

## WHERE IS THE HUNGARIAN LOCAL TAXATION HEADING?

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**Abstract:** *Operation of the Hungarian municipalities has undergone significant change since 1990. While the regulation aimed to decentralise the tasks and sources after introducing the municipal system, the government has taken measures strengthening the centralization since 2010. Aim of the treatise is to present the weight of budget of municipalities within the state finances, the role of own revenues and local taxes in the budget of municipalities, highlighting the development in amount of the business tax by settlement type. Ratio of the own revenues and local tax revenue have increased in the budget revenue of municipalities and the local business tax paid by the companies has played a bigger and bigger role. In addition to the restructuring of resources, the scope of compulsory tasks has also decreased; the state has taken over the public education and the specified areas of health service which has resulted in a decrease of almost 30% in the budget revenue of municipalities. Due to the territorial concentration of the country, the capital and its districts as well as the cities with county rights levy more than 60% of business tax. The largest companies have settled in the capital and most of the undertakings also operate here so the HIPA revenue concentrates here as well. Since 1 January 2015, there has been a change in utilizing the classical taxes: the revenues from the local business tax shall/may be used for funding the social services belonging to the competence of the body of representatives and for the wage costs of office workers. Since 1 January 2015, the municipalities are allowed to introduce not only local taxes but a settlement tax insofar as it is not prohibited by other law as well as the subject of the settlement tax is not burdened by any common charge. The revenue from settlement tax may be used for funding social services and settlement development only. However, according to the first experiences, a restructuring of local taxes has started by introducing the settlement tax and limiting the utilization of local business tax in bigger settlements. Based on the data, it can be stated that there has been a significant change in the structure of revenues of municipalities since 2008; the local taxes play a decisive role in the budget revenues and those ones serve as important sources of funding.*

**Key words:** municipality, state finances, budget, local taxes, business tax.

**JEL classification:** G28, H26, H61

### 1. Introduction

In recent years, the management of local municipalities has been followed with particular attention both in the EU's and OECD countries. In one respect, the financial crisis erupted in 2008 has also affected the municipal sector in most

countries, on the other hand, transformations have taken place in the system of distribution of tasks and resources between the central and local levels of government in most countries. Numerous authors have digested the domestic and international experiences of the subject-matter (Bordás, 2015; Fellegi, 2012; Halmosi, 2013; Horváth et al., 2014; Lentner, 2015, Sivák, 2014). In the course of the research, we will present the main characteristics of local taxation of the Hungarian municipalities, we will analyse the development of budget revenues of the municipalities, we will separately examine role of local taxes and business taxes as well as we will point out some peculiarities of the local taxation. There have been legislative changes concerning the management of municipalities several times throughout the past years but we do not strive to present the change of regulation in detail due to its complexity. Regulation of the Hungarian municipal system was formerly characterized by decentralization of the resources and tasks but the role of the state has increasingly coming to the fore since 2011. We have carried out the analysis based on data of the National Regional Development and Spatial Planning Information System ([TEIR](#)), [the Hungarian State Treasury \(MÁK\)](#) and [the State Audit Office](#).

## **2. Tax harmonisation**

One of the most important concepts of the international taxation is the tax harmonisation. Since the second half of the 1990s, the conscious application of the Hungarian tax policy in accordance with the requirements of the European Union has accelerated which was the first step for the commencement of accession negotiations. During the legislative harmonisation, it is required to endeavour to adapt the domestic tax conditions to the tax policy solutions of the EU member states not only in the interests of the budget but it should reflect the priority of other areas of the economic policy as well. Tax harmonisation appears in case of more laws, not only in case of the direct taxes (VAT, excise duty) but in case of the indirect taxes and budget support as well. (Földes, 2005)

In the area of harmonising the direct taxes, a cardinal issue of the European harmonisation is the action against the harmful tax competition. In the interests of forming and operating the single market, the aim and result of the tax harmonisation is the liquidation of tax law conflicts ensuing from the international relations and differences of the national tax systems or from applying same methods. The European Union does not exercise fully intervention in the tax systems of the member states but it uses the influencing instruments of the legislative harmonisation in order to avoid the negative processes and the double taxation as well as to ensure the operation of the single internal market. (Erdős, 2012)

