# THESES OF A PHD DISSERTATION

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## NEURALGIC POINTS OF THE FLAT PERSONAL INCOME TAX SCHEME

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# 1. RESEARCH BACKGROUND, OBJECTIVES

This PhD dissertation aims to highlight empirical experience regarding the flat personal income tax scheme. This scheme has become largely popular in recent times, however, empirical documentation has insofar been limited to its effectiveness.

The Laffer curve (Illustration 1.) serves as base for the "smaller tax rate – bigger tax revenue" theory. As legend would have it, Arthur Laffer has first sketched out this curve on a napkin. Naturally, the curve assigns zero tax revenue to a zero percent tax rate. Tax revenue is similarly zero when tax rate is 100% – in this case, it is pointless to keep up production, since tax return would result in bankruptcy. Between these extremes, there is a point (a certain tax rate) that coincides with the maximum of government revenue. All flat income tax systems seek that certain point.
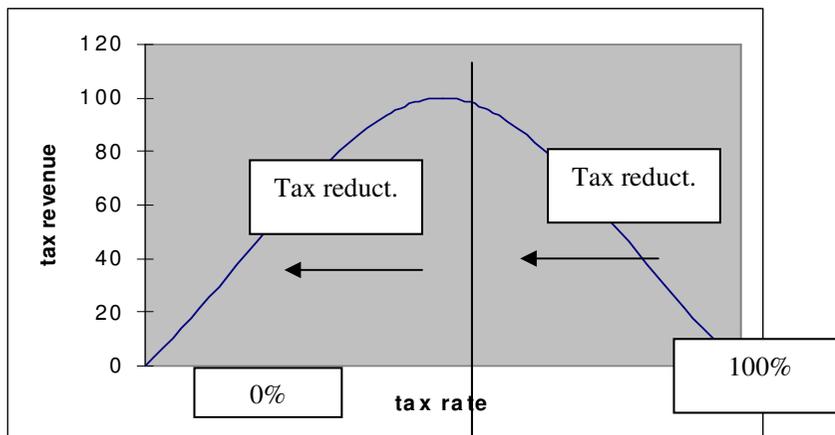


Illustration 1.: Laffer curve

Source: Tünde Kitanics Bokorné Dr. – Anita Budvig Nyáriné Dr.: EU tagállamok a Laffer görbén innen és túl [EU member states on two sides of the Laffer curve]

Usage of the flat income tax system is most prominent in the former countries of the Soviet Union. Introduction of this tax system proved to be

particularly inevitable in states with a low tax culture. Following a brief review of the history, we can draw a conclusion applicable for the past several hundred years, namely, that the majority of taxes imposed on the Hungarian society had always served the interests of foreign cultures (Turkish, Habsburg, German, Soviet) and the revenue was never utilized where it was created.

One of the attributes of our young democracy is that it still lacks a conscious generation that would see taxes as the lubricant of the fundamental unit of society, that is, the families; as engine oil is to a vehicle. The 2004 introduction of the flat tax system in Slovakia has not done magic. However, it has proven to be a solution for improvement: since severe sanctions penalize tax fraud, more people pay taxes, therefore more people are willing to chip in a reasonable amount for the "common good".

In my research work, I seek answers to the following questions: has the introduction of flat tax in Hungary been timely, and whether its implementation is supported by the proper societal and economic conditions. The tax reform of 2004 has been one of the major catalysts of the Slovakian economic boost. A comprehensive, well-designed and well-adapted tax reform is essential to an economic rebound and a stable growth, but it is not the only necessary condition. In the design of a tax reform, economists pay great attention to avoiding a short-term decrease in government revenue, moreover, the medium- and long-term objectives are to increase government revenue, to balance the budget, and to create and sustain stability. Regarding short-term and middle-term objectives, the Slovakian tax reform of 2004 has done well.

The newly designed tax system is simpler and more transparent than the previous system. Its benefits are hard to quantify, but the termination of numerous exceptions and instances of special treatment has significantly decreased the distorting effect on the economy.

My starting point in the development of this topic has been to familiarize myself with and analyse experiences from Slovakia and other countries using the flat tax system.

The main issues regarding Hungary's tax system in recent years are the following: a gradual decrease in the number of taxpayers, and the contraction of the taxpayer base. Collecting taxes has become increasingly difficult, its control increasingly complex and expensive.

In my research work, I am looking for possible propositions for the simplification and streamlining of the personal income tax system applied to private individuals.

The main subjects of my analysis were Slovakian and Hungarian case studies and their comparison, as well as in-depth interviews.

**My aim**, beyond providing a review of the literature about the flat tax system, is to present propositions to the introduction and remodelling of the flat tax system, as well as drafting a simple, easy-to-use PIT return form, complete with short and concise instructions.

In order to realize these objectives, the following tasks are to be completed:

- getting familiar with the introduction and effects of the flat tax system, in parallel with studying the tax systems of the neighbouring countries
- mapping the Slovakian system
- getting familiar with the history of the Hungarian tax system and its changes

- comparison of the Slovakian and Hungarian tax systems at the time of the EU-accession (2004)
- comparison of the Slovakian and Hungarian tax systems in 2010

I present *different case studies* to describe the specific tax groups and the effects of the introduction of the flat tax system on taxpayers' income in each group. Due to limitations in length, I did not consider my task to analyze small business taxes, local taxes, social contributions, and the pension scheme.

