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Original Paper

Hungarian Government on the Whitening of the Economy Measures to Stabilize the Budget

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Abstract

The Hungarian government developed a package of tools for improving legal control and compliance for Hungarian companies and entered into force between 2012 and 2021. Part of this complex package of measures sought to broaden the tax base without raising taxes, while others sought to reduce the size of the black economy by reducing the amount of illegally available benefits. The level of compliance may increase, as inspections are continuous, the risk of failure is high, and compliance with legal actions does not require a large intellectual or financial expense from the taxpayer. Part of this package was the obligation to use online cash registers, the introduction of reverse charge VAT, the targeted reduction of VAT rates, the introduction of an electronic goods tracking and verification system, and the introduction of online invoicing.

Keywords

illegal behavior and the enforcement of law, shadow economy, taxation, tax evasion, tax law

1. Introduction

The common feature of each step of change was that it was built on increased cooperation between taxpayers and/or reduced the tax administration or expanded the audit database by technical means without imposing a significant additional burden on customers. Although voluntary compliance is an important element in the operation of any tax system, it is at least as important that taxpayers are constantly aware of the state's controlling presence. One of the least annoying ways for taxpayers to do this is to enforce mandatory electronic steps built into the process of electronic communication, control, and taxation. Using them can reduce the time spent on inspections and increase their efficiency. As VAT

provides the largest share of budget revenues, twenty to twenty-five percent, in most countries, it was appropriate to incorporate new means of control into the VAT management system of companies.

Value Added Tax (VAT) is a consumption tax charged on most goods and services consumed in the EU. The tax is levied on the "value added" to the product at each stage of production and distribution. This means that VAT is charged when VAT-registered businesses sell to other businesses (B2B) or to the final consumer (B2C). The Member States of the European Union lose billions of Euros in VAT tax revenue as a result of tax fraud and insufficient tax collection systems. The VAT Gap measures the effectiveness of VAT enforcement and compliance measures in each Member State, as it provides an estimate of revenue loss due to fraud and evasion, tax avoidance, bankruptcies, financial insolvencies as well as miscalculations. Quantifying the scale of the VAT Gap can help to develop well-targeted measures and monitor their effectiveness (European Commission, 2020a)

2. Method

The study derives the VAT Total Tax Liability (VTTL) for each country from national accounts by mapping information on different VAT rates (standard, reduced and exemptions) onto data available on final and intermediate consumption, along with other information provided by Member States. This means that the quality of the VAT Gap estimates depends on the accuracy and completeness of national accounts data. When national accounts figures are reliable, the methodology is precise enough to estimate the VAT Gap. The main limitation of the methodology is the quality of the national accounts: better data-in, better estimations-out. Moreover, Member States use different methodology to estimate the informal economy and to reflect it in their national accounts, thus indirectly affecting the VAT gap figures (CASE, 2020).

Variations in the VAT gap reflect the differences in Member States in terms of tax compliance, fraud, avoidance, bankruptcies, insolvencies and tax administration. The estimates also reflect structural differences in national economies and other variables. Indirect circumstances such as the organization of national statistics could also have an impact on the size of the VAT Gap.

3. European Union Requirements Related to VAT

The European Union (EU) lacks a uniform tax policy, however in relation to VAT—since those serve as the basis for EU budget contributions by the Member States—uniform frameworks have been determined to be used by the Member States. The European Union has issued directives in relation to VAT—which is the equivalent of General Excise Tax, ÁFA in Hungary. Based on the provisions of the relevant EU directive, the general rate of the tax cannot be lower than 15%, at the same time it fails to specify an upper limit. According to the directive, the Member States may apply one or two discounted tax rates with regards to specific product sale or service provision categories. The discounted tax rates cannot be lower than 5% determined as the percentage of the tax base. At the same time the regulation allows the Member States which applied tax free status or lower rates in the case of products and

services beyond the discounted categories on 1 January 1991 may continue to apply those. This is how it is possible that in certain Member States three or more discount rates are in effect, including 0% rates (European Commission, 2020c).