Regarding the direct taxes, the rules are less harmonised than in case of the indirect taxes. Relating to these taxes, not the harmonisation prevails but the coordination, the reason of which is that the decisions of the European Court give direction how the direct tax may or may not be regulated. It is important to mention because, apart from the enforcement of the four freedom principles, there are no EU expectations in case of the direct taxes, particularly in relation to the local taxes. This is the reason why the local tax is one of the most important instruments: each member state can elaborate its own tax system in accordance with its intent. In addition to the discrimination, there are no other expectations regarding the local

taxes; this fact gives the legislators and the settlements a large scope for action. (Deák, 2013)

Significance of the local taxes is also considerable in the OECD countries; the property taxation has come to the fore in the local taxation. Central questions of the local tax reforms: in one respect, how a connection can be established between certain tax categories and the services used, on the other hand, creating a balance between the central and the local taxes. (OECD, 2013a) Besides, for instance, decentralization of educational tasks is also a priority issue in most of the OECD countries. (OECD, 2013b)

### **3. Introduction of local taxes**

The aim of introducing local taxes is to ensure the independence of a municipality and to exercise the right of local taxation. Act C of 1990 on Local Taxes (hereinafter Htv.) has empowered the municipalities to exercise the right of local taxation. The tax categories defined in the Act are introduced in the area of their competence by means of a regulation. Since 1990, the tax assessment right has been being performed – we could even say – without traditions.

Due to the Act, 308 municipalities introduced local taxes in 1991. Those ones were mostly larger cities and cities with county right which introduced business tax, communal tax of entrepreneurs and tourist tax. However, the continuously changing economic situation has required more and more municipalities to introduce local taxes, especially the business tax. In 1992, a significant change occurred since 1 461 municipalities had already introduced local taxes and the local tax revenues had significantly soared. While it had been HUF 4 billion in 1991, HUF 17 billion was already received from the local tax revenues in 1992. In 1993, there was no change in number of municipalities introducing local taxes but the revenue resulting from local taxes already reached HUF 27.1 billion (*ÖN-KOR-KÉP, 1997*).

Year of 1994 was characterized by the elections which resulted in that the newly established body of representatives used the opportunity of introducing local taxes. Thanks to this, the number of municipalities introducing local taxes increased to 1 578. In January of 1996, the Act on Local Taxes was modified under which the exemptions and allowances narrowed and the tax rates increased. By 2001, the number of municipalities introducing local taxes (3 027 pcs) increased tenfold compared to 1991. Until the end of 2013, further 127 municipalities introduced local taxes. Currently, 3 178 settlement municipalities work in Hungary and 3 135 of them have introduced some type of local taxes since 1 January 2015. This means a ratio of 98.6%.

### **4. Weight of municipalities in the state finances**

In modern market economies, extent of the weight of municipalities within the state finances shows a quite varied picture and represents the degree of decentralisation prevailing in a given country. Role of the local municipal level is significant in ensuring the collective goods and in organizing the public services. The issue of decentralisation is always a central issue in the course of adjudicating the operation of municipal systems and during the reform of systems operating. Namely, the experiences indicate that the benefits of decentralisation do not prevail

automatically as well as the combinations of advantages and disadvantages are very different from county to country. This diversity is reflected in the fact that, in developed economies, processes of decentralisation and centralisation alternate with each other in the division of tasks among governmental levels according to the state policy. (Sivák, 2014)

In Hungary, the system of state finances has two subsystems since 2010: the central budget and the budget of municipalities. Tables 1 and 2 contain the development of revenue and expenditure structures of state finances.

**Table 1:** Revenue structure of state finances (%)

Description	2009	2010	2011	2012	2013	2014
Revenue of central subsystem	80,5	80,2	79,9	83,7	87,1	86,8
Revenue of municipal subsystem	19,5	18,8	20,1	16,3	12,9	13,9
State finances in total	100,0	100,0	100,0	100,0	100,0	100,0

Source: I1., I3.