# 2. Research material and methods

The structure and the form of the dissertation complies with the instructions set out in the ***PhD Regulations (2011)***. My research is based on secondary data. I have used national and international literature, studies, and databanks accessible on the respective websites of the National Tax and Customs Administration (NAV), the Hungarian Central Statistical Office and the Ministry for National Economy.

I used in-depth interviews to explore data and to draw connections between the facts. Among others, I have prepared interviews with lawyer Dr. Daniella Oravczová, accountant Ing. Viera Knírsová, tax consultant Márta Szoboszlai, and senior professor Dr. Norbert Gyurián PhD.
The experts listed above are actively taking part in the Slovakian economy, whose knowledge encompasses both theoretical possibilities and practical problems. Apart from Slovakian experts, I have performed data collection with 19 registered Hungarian accountants as well, summary of which may be read in the subchapter titled "Conclusions to be drawn from the in-depth interviews performed". The comparative analysis has been prepared on the basis of case studies, carried out in Microsoft Excel software.

Results of my research may be divided into two main topics:
- description of the effects of the tax reform, including a comparison of the Slovakian and Hungarian tax systems in tax years 2004 and 2010.
- effects of the flat tax system on the income of taxpayers in different tax groups, described through case studies

Case studies describing the 4 tax groups in question:

1.      Case study 1.: a family with 2 wage-earners, 2 children, and an average income as defined by the Hungarian Central Statistical Office (KSH)

2.      Case study 2.: single taxpayer with an income above the average defined by the Hungarian Central Statistical Office (KSH)

3.      Case study 3.: comparison of the taxes levied on minimum wage

4.      Case study 4.: analysis of the taxes levied on an employee with an average pension as defined by the Hungarian Central Statistical Office (KSH)

All four case studies are subject to a comparison with respect to tax years 2010 and 2011 in the Hungarian tax system, as well as relating to the Slovakian tax system in tax year 2010, and a hypothetical comparison with the Hungarian system in tax year 201?. In the detailed case studies, there are partial discrepancies between the table regarding tax year 2010 and my own PIT tax return draft scheme. These differences are due to the fact that in 2010, PIT regulations in Hungary applied tax reductions and not tax-base reductions. As a result, these rows are only partially comparable to the subsequent tables, but this does not affect comparison of the differences between instances of tax liabilities.

I have performed PIT calculations based on the 1995 regulation No. CXVII. on PIT (1995. évi CXVII. SZJA tv.).

**My hypotheses** regarding changes in the **PIT regulations** of the **201?** Hungarian tax system are the following:

- o   tax rate 17% in relation to gross income (not super gross)

- tax refund: 90,000 HUF/month (minimum wage) tax-base reduction, upper bound 5,000,000 HUF annual income.
- child tax credit 500,000 HUF, in the form of tax base reduction
- one-page, simplified PIT return form
- more economical administration, more streamlined control
- wider taxpayer base, more severe sanctions
- 90,000 HUF minimum wage

In the filling of the tax return forms ("napkin size"), I have applied the following definitions: **Income = revenue:**

income is a revenue earned on any basis in the given year. Introduction of a flat tax system without super gross requires the expansion of the taxpayer base, the number of taxpayers. It is necessary to calculate the gross amount in case of pensions and any other form of social benefits, and regard them as revenue liable to PIT.

**Revenue**: assets obtained by the private person from another party

**Non-revenue assets:**

**-** obtained assets that the taxpayer is obliged to return (loans and credits)

- tax refund, advance tax payment

- income gained through conveyance of property obtained 5 years ago or before

**Other definitions:**

- dependent: any person in the family, having regard to whom the national family support regulation or any similar regulation in any other EEA member state stipulates a family allowance or any other type of benefit;

- any person receiving disability pension;

- a fetus or twin fetuses from the 91st day after conception, to birth

- any person eligible for family allowance on their own right.

My concept of <u>the family</u> is based on the definition by the Hungarian Central Statistical Office (KSH): "The family is the closest scope (group) of persons living together based on married/ consensual partnership and blood-relationship. As such the persons with family status husband, wife, consensual partner, mother, father and never married child, as well as an unmarried parent with never married child (also known as one parent with child). Foster parents are considered parents as well. Consensual partners living together without a legal marriage are also considered a family."

The legal concept of a consensual partner is defined in the civil code. According to this definition, two people are consensual partners if all of the following conditions are true:

- they are living together;

- they run a common household;

- there is an emotional and economic community between them.

# 3. RESULTS

## 3.1 The more favourable Slovakian taxation described through a case study

After the change in 2004, due to the tax reforms, it became much more favourable to set up enterprises in Slovakia than in Hungary (see Table 1). After taxes, the same amount of earnings allowed the entrepreneur to withdraw 21% more or even up to 42% more Korunas than he could have in Hungary.

Table 1.: Differences between earnings to be withdrawn before taxes in Hungary and Slovakia in 2004

| 2004 | Hungary | Slovakia | Difference |
|---|---|---|---|
| Amount to be withdrawn from a total earnings of 1,000,000 HUF, with an equity of 3 million HUF | 672,000 HUF | 810,000 HUF | - 138,000 HUF |
| Amount to be withdrawn from a total earnings of 4,000,000 HUF, with an equity of 3 million HUF | 2,274,000 HUF | 3,240,000 HUF | - 966,000 HUF |

Source: own calculation

In 2010, the situation still has not improved for the Hungarian entrepreneur, it still proved to be more worth running enterprises with our Northern neighbours. In Hungary in the first half of 2010, from an amount of 1,000,000 HUF before taxes, the following taxes have to be paid: 19% corporate tax (Tao tv. 19. §), then the 25% income tax (Szja tv. 66. §), and the 14% healthcare contribution (Eho tv.3. § (3) e.), which leaves 494,100 HUF, as opposed to Slovakia, where the amount to be withdrawn has been

the same 810,000 HUF for 8 years. Predictability and a stable legal background are two other important factors in a particular region or country, which international investors place a great emphasis on.

