MINISTRY
FOR NATIONAL ECONOMY

A record low corporate tax rate in Hungary

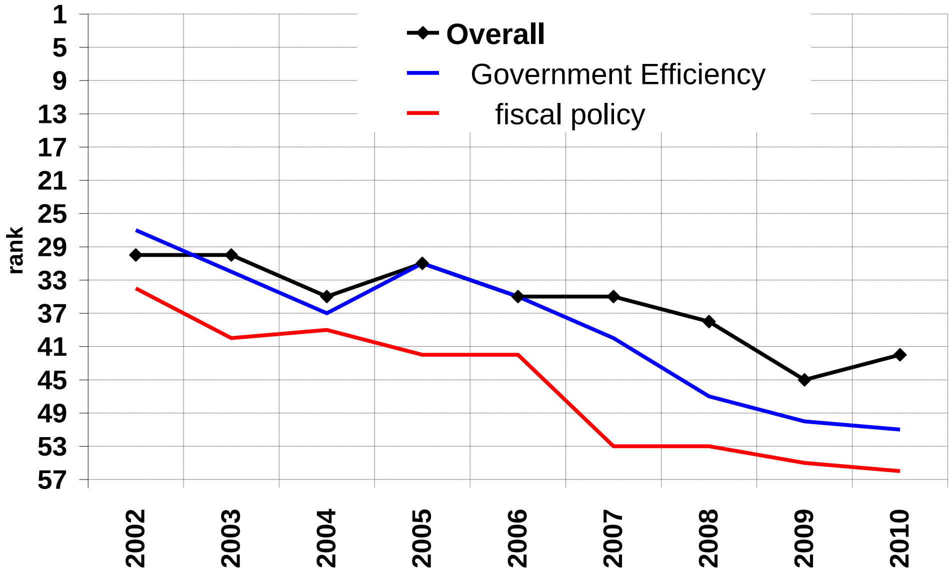
Focus

The Ministry for National Economy regards it as a mission to make the system of taxes uncomplicated and to cut tax rates. A bill being debated in Parliament these days, aimed at creating a proportionate tax system, will introduce from 1 January 2013 a uniform, flat corporate tax rate of 10% applicable regardless of the size of the tax base.

Background

Due to the mistakes of the economic policy of the past couple of years, Hungary's competitiveness has deteriorated sharply. From the middle ranking typical at the beginning of the 2000s, the country has fallen back into the bottom half of the list.

Figure 1: Changes in Hungary's ranking on the compound IMD list, regarding the below aspects.



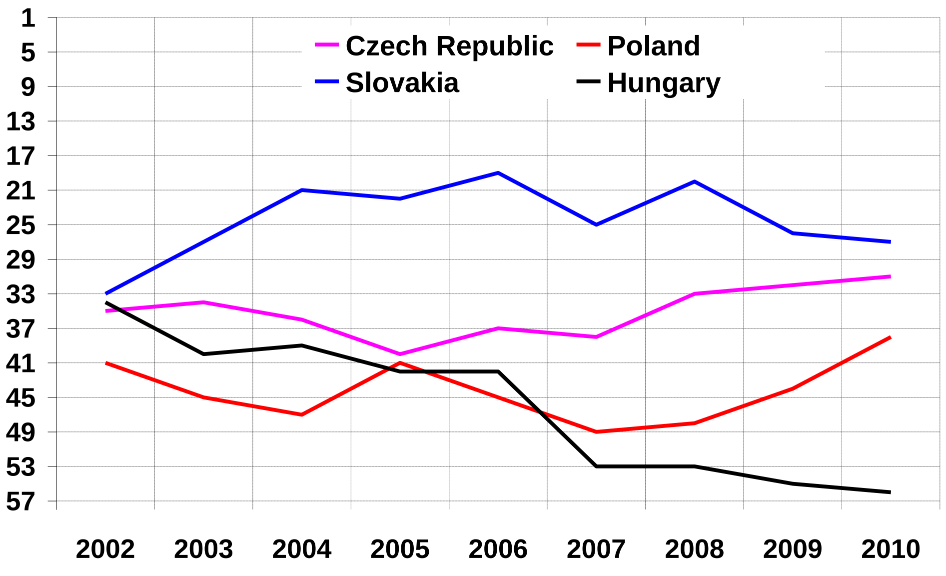
(Source: IMD)