**Table 2:** Expenditure structure of state finances (%)

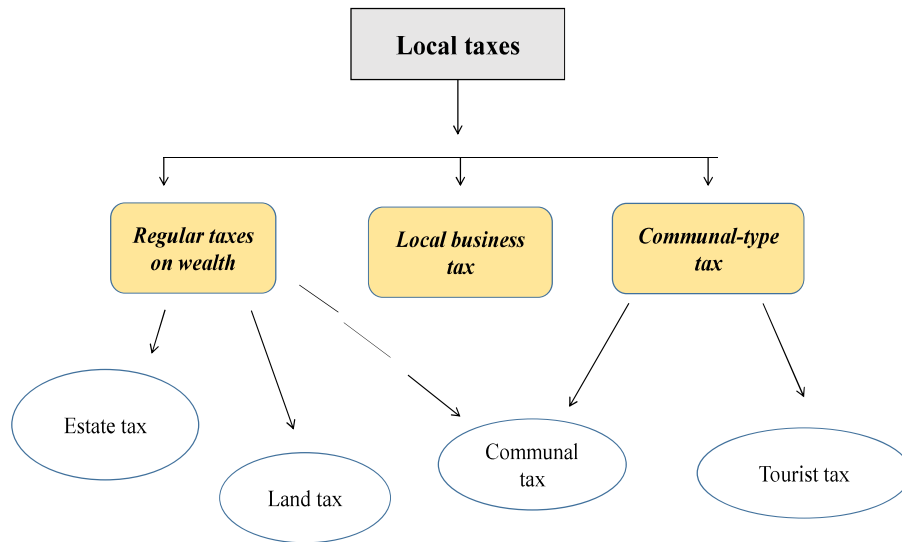
Description	2009	2010	2011	2012	2013	2014
Revenue of central subsystem	81,2	80,5	82,4	84,7	88,2	87,6
Revenue of municipal subsystem	18,8	19,5	17,6	15,3	11,8	12,4
State finances in total	100,0	100,0	100,0	100,0	100,0	100,0

Source: I1., I3.

In the Hungarian municipal system, the Municipality Law adopted in 2011 has resulted in one of the most significant changes with regard to the task system and, of course, it has also caused a significant change in extent and composition of the resources. Decentralisation of the educational and health tasks to local levels has ceased; these ones were compulsory tasks of the municipalities previously and formed a large item of the municipal expenditures. At macroeconomic level, the change is financially shown by that the weight of municipal system within the state finances has changed – i.e. significantly decreased – as a result of the centralisation measure that took place. The ratio of the municipal subsystem revenue within the state finances was 19.8% in 2011 but only 13.2% in 2014. A change has occurred on the expenditure side: the ratio of expenditures was 19.5% in 2010 and only 12.5% in 2014. Of course, this change also meant a significant decrease in the revenues of municipalities; Table 3 contains the figures.

## 5. Forms of local taxes

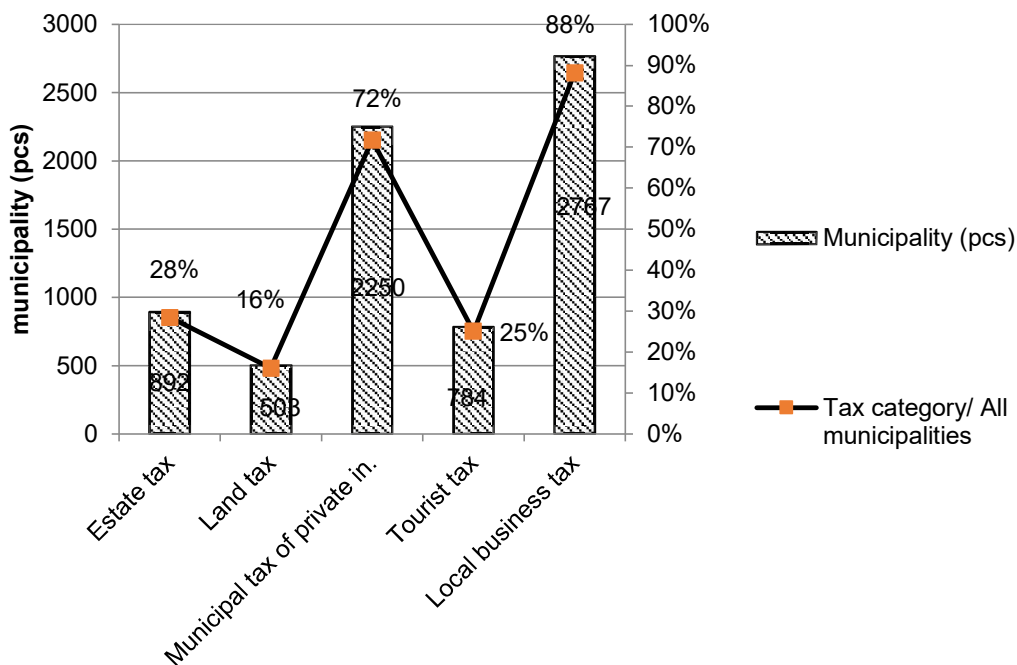
In recent years, the revenues resulting from local taxes play a more and more decisive role within the own revenues and the municipalities strive to increase the tax revenue. It reveals itself in the continuous increase in the measure of local taxes and in the introduction of such tax categories that were not introduced previously. Figure 2 illustrates the grouping of local taxes.