The Hungarian and Slovakian enterprises listed above in the table are eligible to withdraw the following amounts from their enterprise (Table 2), based upon the regulations in effect at the beginning of 2010.

Table 2.: Differences between earnings before taxes in Hungary and Slovakia in 2010, calculated by a tax base above 500 million HUF:

| 2010 | Hungary | Slovakia | Difference |
|---|---|---|---|
| Amount to be withdrawn from a total earnings of 1,000,000 HUF, with an equity of 3 million HUF | 494,100 HUF | 810,000 HUF | - 493,290 HUF |
| Amount to be withdrawn from a total earnings of 4,000,000 HUF, with an equity of 3 million HUF | 1,976,400 HUF | 3,240,000 HUF | - 1,263,600 HUF |

Source: own calculation

Even though corporate tax up to a tax base of 500 million HUF has been decreased with 9 percentage points to 10%, in the event of paying dividends, the Hungarian system is still falling behind the Slovakian system (10% corporate tax, 14% healthcare contribution, 25% capital return tax, 19% corporate tax).

## 3.2. Drafting a PIT return form complete with instructions

Taking into consideration the fact that the mechanism, regulation, control and the return forms of the personal income tax have become excessively complex and complicated in the past 2 decades, it is now time for a change.

My propositions include the introduction of the flat PIT, cleansing of the tax system from social policy issues, and subsequently, the drafting of a transparent, easily understandable, "napkin-sized" tax return form, as shown in Table 3.

Table 3 : Draft PIT return form for the year 201?

|  | 201? DRAFT PIT RETURN FORM |
|---|---|
| Taxpayer's Address: | |
| Taxpayer's Name: | |
| Tax Identification Number: | |
| 1. a) Income | |
| 1. b) Other Income | |
| 1.∑ Income (rows 1.a + 1.b) | |
| 2. Personal reductions | |
| a). 2,160,000 HUF for married taxpayers | |
| b). 1,080,000 HUF for single taxpayers | |
| 3. Number of dependents | |
| 4. Allowances for dependents (row 3 multiplied by 500,000 HUF) | |
| 5. Total personal reductions (row 2 + row 4) | |
| 6. Tax base ( row 1 ∑ – row 5, if positive, otherwise 0.) | |
| 7. Tax (row 6 multiplied by 17%) | |
| 8. Taxes or advance tax paid already | |
| 9. Outstanding taxes to be paid (row 7 - row 8) | |
| 10. Taxes to be claimed (row 8 - row 7, if positive) | |

Source: own calculation

The form must contain the taxpayer's name, address and tax identification number for unambiguous identification.

Following these information, the private person's income is stated in row 1.a). All income obtained by the private person is taxable, meaning all

revenue obtained during the fiscal year, because revenue qualifies as income. Other income (excluding wages) is to be indicated in row 1.b), e.g. pension, scholarship, income from the sale of a property (if purchase and sale are separated by less than 5 years), income from sale of movable property, entrepreneurial withdrawals, capital gains. Pensions and other transactions (e.g. scholarships) currently reported on a net basis must be reported on a gross basis, because they must be liable to PIT, without affecting pensioners' (entitled payees) interests, of course. In order to simplify the tax return form, we have assigned separately taxable income into the category "other income" (1.b) in 201?. The taxpayer defines their income from sale of immovable and movable property, and has to retain this calculation until the end of the limitation period. In row 1.b), the taxpayer only has to report their taxable income. Income from self-employed activities is defined on a similar basis. Self-employed taxpayers have to create a new return form, but the tax on withdrawal has to be declared in this row. Row 1. $\sum$ shows the sum of rows 1.a) and 1.b).

Depending on whether the taxpayer is single or married, row 2 branches off into subsections a) and b). Married couples as a family are eligible for a 2,160,000 HUF tax base reduction, which the system allows by making the projected 90,000 HUF minimum wage non-taxable. Mutatis mutandis, a one-person household is eligible for a tax base reduction of 1,080,000 HUF, which the taxpayer can utilize in row 2 subsection b). The number of dependents is to be reported in row 3. All persons eligible for a family allowance qualify as dependents. The idea behind a tax base deduction after each dependent is that persons of average income can utilize it as well, making contributions to the additional charges that arise with bringing up children. I have defined the 500,000 HUF tax base deduction considering the capacity of the individual budget. Row 5. declares all personal deductions

and dependents' reductions. Row 6. states the adjusted tax base which is the difference between the total income and the tax base reductions, and may be a positive number or zero. The system does not allow a negative tax refund. Tax calculated with the 17% tax rate is to be shown in row 7, which takes the gross income into account. Row 8 shows tax already paid, which has to be verified by the employer. The difference between rows 7 and 8 has to be reported in row 9, this is the amount of tax to be paid. Row 10. is to be filled if a refund may be claimed (that is, if the difference between rows 8 and 7 is a positive number).