3.1 Comprehensive Reform of the EU's VAT System

VAT (General Excise Tax (Áfa) in Hungary) is a significant and increasing important revenue source in the EU. According to a relevant study, in 2015 it accounted for over 1 trillion Euro of revenue, which is 7% of the European Union's GDP 7% (European Commission, 2017a). The European Commission submitted a proposal back in 2016 to reform the current regulations, and on 7 April 2016 the Commission approved the Action Plan on VAT to transform the EU into a uniform VAT area (European Commission, 2017b). The primary reason for the comprehensive reform is that the current system which took effect as a temporary system in 1993 cannot meet the challenges posed by the development of the global, digital and mobile economy in spite of its reforms so far. The VAT system is overly fragmented and at the same time too complicated from the aspect of companies that operate cross-border businesses, the number of which has multiplied since then. Moreover, it provides opportunities for fraud: domestic and interstate transactions are treated differently and it is possible to acquire products and services on the unified market without paying VAT. As a result the Member States lose 160 billion Euro of revenue, which if collected could be used to build schools, to develop highway systems and to modernize healthcare. The following would be the pillars of the new comprehensive system proposed by the European Commission:

- Tackling fraud: VAT will now be charged on cross-border trade between businesses. Currently, this type of trade is exempt from VAT, providing an easy loophole for unscrupulous companies to collect VAT and then vanish without remitting the money to the government.
- One Stop Shop: It will be simpler for companies that sell cross-border to deal with their VAT obligations thanks to a "One Stop Shop". Traders will be able to make declarations and payments using a single online portal in their own language and according to the same rules and administrative templates as in their home country. Member States will then pay the VAT to each other directly, as is already the case for all sales of e-services.
- Greater consistency: A move to the principle of "destination" whereby the final amount of VAT is always paid to the Member State of the final consumer and charged at the rate of that Member State. This has been a long-standing commitment of the European Commission, supported by Member States. It is already in place for sales of e-services.
- Less red tape: Simplification of invoicing rules, allowing sellers to prepare invoices according to the rules of their own country even when trading across borders. Companies will no longer have to prepare a list of cross-border transactions for their tax authority (the so-called "recapitulative statement").

The changes affecting VAT will be introduced in two phases. The first phase started on 1 January 2020, and included measures that simplified and standardized the previous procedures. On 18 February 2020,

the Council approved new measures to transmit and exchange payment data in order to fight e-commerce VAT fraud. The new regime on the exchange of payment data will reinforce the capacity of Member States to fight against e-commerce VAT fraud by launching Central Electronic System of Payment information *(Central Electronic System of Payment information—CESOP).* As of 2024, CESOP will keep records of cross-border payment information within the EU, as well as payments to third countries or territories, for a period of five years (Council Regulation (EU) 2020/283). This will allow tax authorities to properly control the correct fulfillment of VAT obligations on cross-border Business to Consumer (B2C) supplies of goods and services (European Commission, 2020c). On 18 February 2020, finance ministers agreed to new simplification rules which will open the VAT exemption to small businesses established in other Member States and help reduce VAT compliance costs. The new regime should reduce red tape and administrative burdens for SMEs and create a level playing field for businesses regardless of where they are established in the EU. The new VAT scheme for SMEs will apply as of 1 January 2025 (European Commission, 2020d).

The second phase starts on 1 January 2021. In the framework of this the MOSS system (Mini One Stop Shop System) introduced in 2015 for the simplification of fulfilling registration, financial and administrative obligations for non-taxpayer customers related to services provided including remotely, will be expanded to the sale of products originating from another Member State or third countries with value below 150 Euro (OSS) (Salamon-Véber, 2019).