**Figure 1:** Grouping of local taxes  
Source: Herich, 2016

Based on the data of Figure 2, it can be seen that 72% of the local municipalities introduced the communal tax of private individuals and 88% of the municipalities introduced the local business tax in 2015. The local business tax burdens the undertakings. Based on statistical data, it can be observed that the taxation of undertakings has been brought to the forefront in the cities being more developed industrially. Tourist tax has primarily been introduced in those areas which are popular from the point of view of tourism; this kind of tax does not burden the local residents but the tourists arriving at the settlement. Population could be obliged to pay local tax where neither the business tax nor the tourist tax is specific.

However, the levy of local taxes was never without limits; it is set out in law what type and how large tax can be levied, how large the limit of its extent is and what allowances and exemptions can be enforced. (Bordás, 2015) At the same time, the opportunity to increase local taxes is limited by numerous economic and political circumstances reinforcing each other. In 2008, Lóránt already worded that the increasingly strict economic circumstances. The tax burden of potential taxable entities (undertakings and private individuals) is equally influenced by the central taxes, unemployment, the growth in number of inactive people and the decrease in real incomes. In case of introducing certain local taxes, the municipalities are also forced to consider seriously from the aspect of choosing the taxable entities (undertakings and/or population) as well as determining the tax rate, allowances and exemptions. (Lóránt, 2008)



**Figure 2:** Number of levied taxes by tax category (2015)  
Source: Hungarian State Treasury, 2016 (I1)

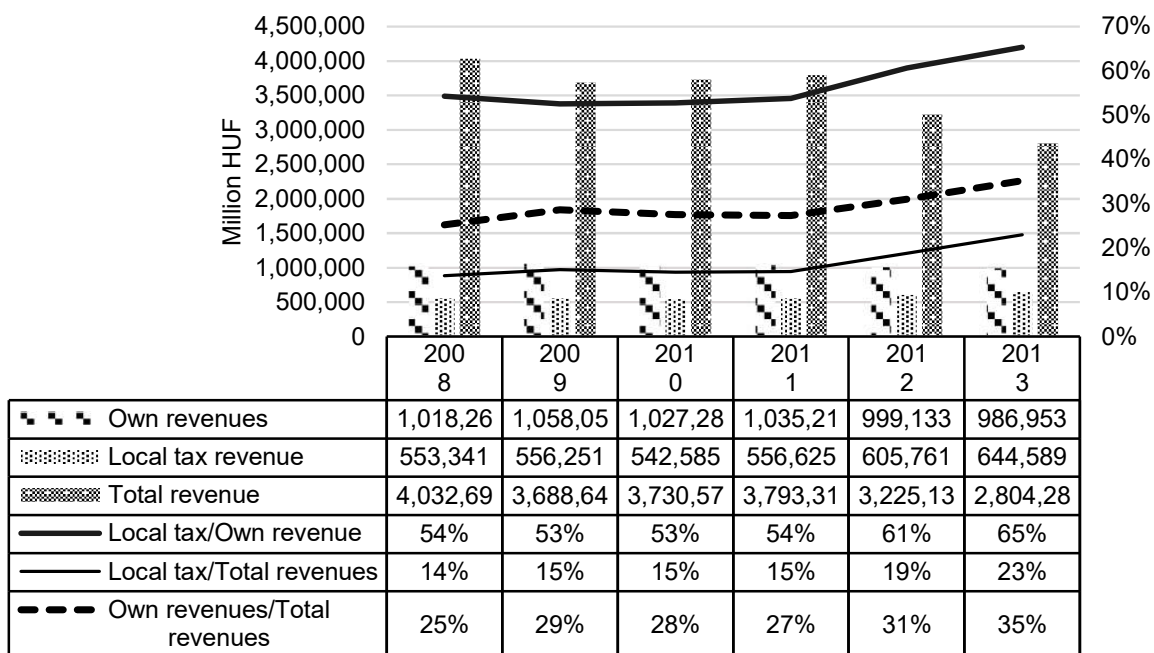
## 6. Role of local tax revenues

Amount of total revenues of the municipalities exceeded HUF 4 thousand billion in 2008. It significantly regressed after the crisis: it decreased by 8.5% by 2009, by almost 15% from 2011 to 2012 and by further 15% i.e. to HUF 2.8 thousand billion by 2013 (Figure 3). One of the most significant changes of the municipality law (Mötv.) adopted in 2011 i.e. the restructuring of the task system explains the decrease in revenues. Decentralisation of the primary and secondary education and the healthcare tasks to local level has ceased and the state has taken over these ones which were previously a part of the compulsory tasks of municipalities. Thus, the municipalities have lost meaningful revenues, the expenditure structure of their budget has also changed and the scope of their compulsory tasks has narrowed simultaneously. (Sivák, 2014)