## 3.3. Case studies comparing the Hungarian tax system in 2010 and 2011, the Slovakian tax system in 2010 and a hypothetical Hungarian tax system in 201?

*Case study 1.*: involving **a family with two children and an average income**

Adam Average works as an employee at an enterprise **in 2010**, and earns a monthly wage of 206,700 HUF, considered average by the Hungarian Central Statistical Office. His wife, Mrs. Adam Average works as a government employee in the budgetary sector, earning an average wage of 203,900 HUF. The tax scale of 2010 provides them with a tax deduction of 15,100 HUF, which amount both of the adults in my case study were able to utilize. To be able to include this case study in the comparisons with the model described above and other models, I have taken the gross amount of the 15,100 HUF tax reduction into account.

Accordingly, Adam Average's tax base has seen the following changes: the tax base is the gross wage increased by 27% (contributions) (2,480,400 x

1.27 = 3,150,108 HUF), which is then decreased by the 15,100 HUF/month tax deduction (calculating with the gross amount: 15,100 / 0.17 x 12 = 1,065,882 HUF/year). After the utilization of the reduction, the tax base is decreased, 3,150,108 - 1,065,882 = 2,084,226 HUF. Using the same method of calculation, Mrs. Adam Average's tax base changes to 2,041,554 when calculating deductions.

Taking all this into account, this average-income family with two children pays 354,318 + 347,064 = **701,382** HUF tax to the state budget in 2010.


The next case study describes the same family but in the **Slovakian circumstances**. To ensure proper comparison, I calculated the data in HUF in the following case studies, even though Slovakia has introduced the Euro as of January 1, 2009.

Adam Average works as an employee at an enterprise in 2010, and earns a monthly income of 725.26 EUR, amounting to 206,700 HUF. His wife, Mrs. Adam Average works as a government employee in the budgetary sector, earning an average income of 715.44 EUR, amounting to 203,900 HUF. In 2010, an average income family with two children could utilize a 20.02 EUR/child tax refund per month, regulated by the Zákon o Dani z Príjmov (Income Tax Law). Calculating with the gross amount and counting with a 19% tax rate and a 285 HUF (HUF/EUR) exchange rate, this amounts to a 720,720 HUF tax deduction. To ensure the data is comparable, the tax deduction has to be exchanged to tax-base reduction. The Slovakian system counts tax deductions differently from the Hungarian practice. They decrease the gross income by the amount of the contributions levied on the private person, after which they get the tax base. This is the base of tax calculation, but first they use the tax deduction of 335.47 EUR applicable to

employees, to get the amount of tax to be paid, which is subsequently decreased directly by the tax reduction after the children.

This tax reduction item (80,832 SK) was accessible for everyone in the year of the reform (2004), but as an effect of the introduction of the millionaire's tax, this item can be fully utilized only up to a yearly income limit of 20,000 EUR. Above this income limit, the reduction is decreased, and above a 33,000 EUR limit, it is no longer applicable at all. In the case study described above, the Average family pays a total tax amount of 1274.55 EUR, which amounts to a 116,347 + 246,900 = **363,247** HUF.

**In 2011**, the flat tax system has been introduced in Hungary, regarding personal income tax. The super gross, which has been in effect in 2010, has remained, meaning a 20.32% effective tax rate instead of the 16% tax rate. To ensure effective comparison, Adam Average (206,700 HUF) and his wife (203,900 HUF) earn the same average income as in the previous case studies. The Average family raises two children, making them eligible for tax reductions for the first time in many years by the Hungarian tax system. The tax refund is a maximum of 12,100 HUF/month. In the current case, Adam Average is only eligible for a 8,099 HUF tax refund. The tax refund is applicable until a maximum of 180,455 HUF and gradually decreases above that amount, until the final limit of a 259,840 HUF gross income, where it is no longer applicable. Taking into consideration the number of dependents (after whom the parents are eligible for child benefit), Adam Average utilizes a 62,500 HUF/month tax-base reduction after the two children, amounting to 1,500,000 HUF per year. Converting the personal tax reduction into tax-base reduction and adding it up, Adam Average is eligible for a 2,107,425 HUF tax reduction. The reduced tax base amounts to 1,042,683 HUF. The tax rate is 16%, or 166,829 HUF, which sounds favourable if we

take Adam Average's 13,903 HUF personal income tax per month. However, since we are discussing family reductions, let us take a look at the total PIT levied on the entire family. Mrs. Adam Average earns an average income at the budgetary sector: 203,900 HUF. She is eligible for a somewhat larger amount of tax refund than her husband: 8,526 HUF. Since the husband has already utilized the tax-base reduction after the two children, his wife can no longer utilize it. According to the 2011 tax system in Hungary, she has to pay a tax of 32,907 HUF/month, based on the conditions described above. This means that the Average family has a **561,707 HUF** (166,829 + 394,878) annual tax to pay, parallel to raising two children in Hungary in 2011.

The next case study describes the same family model with PIT levies planned for **201?** (future year):

Adam Average is the head of a family with two children. His monthly gross income is 206,700 HUF. His wife, Adam Average earns a monthly gross income of 203,900 HUF. They are raising two children, making them eligible for a 500,000 tax-base reduction per child, amounting to a total of 1,000,000 tax-base reduction. Consolidated income of the family is 4,927,200 HUF. With these conditions, based on the PIT system I propose, average income families in 201? with two children would pay less personal income tax (**300,424 HUF**) than in 2010.