As the diagram shows, Hungary's competitiveness has been deteriorating for the last couple of years, due mainly to the steadily and substantially falling efficiency of the government. According to this year's competitiveness ranking of the IMD (Institut für Management-Entwicklung), the management training institution and economic think tank, as a result of the government policy of the past eight years, Hungary has fallen back by 24 places to Nr. 51 by 2010. In the meanwhile, the three other members of the Visegrad Group, the Czech Republic, Poland and Slovakia, are around Nr. 35, leaving us well behind. The situation is even more serious considering that, in the above ranking, Hungary was well ahead of all the three other countries back in 2002.

The above data by the IMD also suggest that the main reason behind Hungary's competitiveness deficit was the inefficiency of the government.

The tax burden on households and companies, or fiscal policy in the terminology of the IMD, plays a crucial role in the changes of the government efficiency barometer. The below figure shows that back in 2002 Hungary was the 34th in the ranking regarding the private sector tax burden. However, due to the steadily increasing tax liabilities of late, the country has fallen back to Nr. 56 by 2010 (while the average for the Visegrad Three was modified from 36 to 32), so there are only two countries behind us by now.

Figure 2: Changes in the ranking of the region's countries, regarding fiscal policy.



(Source: IMD)

It is obvious from the above diagram that Hungary's tax system had to be reconsidered. To improve the competitiveness of the country it was necessary to make the tax system less complicated and to cut the tax burden in order to aid every participant of the Hungarian economy.

"Cornerstones"

One of the very first measures the government has introduced after its inauguration was the extension of the preferential corporate tax rate. From 1 January 2010, many more small and middle-sized private companies can apply the 10% instead of the 19% tax rate, as the earlier tax base limit of 50 million HUF (181 403 EUR) was raised to ten times this sum, or 500 million HUF (1 814 026 EUR). Nonetheless, there is still more aid than the numbers would indicate: some other preconditions for the application of the preferential tax rate were also abolished; since July only the size of the tax base determines the tax rate.

In Hungary, the 19% corporate tax rate applicable until recently has been too high relative to rates of our immediate competitors, and it was a burden on competitiveness. However, due to the introduction of a radically reduced tax rate, Hungary has become attractive for domestic and foreign investors alike, meaningfully facilitating the creation of jobs.

As a result of this measure, the 10% corporate tax rate has become generally applicable for lots of small and middle-sized private companies.

The cut in tax rate also helps bigger companies. The amendment eases the tax burden of almost 262 000 profitable companies, or 72% of the app. 362 000 companies submitting a tax declaration each year.

In detail, according to statistics **the following enterprises can apply the 10% tax rate**:

- 233 000 micro companies
- 21 500 small companies
- 3 500 middle-sized companies
- 4 000 other companies

Besides the positive impact of the measure on small and middle-sized private companies, we can certainly reckon with a positive effect on black economy too. When such a low tax rate is applicable, it will no more be worth risking tax evasion by apparently break-even or loss-making companies.

The extra profit this measure leaves at the companies will be 70bn HUF (254 million EUR) in 2010, 140bn HUF (508 million EUR) in 2011, 148.3bn HUF (538 million EUR) in 2012, and 157.3bn HUF (571 million EUR) in 2013, or altogether during these four years 682.2bn HUF (2 475 million EUR).

Conclusion

As a result of the cut in tax rates, Hungary will provide the most optimal tax environment in the Central-European region, regaining its reputation with it and increasing its potential to attract more capital and to create many more jobs.

Budapest, 2 November 2010.

Ministry for National Economy