Structure of the resources has also changed simultaneously with the restructuring of the tasks. The most significant element is that the personal income tax has been removed from the resources as well as the state aid and contributions have decreased due to the centralisation of a part of the compulsory tasks. During 6 years, amount of own revenues has decreased by 4%; in contrast, the local tax revenue has continuously increased by HUF 111 billion in total i.e. by almost 16.5% between 2008 and 2013, except the year of 2010. Nevertheless, the share of local taxes from the revenue has significantly increased in the years examined. Ratio of the local taxes within the own revenue has increased from 54% to 65% and its ratio compared to the budget has increased from 14% to 23%. Data demonstrate that the municipalities need an increasingly growing own revenue to carry out their remaining tasks.

Based on researches of Horváth and his co-authors, the western-eastern differences in the economic and developmental levels of certain large regions can be seen from the territorial data (Horváth et al, 2014). The municipalities are capable of utilizing the possibilities of their own revenues in the developed parts of Central Hungary and Transdanubia while the ratio of own resources is much smaller within the total revenues in the other regions. In 2010, ratio of the own revenues in the total revenues was the highest in Central Hungary (44.2%) and Western Transdanubia (33.6%), it was the lowest in Northern Great Plain (22.2%) and North Hungary (21.8%) while the national average was 31.9%.

Horváth also points out the differences of urbanization that the amount of local tax per capita is double the national average in Budapest while the local tax revenue declines sharply in settlements with less than ten thousand residents, its sum per capita amounts to only a few thousand HUF.



**Figure 3:** Development of local tax revenues of the Hungarian municipalities

Source: TEIR, I5

## 7. Business tax

The local taxes amount to almost two-thirds of the own revenues and a quarter of the total revenue (Figure 3). In addition to taxes relating to real estate (communal, wealth), the local business tax paid by the undertakings has been most frequently introduced by the municipalities. It can be seen from data of Table 3 that the revenue resulting from business tax was HUF 472 billion in 2010, HUF 501 billion in 2013 which amounts to approximately 85% of the local tax revenues. Share of the other tax categories is about 15% in the local tax revenue of the municipalities. (State Audit Office, 2010)

Due to the territorial concentration of the country, the capital and its districts as well

as the cities with county rights levy more than 60% of business tax. The largest companies have settled in the capital and most of the undertakings also operate here so the HIPA revenue concentrates here as well. There are also significant divergences in the amount of revenue per settlement. While the national average was HUF 159 million per settlement in 2013, the amount was HUF 99 billion in Budapest and HUF 4-5 billion in the capital, its districts and the cities with county rights. The tax levied by 2074 village municipalities is only tenth part (HUF 16 million) of the national average.

Settlement	People Thousand	LBT* Million HUF	%	LBT per settlement Million HUF	2010		2013**	
					LBT Million HUF	%	LBT Million HUF	%
Capital		94 431	20	94 431	99 554	20	99 431	
District (23)	1 705	108 596	23	4 722	95 650	19	4 159	
City with County Rights (22)	1 986	103 874	22	4 722	113 084	23	5 140	
Other towns (266)	3 089	122 760	26	462	140 650	28	528	
Large village (152)	643	14 165	3	93	10 232	2	67	
Village (2704)	2 702	28 329	6	11	42 065	8	16	
Country in total (3145)	10 125	472 155	100	150	501 238	100	159	

**Table 3:** Local business tax revenues of the local municipalities by settlement type  
Source: State Audit Office, 2010-2013, Hungarian State Treasury

Explanation:

\*LBT: local business tax.

\*\*From 2010 to 2013, the number of population decreased by almost 216 thousand heads which arises from the difference between number of births and deaths. At the same time, it can be observed that number of capital and urban population has increased somewhat while the number of people living in villages has decreased.