Beyond the reduction after children, the proposition includes a PIT reduction applicable to anyone – to be precise, after a registered employment of 90,000 HUF/month –, which coincides with the minimum wage planned for 201?. This item in the future system proportionately decreases, and above 5,000,000 HUF, this 90,000 HUF/month PIT reduction disappears.

Comparing data from 2010, there are significant differences in taxes paid by average income families in Hungary and Slovakia (Illustration 1). With the 17% tax rate planned for 201?, a monthly tax reduction corresponding the minimum wage and an increased tax-base reduction after children (500,000 HUF), the Hungarian family would have a much favourable situation than its Slovakian counterparts (300,424 HUF versus 363,247 HUF).
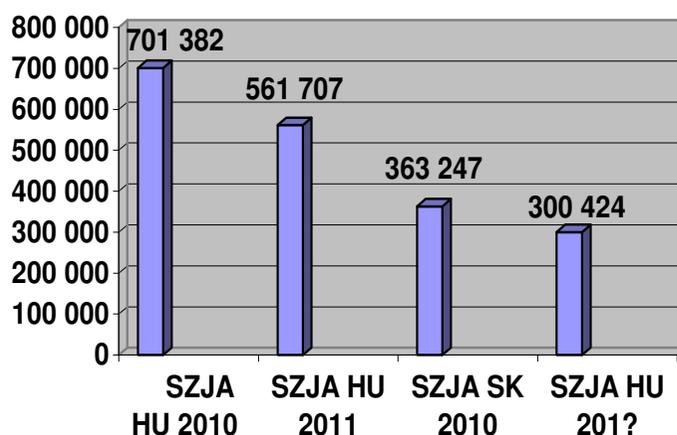


*Illustration 1.* Taxes to be paid by an average income family (defined by the KSH) with two children, based on the 4 previous case studies
*Source: own calculation*

*Case study 2:* taxes to be paid by **a single taxpayer in better circumstances, with an income of 1 million HUF per month** in Hungary in 2010. Gábor Rich is a wealthy citizen who lives alone and has a monthly income of 1,000,000 HUF. He is not eligible for the 15,100 HUF tax refund. He is not eligible for a reduction after children. His tax base is 127% of his gross income, amounting to 15,240,000 HUF. The two-bracket tax system in effect in **2010** (17% and 32%) meant that he had to pay **343,900 HUF** personal income tax **per month**, which amounts to 4,126,800 HUF per year.

People with income higher than average especially benefit from the **Slovakian** type tax system. Taxpayers in Slovakia in 2010 had to pay 45% less tax than their Hungarian counterparts. He would have an amount of 2,280,000 HUF taxes to pay instead of 4,126,800 HUF.

In 2011 in Hungary, tax base is counted by multiplying the income by 1.27, meaning a 16% personal income tax to be paid. With Gábor Rich's 1,000,000 HUF/month income, his annual personal income tax would be 2,483,400 HUF.

Based on the PIT **proposed for 201?,** Gábor Rich with an income of 1,000,000/month would be liable to taxes by the following rules: In 201?, with no reductions and a linear flat tax, since his 12,000,000 HUF gross annual income is above the 5,000,000 limit, he is not eligible for the 1,080,000 HUF (90,000 HUF/month) tax reduction, and since he has no children, he is not eligible for reductions after children, either. He is liable to pay 17% of his 12,000,000 HUF, amounting to a personal income tax of 2,040,000 HUF. Illustration 2 below shows the differences between the 4 cases.
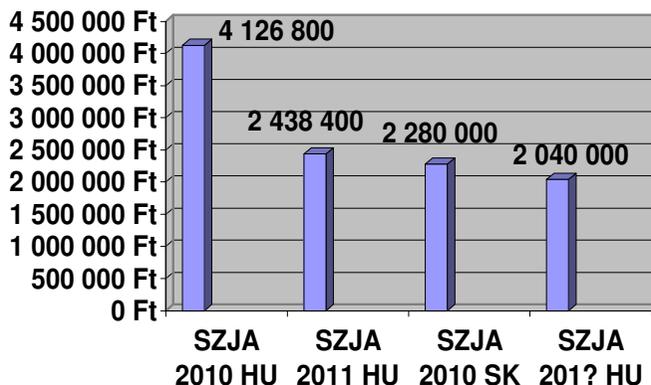
*Illustration 2:* taxes to be paid by a single taxpayer with an income of 1,000,000 HUF which is above average, based on the previous 4 case studies
*Source: own calculation*

Similar to the Average family with two children, there are also significant differences in the wealthy citizen's case when viewing the 4 case studies. Comparing data from 2010, differences between the Hungarian and Slovakian situation are visible (Illustration 2). With the 17% PIT rate planned for 201?, Gábor Rich's situation is more favourable than that of his Slovakian counterparts, even if he is above the 5,000,000 HUF wage limit, making him ineligible for the 75,000 HUF personal income tax reduction.

Despite the fact that all four systems involve some kind of tax refund, there are differences even related to minimum wages. These differences are highlighted by the next case study, which omits families with children and focuses instead on people with minimum wage and people with lower wages.

