of tax allowances and exemptions has expired and new ones can be provided by the state only in more strict conditions because of the strict supporting policy of the European Union.

21. **The Role of Items Affecting the Profit Before Taxation**

- protection of the tax basis; according to the accounting standards the entrepreneur has a certain freedom in the calculation of the costs and expenses (e.g.: amortization, entertaining expenses)
- preventing the double taxation (e.g. dividend, tax paid abroad)
- social considerations (e.g. providing work for the unemployed, specialized training)
- supporting economy policy objectives (reducing regional differences)
- stimulation (investment, R&D, other)
- sanctioning certain economic events (e.g.: fines)

Out of the items reducing the profit before taxation in the case of micro and small sized enterprises, the value of the investment for the given taxation year, deducted when commissioning new equipment and the development reserve have attained their objective; these have reached the addressees and they can make use of it with a minimal tax administration.

22. The greater of the capital demand of the enterprises, the more the **amortization policy** exerts its effects to the profitability of the enterprises, influencing their investment intentions. Taxation effect of the investments are jointly determined by the definition of the notion for investment, the sphere of relating expenses, amortization regulations (method of deduction, rates, method of calculation) and inflation effects. The Hungarian taxation system is regulating primarily the amortization period, the method of deduction and the basis of calculation for amortization.

The amortization regulations in the Tax Act are advantageous in international comparison, rising the deductible limit for the lump-sum tool procurement would decrease the administration.

23. When examining the distribution per branches of the **state supports**, we can see that the processing industry has obtained the greatest support within the European Union, except for Portugal, Ireland, the Netherlands, Austria and Finland. Owing to the unfavourable natural endowments in Finland and Austria the support of the agriculture is outstanding while in Portugal most of the support has been driven to the service sector.

Regarding the form of the supports within the EU, the non-refundable support is the most frequent form in the processing industry (67%) followed by the tax allowance (25%). At the same time the practice in the individual member states can be very different. In Belgium, Denmark, Spain, Luxembourg, Austria and Sweden, more than 85 % of the supports is non-refundable support while in other member states the tax allowance is favoured.

In contrast with the developed countries where the financial supports are more widespread among the investment incentives, in the new member states the supports of budgetary character have a larger role. This can be explained by the fact that owing to the more restricted resources a future tax income is given up rather than providing financial support for starting an investment. The tax allowance is determinant in Cyprus, Latvia, Slovakia and Hungary. In Estonia the non-refundable support is dominating, however, this is also important in Lithuania and Hungary.

In 2001, in Hungary, 60% of the supports were implemented as non refundable supports, this being characteristic to developed countries. The advantage of this is that it widens the opportunities of the enterprises, assisting the commencement of their activity or the development providing an additional resource. Tax allowances constitute a nearly 40% proportion, the determinant part of which has been conveyed to the processing industry.

24. A significant amount of tax allowances and tax exemptions were ensured for the foreign capital coming to Hungary at the time of the system changeover.

The empirical analyzes demonstrate that the **enterprises being in foreign ownership** have a lower average tax level than those being in domestic ownership. Basically, the foreign-owned enterprises can make use of the tax allowances and tax exemptions.

The foreign investments reached the determinant ownership proportion mainly in those the branches that are the main areas of the international competition. Therefore, primarily in machine industry, in chemistry industry, in the production of non - metallic products, tourism and financial services. It can also be observed that in several cases the setting enterprises brought with them their financial and infrastructure service providers as well.

Enterprises with foreign interest represent a determinant part of the enterprises' total gross added value, net sales, export and investment.

Enterprises with foreign interest represent only 10% of the total number of enterprises, however they contribute to the gross added value and net sales with 50%, realizing 3/4 of the export. They are able to make use of 91% of the tax allowances. Owing to the tax allowances, the tax burden of the enterprises with a foreign interest is 10.1%.

Enterprises with domestic ownership represent 90% of the total number of enterprises and they have a share of 50 % from the added value, net sales and registered capital. They have a prominent role in employment, hiring 3/4 of the total number of employees. Also, they provide more than a half of the total payable corporate tax, the reason for this is that the enterprises with domestic ownership have only a 9% to share from the all tax allowances, therefore their tax burden is 16.9% exceeding with 6.8% the tax burden of the enterprises in foreign ownership.

25. The decisive proportion of the tax allowances was utilized by enterprises with a **staff number exceeding 250 employees** (this was 95.1% in 2003).

The average tax burden in 2003 was 13.03%. The tax burden is the highest in micro companies (17.6%) and is the lowest in large enterprises (9.8%).

It can be stated that the higher the number of employees is the lower the tax burden becomes. Corporate tax strikes mostly the micro enterprises.