If we consider the number and ratio of the residents then around 61% of the local business tax is levied in the territory of the capital, its districts and 22 cities with county rights where almost 37% of the total population lives. Besides, the business tax is significant in case of a few other settlements having high tax-power ability (e.g. Paks, Budaörs). The business tax does not mean a decisive source of revenue for the villages, large villages and small towns, at least 3 000 settlements; it does not provide real solution to their funding problems. (Fellegi, 2012)

## 8. Settlement tax

Since 1 January 2015, the municipalities are allowed to introduce not only local taxes but a settlement tax insofar as it is not prohibited by other law as well as the subject of the settlement tax is not burdened by any common charge. In 2015, 128 local tax liabilities were newly stated. Most of the municipalities (66 settlements) introduced the local business tax among the existing local taxes. According to the data of MÁK (Hungarian State Treasury), 98 municipalities have introduced the newly stated settlement tax which means 116 tax liabilities. The following tax



categories belong to the newly stated settlement taxes: land tax levied by most of the municipalities, vehicle tax, high estate tax, dog tax and road tax. In the real estate registry, the following items are subject of the land tax: plough-land, vineyard, orchard, reeds, field, pasture, wooded area, fish pond and agricultural land recorded in land usage. (MÁK, 2016)

Before a settlement tax would be introduced, the body of representatives should ponder whether it makes sense to introduce another tax burden and how large resource will be provided for the settlement, what can be funded by means of it. In 1987, Stanford already worded seven requirements in respect of introducing local taxes; these are the following: a local tax shall be wide and relatively evenly distributed, the tax burden shall concern the local residents, the levied tax shall be high and it should possibly ensure constant returns, the cost of levy shall be thrifty, fair and transparent as well as it should ensure the accountability at local level. Bordás draws up a further expectation that the tax cannot be devolved to other entity i.e. the limitation of tax export should prevail. (Bordás, 2015)

In the Hungarian practice, according to the experiences, the companies reckon the local taxes as cost when defining the market prices, they calculate the taxes into the price so they make the customers pay the taxes. Majority of settlement taxes (land tax, vehicle tax) is attached to agricultural activities and it is against the policy of the central government since it burdens the agricultural producers.

The question may arise why the municipalities have decided to introduce more classical taxes (local tax) than settlement tax. This is due to several factors. One reason is that the municipalities did not prepare in time for receiving the opportunities, they were afraid of the administrative burdens. The other reason is that the revenue resulting from settlement tax may be used for funding social services and settlement development only; thus the revenue resulting from these taxes is favourable just for those municipalities which have no enough resources for funding these tasks. Contrary to the settlement tax, the local tax was free to use until 2015 therefore it ensured a kind of flexibility for the municipalities. Since 1 January 2015, there has been a change in utilizing the classical taxes: the revenues from the local business tax shall/may be used for funding the social services belonging to the competence of the body of representatives and for the wage costs of office workers.

## **9. Summary**

In Hungary, there were more modifications in the funding system of municipalities during the last quarter of century but the system built step-by-step could work – toward the decentralisation.

The economic crisis erupted in 2008 has made a large contribution to the decrease in revenue of the municipalities. A part of the settlements has tried to solve the situation having lack of resources by borrowing money and other ones have eased the lack by increasing the tax revenues. In 2011, the state primarily tried to deal with the situation by decreasing the expenditures which resulted in decrease of municipal support. At macroeconomic level, the change is shown best by the fact that the weight of municipal system within the state finances has significantly decreased as a result of centralisation actions. Ratio of the own revenues and local tax revenue have increased in the budget revenue of municipalities and the local business tax paid by the companies has played a bigger and bigger role. In

addition to the restructuring of resources, the scope of compulsory tasks has also decreased; the state has taken over the public education and the specified areas of health service which has resulted in a decrease of almost 30% in the budget revenue of municipalities.

In addition to the restructuring of resources and tasks, it can be stated based on the data that there are significant so-called urbanization differences between the amounts of local taxes levied by the settlements: the capital and the city with county rights can earn 61% of the business tax while 37% of population lives in these settlements. On the other hand, the local business tax revenues are extremely low in around 3000 settlements where a few hundred or a few thousand people live. However, according to the first experiences, a restructuring of local taxes has started by introducing the settlement tax and limiting the utilization of local business tax in bigger settlements.

Self-governance is an essential feature of the democratic states and it involves the decentralisation as well as the realisation of central measures at local level. There are such countries where the decision-making entitlements of the municipalities are more limited and the local authorities are under strict control. In other countries (e.g. England), the right of participation in public affairs prevails almost fully. (Paulo et al, 2013)

Based on domestic and international experiences, the Hungarian decision-makers should strive to ensure independence and a predictable law environment for the long-term operation of municipalities.

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