3.2 VAT Revenue Gap EU Member States

The numeric expression of the size of the VAT Gap facilitates the development of targeted collection improvement measures and monitoring their efficiency. The methodology of estimating VAT Gap is based on econometric models developed for this purpose and the historic tracking of VAT Gap trends in certain mem between 2000 and 2017 (European Commission, 2020e). The overall VAT Gap in EU Member States fell from €140.9 billion in 2017 to €140.0 billion in 2018. Because of the higher increase in revenues, in relative terms, the EU-wide gap dropped to 11.0%, down from 11.5% in 2017. In 2018, the overall VTTL for EU Member States increased by 3.6% to €1.272 billion, whereas VAT revenue increased by 4.2% to €1,132 billion. Fast estimates show that the VAT Gap will likely continue to decline in 2019 and could fall below €130 billion and 10 percent of the VTTL *(VAT Total Tax Liability)*. The ranking of Member States with respect to the relative size of the Gap remained relatively stable. Overall, the VAT Gap decreased in the majority of Member States, with the largest improvements noted in Hungary, Latvia, Poland, and Greece. A positive downward trend was more visible not only in the number of the countries that reduced their VAT Gap, but also in terms of the percentage of increases compared to decreases in VAT Gap (the average decrease (0.7 percentage points) is less than half of the average increase (1.6 percentage points). In 2018, the estimated VAT Gaps among Member States ranged from 0.7% in Sweden, to 33.8% in Romania. The smallest Gaps were observed in Sweden (0.7%), Croatia (3.5%), and Finland (3.6%)—the largest in Romania (33.8%), Greece (30.1%), and Lithuania (25.9%). Overall, half of the EU-28 recorded a Gap above 9.2%. In

nominal terms, the largest Gaps were recorded in Italy (€35.4 billion), the United Kingdom (€23.5 billion), and Germany (€22.1 billion). The VAT Gap in 2020 is forecast to increase. If the EU economy contracts by 7.4% in 2020 and the general government deficit jumps as set out in the Spring Forecast, the Gap could increase by 4.1 percentage points compared to the previous year up to 13.7% and €164 billion in 2020 (CASE, 2020).

4. Hungarian Government Measures to Whiten the Economy

In Hungary from the results improving year after year it can be clearly concluded that the Hungarian government's measures to whiten the economy are successful. In 2013 the tax evasion rate in Hungary was 21%, in 2019 it was only 6.6% according to the relevant VAT Gap study (CASE, 2020).

The Hungarian government's measures to whiten the economy, among other things, were targeted at reducing the size of the black or grey economies, and at reducing tax evasion, and within that particularly VAT evasion (Állami Számvevőszék, 2019). Between 2012 and 2018 Hungarian government developed and introduced a legal inspection and law compliance measure package pertaining to Hungarian businesses. The obligation to use online cashiers; the introduction of reverse VAT payments; the targeted reduction of VAT rates; the introduction of the Electronic Trade and Transport Control System (EKÁER); and the mandating of online invoicing were parts of this measure package (Szilovics, 2019).

4.1 Introduction of Online Cahiers

The introduction of online cahiers was mainly justified by the fact that it results in higher revenue without increasing the VAT rate. Therefore, online cahiers should be used for the invoicing of transactions where the sale is to the end user who pays cash onsite. Specifically, in these cases the customers is typically not interested in asking for an invoice, while the salesperson may be strongly interested in hiding the involved income. Online cahiers make retail transactions traceable, in a way that the commercial transaction data are displayed directly at the National Tax and Customs Administration. However, for this it is essential to operate a secure data communication system between online cahiers and the tax authority that cannot be externally manipulated. With these basic ideas in May 2012 the conversion of cashiers applied since 1995 started (Adó Online, 2017). The technical requirements of online cahiers became known in December 2012 by Decree 3/2013 (II. 15.) NGM on the Technical Requirements of Cashiers and Taximeters, the Sale, Use and Maintenance of Cashiers and Taximeters Serving to Issue Invoices as well as the Reporting of Data Recorded by Cashiers towards Tax Authorities (Hungarian Government Decree 3/2013 (II. 15.) NGM). After the completion of the notification procedure at the European Commission, the regulations related to taximeters and online cashiers were separated (Hungarian Government Decree 48/2013. (XI. 15.) NGM). Article 106 of Act CL of 2017 on the Rules of Taxation (new ART) contains the detailed rules of data reporting related to online cashiers, and the requirements ensuring high quality data reporting (Hungarian Act CL of 2017). The online cashier has the capacity to store the summarized income data

onsite, and to forward them in real-time through a communication channel as data reporting to the National Tax and Customs Administration. An advantage of the Hungarian regulation is that the data reporting fully includes the sales of the taxpayer, changes made to the online cashier (power outages, daily opening and closing times); its complete data content can be downloaded from the online cashier's memory and it is automatically integrated into the registry of the tax authority. The tax authority uses the data incoming by the data reporting of the online cashier for a risk analysis procedure, during which the tax authority performs risk analyses to identify the risks related to the fulfillment of tax obligations as well as the exclusion or confirmation of the existence of the identified risks (Adó Online, 2017).