Examining the enterprises according to the number of employees it can be stated that the micro and small enterprises comprise more than 97% while in the large enterprises the proportion is below half percent (0.41%).

In contrast, the 0.41% large enterprises produce more than half of the gross added value and they have a share 40% in the net the sales. Large enterprises are characterized by a strong export orientation, realizing 70% of the total export.

95.1% of tax allowances are utilized by the large enterprises while from the remaining part the medium-sized enterprises have a 2.75% share.

The micro and small enterprises represent 97% to of the total number of enterprises, having a 30% share of the gross added value, and 40% share in net sales, registered capital and employment. However they can make use of the total amount of tax allowances only 2.1% therefore the average tax burden is 17.6%.
Tax allowances can typically utilized by large enterprises, causing a competition disadvantage to the smaller enterprises.

26. The **distribution of allowances according to the branches** shows significant differences, the determinant proportion of the tax allowances being used by the processing industry.
82% of the total of tax allowances that could be demanded was conveyed to the processing industry in 2000, and this grew to 95% by 2003. Utilized tax allowances show a strong concentration when examining it according to the branches: crude oil processing, vehicle manufacturing, electrical machine and tool manufacturing are determinant.

27. The average corporate tax level is increasing together with the gradual discontinuance of the tax allowances. In some areas this can not be employed in 100% or the tax allowances granted for fixed period are gradually expiring; these areas include for example the vehicle manufacturing where even in 2003 the tax burden of the branch was minimal (5.65%).

In 2000 the tax allowances from the previous years constituted 46.4% of the total tax allowances, the determinant majority of which could be utilized for the last time in the fiscal years 2002 or 2003. Certain tax allowances did not achieve their set objectives, only a few enterprises could make use of it and even then, in a moderate extent only. Supporting enterprises obtaining tax allowance was not advisable to carry out by allowances offered by the corporate tax law since the regulation, utilization and control became more sophisticated and its social and economical usefulness remained low.

Tax allowances bound to investments amounting up to 3 and 10 thousand million Hungarian forints can be demanded up to 2011, the enterprises could become eligible until 2003. According to the data several enterprises made use of it; in 2003 these two allowances represented more than 75% of the total tax allowances.
A wide range of enterprises could make use of tax allowances provided to small and medium sized enterprises and this was the tax allowance that was not available to the large investors only.
2003 was the first year of the development tax allowance embodying the EU-conform tax allowance; the large investors were targeted, however, few of them could utilize it therefore it has been amended according to the experiences in 2004 and 2005 too.

## Proposals

### Taxation

1. Economy policy should unambiguously specify the taxation objectives and tasks. The objective is to ensure a predictable taxation system and to render the performance of tax paying obligation simpler and easier.

2. It is necessary to widen the tax basis and the sphere of taxpayers as well as narrowing the range of allowances; the allowances should be tracked against the set targets and effective results.

3. The same extent of taxation has to be applied to different income types.

4. On the area of corporate taxation, support has to be provided for stimulating investments and R&D activities.

5. The tax burden of large enterprises – according to 2003 data – was 9.8% therefore it would be advisable to increase the competitiveness of the micro and small enterprises in order to decrease their tax burdens to this level. One of the means for this might include that the first 5-10 million forint positive tax basis has a 10% tax rate.

6. The number of taxes is exaggerated. There are a lot of small taxes such as the specialized training contribution, rehabilitation contribution, land protection contribution, energy tax, environmental protection product fee etc.
It would be advisable to merge or terminate the large number of small taxes: employment, specialized training, environmental protection serving the same objectives should be taxed only once by a certain tax.

7. In order to reduce the tax avoidance it is necessary to modernize and develop the tax administration, increase the severity of collection of taxes and to improve the taxation moral.

8. Decreasing the administration burdens. In order to ensure the national incomes, it is necessary to render the taxation and taxpaying simpler and easier. The EVA (simplified entrepreneurial tax) is the prominent example for implementing this simplification. Electronic tax returns, and the development of the APEH's (Hungarian Tax and Financial Control Administration) information system are also necessary. Communication is essential: the message needs to get through to the taxpayers explaining the necessity of taxation.

9. Reducing the income decentralization can only be done in parallel with the reduction of expenses, by the harmonized transformation of the whole government budget; an important element of which would be the transformation of the financing structure and restructuring the institutional system.

<u>On the income side:</u>
reducing the income centralization,
decreasing public burdens,
modification of the focal points in rates and taxes,
stimulating the domestic savings and foreign capital import.