*Case study 3:* **Taxes to be paid by a taxpayer with a minimum wage income**

**In 2010**, minimum wage in Hungary was 73,500 HUF and the following tax regulations applied: The tax base is the gross income increased by 27% (93,345 HUF), whose 17% (15,868 HUF) is then decreased by the 15,100 HUF tax reduction. As a result, minimum wage in Hungary is taxable, there is a 9,216 HUF per year personal income tax levied on it.

In Slovakia, owing to the tax reduction system, the non-taxable limit surpasses the minimum wage, making the situation more favourable for people with lower wage. The tax base reduction of 335.47 EUR decreases the amount calculated from the gross wage reduced by contributions. As a result, wages are non-taxable up to a gross limit of 387.38 EUR/month

(110,403 HUF with an exchange rate of 285 HUF/EUR). Minimum wages are also non-taxable in the proposed case study for 201?. However, a tax-base reduction is no longer applicable above an annual income of 5,000,000 HUF. The illustration below shows facts previously stated.
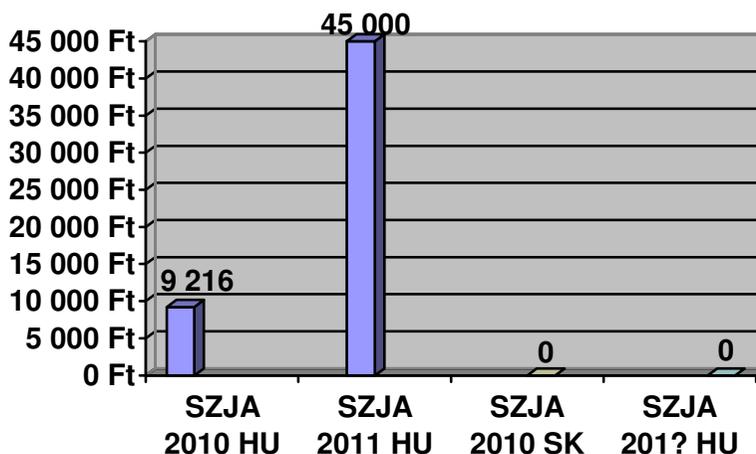


Illustration 3: taxes to be paid by a taxpayer with a minimum wage, based on the previous 4 case studies
*Source: own calculation*

*Case study 4:*

In the following 4 case studies, an **employee** with an **average pension** (90,055 HUF) earns an **average** monthly **income** (206,700 HUF) (averages defined by the KSH) above the pension.

Norbert Pensioner is liable to pay taxes based on the following rules in the Hungarian system **in 2010**. His annual income from his work amounts to a gross 2,480,400 HUF. The annual amount of his pension is 1,080,660 HUF. In 2010, pensions qualified as non-taxable income, but they increased the tax base. This has significantly increased taxes to be paid for those employed as pensioners, because these taxpayers were moved into a higher tax bracket, therefore had to pay more taxes. The flat tax system solves this problem as well, because there is no higher tax bracket.

The consolidated tax base is the income (2,480,400 HUF) multiplied by 1.27 (amounting to 3,150,108 HUF), to which then the pension is added (1,080,660 HUF), which is listed as "other income". There is a 56,064 HUF personal income tax reduction, and amounts declared as non-taxable reduce tax to be paid by 183,708 HUF. According to this, the reduced tax base is calculated as follows: (2,480,400 x 1.27 = **3,150,108**; + **1,080,660**; 56,064 + 183,708 = 239,772; 239,772/0.17 = **1,410,424**) 3,150,108 + 1,080,660 − 1,410,424 = **2,820,344 HUF**. Tax to be paid is 17% of the tax base: 2,820,344 x 0.17 = 479,458 HUF.

Norbert Pensioner is an employed pensioner in **Slovakia**. To ensure that the results are comparable, he earns the same nominal amount (average income defined by the KSH, 206,700 HUF) as an employee, and receives the Hungarian average pension for 2010 (90,055 HUF defined by the National Pension Insurance) in EUR (with an exchange rate of 285 HUF/EUR as of 27. 07. 2010., Hungarian National Bank), amounting to a wage of 725.26 EUR/month and a pension of 315.98 EUR/month. In 2010 in Slovakia, if someone works as a pensioner, their pension is still non-taxable, and there is an uniform 19% tax rate to be paid after the wage earned as an employee. This means he cannot utilize the 335.475 EUR tax-base reduction per month. Even so, there is a difference of 8,000 HUF which makes his situation more favourable in Slovakia than in Hungary in 2010.

Norbert Pensioner's situation improved **in 2011** compared to both Hungary and Slovakia in 2010. Norbert can keep 6,052 HUF more for himself per month.

Norbert Pensioner's pension would be paid in the gross amount, meaning that his 90,055 HUF net pension would amount to a gross 108,500 HUF. As a result of gross calculation, the actual pension is not reduced by taxes. The actual taxes to be paid from a total of 643,008 HUF tax liability would be 643,008 – 221,340 = 421,668 HUF.
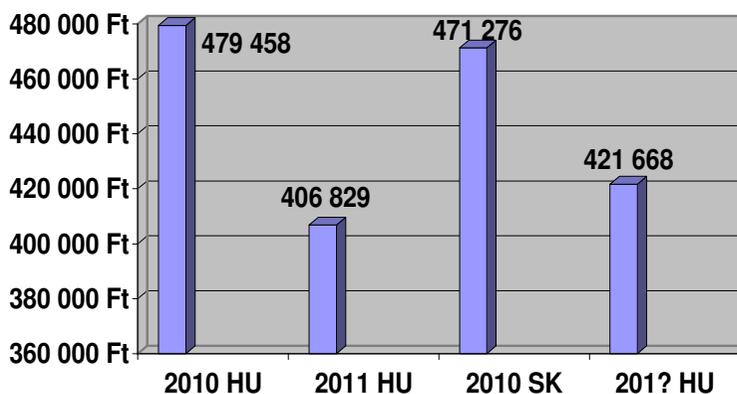