4.2 Introduction of Reverse VAT Payments

According to the rules related to reverse taxation, the taxpayer is not mandated to determine and account the VAT applicable to the transaction, rather its client (i.e. the customer or the taxpayer using the service) (Hungarian Act CXXVII of 2007). The EU VAT systems are based on basically fractioned payments, VAT is collected in every phase of the production and distribution chain, and then the advanced VAT payments after the purchases are calculated into the outgoing VAT received after final sale. The main rule specified in Article 193 of the VAT-Directive is that VAT shall be payable by any taxable person carrying out a taxable supply of goods or services. The responsible person is the one who pays the VAT to the Treasury (EU Council Directive 2006/112/EC). In certain well definable cases, VAT shall be payable by any person who is identified for VAT purposes in the Member State in which the tax is due and to whom goods are supplied, and not the person supplying the products or services. Such mandatory reverse taxation is applicable in the entire territory of the EU, in all EU Member States with the conditions specified in Articles 195-198 of the VAT Directive. VAT shall be payable by any person who is identified for VAT purposes in the Member State in which the tax is due and to whom goods are supplied, or it can be mandated that the person responsible for paying VAT is the person who receives the products or uses the services, if the supplies are carried out by a taxable person not established within that Member State. Such reverse taxation is not regulated by national laws. In the Member State in which the tax is due it may be mandated that the VAT shall be payable by any taxable person to whom the services are supplied, if the services are supplied by a taxable person not established in that Member State. Such reverse taxation is regulated by national laws. The Member State in which the tax is due may mandate that the VAT shall be payable by any taxable person to whom the services are supplied, if the services are supplied by a taxable person not established regardless of where the supplier is established or resides. Such reverse taxation, the purpose of which is to deal with possible tax evasion and tax fraud, is regulated by national laws.

The reverse taxation mechanism may be conducted by the Member States in specific cases based on Article 395 of the VAT-Directive (or based on the provisions of Article 94) in harmony with the provisions of the separate permission, and in accordance with the conditions specified in Articles 199, 199a and 199b of the Directive (ANNEX to the Report from the Commission).

The reverse taxation mechanism places the responsibility of accounting VAT from the supplier to the customer. This prevents the supplier from charging the VAT to the customer but not pay it to the Treasury. With this the Member States have the option of applying reverse taxation in the case of the predetermined sale of products or services, particularly in the case of products and services that are suitable for fraud committed within the EU by fraudulent traders.

4.3 Targeted Reduction of VAT Rates

In recent decades the black economy and the presence of tax fraud as well as tax evasion for obtaining illegal income has been typical in food production and distribution in Hungary. Therefore, the products affected by VAT rate reduction in recent years have been characteristically agricultural products. VAT related fraud can be directed at avoiding payment obligations or unlawful tax deductions (and redeeming), which constitutes budgetary fraud (Hungarian Act C of 2012; § 396).

In the case of VAT payers hiding the performed transactions and the incomes originating from them reduces VAT payment obligations. The presence of the black economy was particularly typical in the pork sector; here experts estimated the ratio of the black economy to be as much as 40-50%. Obtaining illegal income was performed by forging the source of the product, or by fictitious export, or by unlawful tax deduction and redeeming through a chain of companies, or not fulfilling tax payment obligation. Within the sector the so-called merry-go-round fraud was particularly widespread. In which during import or export, with the involvement of several cooperating companies, at a certain point of the chain of sales an illegal tax redeeming occurs (Állami Számvevőszék, 2019). VAT rate reduction happened mostly in the case of products where illegal activities had been significant on the market. Thus, live pigs and half-pigs (Hungarian 2013 CC. law), large animals such as cattle, sheep and goats (Hungarian Act LXXIV of 2014), pork (Hungarian Act LXXXI of 2015), poultry (New section 52 of the Hungarian 2007 Act), bird eggs, fish for human consumption, pig innards) (New sections 55, 56, 57 of the Hungarian 2007 Act), milk (Amendment to Part I of Annex 3 to the Hungarian 2007 Act with effect from 1 January 2018) etc. in these cases the goal of the lower VAT rates was primarily to reduce the black economy and tax evasion.