<u>On the side of expenses:</u>
reducing the size of government budget,
unambiguous specification of governmental tasks and assessment of resource requirements,
reviewing and rationalizing budgetary expenditures cannot be postponed any more,
improving efficiency and economy,
improving the quality of governmental services
decentralization, deregulation, regulation.

**Proposals – Break-out Points, Opportunities for Hungary**

10. Owing to the globalization, only those countries are able to speed up their economical growth which attempt to exploit the globalization processes.

11. The long term objective of the Hungarian economical strategy is to catch up the economy to the average of the EU. Besides ensuring the economic growth it is also a very important objective to widen the employment and to maintain it in the largest possible extent.
In order to do this the most important tasks are as follows: Increasing the competitiveness, strengthening the capital attraction force, infrastructure investments, modern specialized training and stimulation of research and development.
Increasing the competitiveness requires productivity increase for which the innovation, developments and investments are essential.
In order to encourage the foreign investments, it is a basic condition to have a trained workforce, tax allowances for developments, low corporate tax rate and simplified administration.

12. Interpreting competitiveness as a mere tax competition is erroneous, competitive position of national economy is determined on a long term by education, specialized training and infrastructure.

13. By reducing income centralization, the resources left in the enterprises can be increased. These resources can be used to increase investment activity for technological developments as well.
In order to maintain Hungary's competitiveness the burdens of enterprises have to be decreased enabling the implementation of developments and investments from the remaining resources.
Out of the areas to be supported, the investments of small and medium sized enterprises, R&D, environment-friendly technologies and specialized training are of utmost importance.

14. Connected to the allowances it should be considered whether these allowances should be enforced within the taxation system or in some other ways.

15. Instead of tax allowances it could be a new tool for the government or the local governments to ensure real estates supplied with public services, infrastructure development, etc.

16. Focal points:

- increasing the local added value,
- switching over to more knowledge-demanding products and work processes where the R&D expenditures are higher, scientific and technical workers are employed in a higher proportion and the product's innovative character and complexity is important (tomorrow's and the day after tomorrow's product),
- the basis of increasing competitiveness are not the lower wages but the development of a specialized training,
- commencement of investments targeted to know-how, education and training,
- language knowledge,
- regional development, investment targeting policy,
- developing small and medium sized enterprises,
- service providing government,
- appropriate infrastructure: transport, site, logistic centres,
- among the infrastructure of investments, building motorways has the highest capital attraction effect,
- establishment of cross-border networks: for example the production is carried out in Romania, Ukraine while the logistic, commercial and research centre would be in Hungary.

17. Those states are most successful which are able to identify and reach new potential investor groups. These are in the following industries: IT, electronics, telecommunication, nanotechnology, biotechnology, environmental protection technologies, and renewable resources

18. Diminishing the disadvantages of the domestic companies and promoting their catch up cannot be postponed. The task is to support the improvement in productivity, export ability, and competitiveness.

The success of further development is depending in a less extent on the attraction of the foreign capital; maintaining the capital and having the domestic investors and enterprises catch up will have a much greater role.

Ensuring economic growth on a longer term is not possible without Hungarian-owned enterprises.

Tax policy should serve the achievement of economic policy objectives mentioned above.

## Publications with the theme of the thesis


Befektetői adókedvezmények vizsgálata a magyar társasági adózás területén
Tanulmánykötet Akadémiai Kiadó Budapest 2005. p. 137-153.

Survey on taxation systems and tax revenues in the European Union
„Lumea Financiara – Prezent si Perspective" Sesuine de Comunicari Stiintifice cu Participare Internationala Babes-Bolyai Egyetem Kolozsvár (Cluj-Napoca) 2004. p. 347-352.

Survey on Investment Tax Exempts in the Mirror of the European Union Accession
3rd International Conference for Young Researchers Szent István Egyetem 2004. p. 72-80.

Az adóztatás, mint versenyképességi tényező vizsgálata Magyarország Európai Uniós csatlakozásának tükrében
Fiatal regionalisták IV. országos konferenciája Magyar Tudományos Akadémia Regionális Kutatások Központja Nyugat-magyarországi Tudományos Intézet és Széchenyi István Egyetem Győr 2004. p. 9

Befektetői adókedvezmények vizsgálata a magyar társasági adózás területén
XXVII. Országos Tudományos Diákköri Konferencia Doktorandusz Szekció Nyugat-Magyarországi Egyetem Közgazdaságtudományi Kar Sopron, 2005. p. 16

Adóverseny vagy adóharmonizáció? Az Európai Unió tagállamainak adózási rendszerei
Gazdaság és Társadalom 2006/1. szám

Nemzetközi kitekintés az Európai Unió tagállamainak adózási rendszereire
Comitatus 2006. év