*Illustration 4.* Norbert Pensioner, a single taxpayer receives an average pension (90,055 HUF defined by the National Pension Insurance) and an average income defined by the KSH (206,700 HUF) in case study 4.
*Source: own calculation*

Receiving an average pension (90,055 HUF) and employed (for an average wage, 206,700 HUF), Norbert Pensioner's situation was the best in 2011, whereas he paid the most during the 2010 Hungarian tax system. The defining difference between the Hungarian tax system in Hungary in 2011, the Slovakian tax system in 2010 and the Hungarian tax system in 201? for the employed pensioner is the following: in the latter two systems, **the pensioner is not entitled a reduction after his monthly wage**, whereas in the 2011 Hungarian tax system, he is.

## *3.4 Analysis of the Hungarian and Slovakian tax system through in-depth interviews*

I have done several in-depth interviews with Slovakian and Hungarian experts alike. During my research, I have also made sure to gather and analyse opinions of experts from more fields. This is how I came to interview a Slovakian accountant, who shed light on the practical side of the problems, but I also collected important information through interviewing an university professor with an academic degree, who represents the theory in this case. I have also had the chance to interview a tax consultant, who, by answering my questions, provides a summary on both theory and practice and contributes to the conclusion of my dissertation. The last interview was done with a lawyer practising in Révkomárom, who might not be a tax expert, but the majority of her clients are enterprises that moved to Slovakia from Hungary. Apart from the Slovakian experts, I have done my research involving 19 Hungarian accountants as well.

# 4. CONCLUSIONS

In 3 out of 4 case studies carried out during my research, the flat personal income tax proposed for 201? incorporates the smallest amount of tax to be paid by employees. Persons receiving an average income (defined by the KSH), persons on minimum wage, and persons above the average income (defined by the KSH) all had the smallest tax liability in the case study for the 201? time period. The proposed, "napkin-sized" PIT return form, owing to its simplicity and transparency, may be filled out quickly, saving time for both the taxpayers and the National Tax and Customs Administration (NAV). In my research it has been proven that the Slovakian tax reform had solved one of the most significant problems in business life, because in the corporate sector, the biggest obstacle had been the complexity of the tax system and the frequent changes to the tax regulations. In Slovakia, a stable, predictable PIT has been in effect for 8 years.

After in-depth interviews with Slovakian experts, I have reached the following conclusions:

- the main characteristics of the 2004 Slovakian tax reform are **simplicity** and **transparency**. - **introduction of the flat tax**, and omission of the **capital return tax** has significantly contributed to **improving Slovakia's competitiveness**.

- subsequent to the reform, electronic tax return was introduced

- according to all 4 experts, **more people have been paying their taxes** since the reform

- **the Slovakian economy is whitening.**

- **owing to the 2004 tax reform, there is an increase in Hungarian clients in Slovakian accountant agencies and in lawyer's offices** as well.

Hungarian experts' opinions are more divided about the flat personal income tax than their Slovakian counterparts' opinions.

# 5. NEW FINDINGS

1. I have shed light on the differences between the Hungarian and Slovakian tax system, and possible ways of adaptation of the Slovakian practice on the Hungarian circumstances.

2. I have drawn up a "napkin-sized" PIT return form complete with short, concise instructions.

3. Through case studies, I have described the effects of my proposed 201? PIT on the income of several tax groups (minimum wage, KSH average wage family with two children, single taxpayer with an income above average, employed pensioner).

4. Through carrying out and analysing in-depth interviews, I have shown the differences and similarities between the Slovakian and Hungarian tax reform.

5. Through a summary of the case studies and in-depth interviews, I have justified the aptitude of the 201? scenario that I have proposed.

6. In my research, I have come to the conclusion that with a well-chosen flat tax rate applied in the appropriate time, the flat tax system can contribute to economic growth, stability, transparency, and it is a catalyst for investments. The Slovakian flat tax system is simple, predictable, it can be planned with and has been stable for 8 years, whereas the Hungarian PIT changes year to year, is hard to plan with, and in the last few years it had been excessively complex.

# 6. PROPOSITIONS

Certain aspects of the Slovakian tax system may be used in Hungary as well. In Hungary, local governments have little independence in determining the dimensions of particular tax categories, and the majority of revenue from these flows into the central budget anyway, whereas in Slovakia, they have established a system that works very well, in which 70% of the revenue from personal income tax stays with the local government, 24% with regional government and only 6% goes into the central budget. (There is a similarly decentralised system in Switzerland as well.)

**Tax policy and social policy have to be kept separately.** The moment this is in effect and the tax system is deliberated from all interferences, a more transparent, simple and effective tax system is born. As a result of the whitening of the economy, **an increased taxpayer base** would balance out tax revenue lost by the decrease in the tax rate.

Indirect tax collection is more effective and means less administration and control work on both sides (taxpayer, authority), and it is more difficult to evade. Complexity has created a lot of loopholes. The discontinuation of the previous tax system has mitigated the distorting effects of the personal income tax. The reform aimed at putting an end to using tax policies for social policy reasons. The discontinuation of double taxation was carried out by omitting capital return tax, gift tax, estate duty, and the tax on registering transfer of property.