4.4 Introduction of the Electronic Trade and Transport Control System (EKÁER)

EKÁER is a technical system established and operated by the National Tax and Customs Administration that monitors, inspects and registers the movement of goods, the primary purpose of which is to reduce the number fraud related to the transport of goods and VAT fraud (Szilovics, 2019). The most important element of the new system's operation is that goods planned to be transported by trucks which became subject to road fee starting on 1 January 2015, those with a total weight of 3.5 tons or more, must be reported to the authority before the beginning of the trip by the person responsible for the transport or the transport company, and a so-called EKÁER-number must be requested. Those in the above specified category may only perform transport activity with a valid EKÁER-number. The law states that in the case of so-called risky products stricter rules must be applied. Mostly food products were classified in the risky products category (meat, milk, butter, cheese,

flour, sugar, cooking oil). In the case of this product range even those transports that are under the total weight of 3.5 tons must be reported and permitted. The HU-GO nationwide camera system is connected to the operation of the system, the rules for the functioning of which are specified in Hungarian Act LXVII of 2013. Accordingly, as of 1 January 2015 the National Tax and Customs Administration is authorized to receive and use for its work the digital transport data collected by the HU-GO system. By the cameras monitoring road traffic the movement of goods transports can be accurately traced on the entire Hungarian road network, and the collected data can be compared with the data obtained by the National Tax and Customs Administration, thus including information based on EKÁER-reports. The system has been supplemented by a financial warranty system provided by transport companies. The following laws and legal regulations are relevant from the aspect of EKÁER:

- Act CLI of 2017 on Tax Administration and the Regulation of Tax Administration;
- Act CL of 2017 on the Rules of Taxation, Act CLIII of 2017 on Enforcement Proceedings to be Implemented by the Tax Authority;
- Act CXXVII of 2007 on Value Added Tax;
- Government Decree 465/2017. (XII.28) on the Detailed Rules of Tax Administration Procedures;
- Decree 13/2020. (XII. 23.) PM on the Operation of Electronic Trade and Transport Control System (EKÁER);
- Decree 51/2014. (XII. 31.) NGM on the Determination of Risky Goods in Connection with the Electronic Trade and Transport Control System (EKÁER).

The laws and legal regulations that serve as the basis for EKÁER have changed as of 1 January 2021. The most important change is that as of 1 January 2021 only those products must be reported that are listed in the Annexes of Decree 51/2014 of NGM on the determination of risky goods in connection with the Electronic Trade and Transport Control System). The range of those that are exempt from the risk deposit has been expanded. According to the main rule a risk deposit must be provided for products subject to EKÁER, but the regulation gives an exemption from this obligation in certain cases. 2021. As of 1 January 2021, on top of the previous exemptions, those who qualify as reliable taxpayers do not need to provide a risk deposit either. Goods transport with road vehicle can still only be performed with a valid EKÁER-number, along with sales involving road transport and the movement of goods for other reasons. The EKÁER system assists in the inspection work of the National Tax and Customs Administration (NAV) makes financial transactions more transparent and broadens the rage of compliant taxpayers.

5. Summarizing Conclusions

The Hungarian government started the online era of whitening the economy in 2014; this is when using online cashiers became mandatory. After this started the live operation of the Electronic Trade and Transport Control System. The system of online invoicing was introduced after this. As a result of all of

this, in 2018 the VAT Gap was reduced the most in Hungary among European countries and in 2019 it was further improved, and with this from the aspect of the VAT Gap we managed to surpass counties like Germany, Austria and Denmark. On top of the fact that the online inventions of the Hungarian economy whitening have by now become exemplary models on the international level, they created the possibility for tax reductions. During the corona virus crises it is especially important that the state should protect law abiding businesses, and nobody should be able to avoid paying their taxes, so the fight against the black economy will continue to age the tax evasion rate as low as possible.

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