Beyond simplicity, the aim of the reform was to incite citizens' job market activity and to motivate enterprises in investment, development and job creation. Moreover, the tax reform solved one of the most significant

problems in business life, because in the corporate sector, the biggest obstacle had been the complexity of the tax system and the frequent changes to the tax regulations. In the long term, simplicity and transparency of the system also has a positive effect on the corporate environment and direct foreign investment.

**It would be effective in our country to similarly reduce tax burden on labour, increase taxes on income on equity and on harmful goods, as well as introducing a 17% flat personal income tax system.**
After having completed the tasks of mapping the flat tax system, the Slovakian system, and the comparison of the Slovakian and Hungarian systems, my conclusion based on the calculations in the case studies is that **the 17% flat tax and the proposed "napkin-sized" return form may be introduced simultaneously with the discontinuation of super gross tax calculation,** the only requirement would be political willingness. In 2011, the tax package introduced by the government kept using the super gross amount with 16% flat tax rate, which created an actual tax rate burden of 20.32%. It has been extended with a strong family supportive aspect, which only a small group of taxpayers can utilize. In **my proposed scenario, taxpayers with an average income could also fully utilize the reduction after children, even after 3 children.** The well-kept secret of the flat tax system, which provides an essential second pillar, is the property tax. According to calculations made by József Papp (associate professor at Corvinus University of Budapest), **introduction of the property tax above 50 million HUF would create a tax revenue of 500 billion HUF**. **The flat personal income tax and the property tax together would create a fairer, simpler situation** than the current one. The flat personal income tax leaves more in the pockets of taxpayers with a higher income, but the property tax

compensates for this, while not affecting taxpayers with a property valued under 50 million HUF. Needless to say, in order to achieve this, accurate records should be kept that are not limited to immovable property. An appropriate **property tax rate** would **significantly mitigate the deficit in the financial statement in a 10-year period**, based on the existing Swedish model.

Types of taxes on assets increase the efficiency of the tax system especially if concealment of income is a widespread and relatively easy task, whereas the concealment of asset items from the tax authority is expensive feat, moreover, collection of taxes on assets is simpler and cheaper. Certain types of assets, first of all immovable properties are characteristically more difficult to conceal than income. **(Krekó et. al. 2007)**

# 7. LIST OF PUBLICATIONS RELATED TO THE TOPIC OF THE DISSERTATION

## 7.1 Articles in foreign languages

Peter Weber - Tünde Kitanics Dr. Bokorné: The main differences between Slovakian and Hungarian tax system, Acta Oeconomica Kaposvariensis, 2008. Vol. 2. No.2., pp. 9-18

## 7.2 Articles in Hungarian

Wéber Péter – Bokorné Dr. Kitanics Tünde: A Szlovák egykulcsos SZJA adaptálásának neuralgikus pontjai [Neuralgic points of the Slovakian flat PIT], Gazdasági és Társadalomtudományi Közlemények, 2013. IV. évfolyam, 2. szám., pp 207-216.

Wéber Péter – Bokorné Dr. Kitanics Tünde: A Szlovák egykulcsos SZJA adaptálásának lehetőségei esettanulmányokon vizsgálva [Possible adaptations of the Slovakian flat PIT, analysed through case studies], Könyvvizsgálók Lapja, 2012. I. évfolyam, 11. szám., pp. 13-16.

Wéber Péter – Gyurián Norbert: Szlovák kontra Magyar adórendszer [Slovakian vs. Hungarian tax system]; III. Nemzetközi Tudományos Konferencia SJE „A tudomány és az oktatás a tudásközpontú társadalom szolgálatában". Komárom, 2011, szeptember 5-6.

Wéber Péter – Bokorné Dr. Kitanics Tünde – Dr. Kovács Tamás: Küszöbön az egykulcsos adórendszer [The forthcoming flat tax system]; A Magyar Tudomány Hete 2010, Konferenciasorozat, „A tudomány az élhető Földért",

A Közgazdaságtudományi és vezetéstudományi Konferencia előadásai, A Dunaújvárosi Főiskola közleményei XXXI., III. kötet, Dunaújváros

Wéber Péter: A társasági adóról és az osztalékadóról szóló 1996. évi LXXXI. törvény módosítása [Modification of the 1996 LXXXI regulation on corporate tax and capital return tax]; A munkaadó lapja XIII. évfolyam, 2006. augusztus – szeptember, pp. 16 – 21.

Wéber Péter: Társasági adó, osztalékadó [Corporate tax, capital return tax]; Cégvezetés: XIV. évfolyam, 1. szám, 2006. pp. 59-62.

Wéber Péter: Új adónem a luxusadó [New tax category: luxury tax]; Cégvezetés: XIV. évfolyam, 1. szám, 2006. pp. 77-80.

Wéber Péter: A társasági adóról és az osztalékadóról szóló törvény változásai [Changes in the regulation regarding corporate tax and capital return tax]; Cégvezetés: XIII. évfolyam, 1. szám, 2005. pp. 68 - 73

## 7.3 Presentations

Wéber Péter: Változások a társasági adó és az általános forgalmi adó területein [Changes in corporate tax and value added tax], Pataky Művelődési Központ, Budapest, X. kerület, 2006.