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Austin Kissinger

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MORE THAN REVENUE: TAXATION IN HUNGARY AS A POLITICAL TOOL

Austin Kissinger

I. INTRODUCTION

People complaining about their taxes is probably a phenomenon as old as taxation itself, and there are several reasons why. For one, taxes are complicated. "The hardest thing in the world to understand is the income tax," said Albert Einstein. And once liabilities are finally deciphered, a taxpayer often finds that taxes are also quite expensive. One might still not complain if they thought that all their taxes were going to a good cause, but people don't always feel like they're getting out of the system what they put in. Beyond these personal annoyances, much of political discussion today centers around economic efficiency concerns that come from taxation.

But there are often more to tax issues than just day-to-day headaches and economic inefficiencies. Taxes are an incredibly powerful tool to change citizens' behavior. This power may be used inadvertently, or may be used towards socially beneficial policies, like tax breaks to start new businesses or additional taxes on activities with negative externalities. Tax incentives, however, may instead have other, more questionable motivations, like corruption, discriminatory social policies, or political power. Again, this isn't a new problem. "To compel a man to furnish funds for the propagation of ideas he disbelieves and abhors is sinful and tyrannical," wrote Thomas Jefferson. But though these are old issues, new tax developments in Hungary have shed light on just how powerful a tax system can be for accomplishing political

aims. In 2010, Viktor Orbán and his Fidesz party took control of the Hungarian government, holding enough of a majority to make constitutional adjustments with relative ease. Using this control, the Fidesz party has been able to firmly dictate policy in a wide variety of areas through both constitutional and para-constitutional mechanisms. This paper will highlight how tax can be used for corruptive and political purposes, using the Hungarian Government's actions in recent years as an example.

II. CORRUPTION

Though corruption is a broad issue that can impact many, if not most, areas of government, taxation appears to be especially susceptible. Because of the universality of taxation and the complexity with which tax systems are applied, there are ample opportunities for government officials both to funnel money to certain causes or organizations (that are preferred for perhaps questionable reasons), or to simply collect extra payments from tax payers. There is evidence of the Hungarian Tax system being used in both of these ways, which will be the subject of this section.

a. Tax breaks for a home field advantage

A primary example of funds being used for suspicious purposes relates to Victor Orbán's childhood home and his love of football. When Orbán was 10 years old, his family moved to Felcsút, a village approximately 45 kilometers west of Budapest.¹ There, as well as in his later hometown of Székesfehérvár,

¹ David Goldblatt & Daniel Nolan, *Viktor Orbán's reckless football obsession* (Jan. 11, 2018).

Orbán showed a propensity and love for the game. Once his political career began to take off years later, he founded Puskás Academy, a football club in Felcsút. It was founded on April 1, 2007, the would-be 80th birthday of Ferenc Puskás, Hungary's most famous football star and an international phenomenon in his day.² This club, among others, would receive quite the boost when Orbán's Fidesz party gained a substantial majority in 2010.

In 2011, the Hungarian government adopted a corporate tax credit in order to encourage contributions to sporting clubs, a system known as TAO. Through this credit, companies are able to forgo paying up to 70%³ of their corporate tax by contributing this amount to clubs and organizations in one of 6 sports: football, basketball, handball, water polo, ice hockey, and (after a 2017 addition) volleyball.⁴ The amount contributed goes directly to the sports organizations, making it more or less a direct reduction in state revenue.

Is there problem? No doubt a policy like this is going to be controversial. Sports, though popular, a certainly not universally beloved, so a tax system specifically designed to encourage and strengthen athletic programs is likely to be criticized. But, if a government feels that sport creates national unity, better child development, or a happier populace, is that so bad? According to

² *Id.*

³ Miklós Ligeti and Gyula Mucsi, *Opening the door to corruption in Hungary's sport financing*, TRANSPARENCY INTERNATIONAL (2016).

⁴ CORRUPTION RISKS IN HUNGARIAN SPORTS FINANCING, TRANSPARENCY INTERNATIONAL (Oct. 22. 2015);

http://en.nav.gov.hu/taxation/taxinfo/summary_companies.html?query=corporate+tax+credit

the international anticorruption organization Transparency International and other critics, the primary concern with the TAO program is the lack of info on the scheme's application. There is also evidence to suggest that it has been used to target certain clubs, such as Viktor Orbán's Puskás Academy.

First, it has been hard to gather information on exactly where these corporate donations to sports clubs are going and just how much is being diverted from the tax system. This is in large part due to the fact, that, until recently, these donations were considered to be just that, private donations. Therefore, they did not qualify as public funds and were subject to less stringent reporting standards.⁵

This categorization was eventually overruled in 2017 by the Curia, Hungary's Supreme Court,⁶ which ordered the Ministry of Human Resources (EMMI) and the Ministry of National Economy (NGM) to publish all of its data on the TAO program within several months.⁷ However, after this order was issued, the government's reluctance to hand over information remained. "While the government claims that more than HUF 400 billion has been run through the TAO program since its inception, EMMI only turned over documents accounting for only HUF 4.2 billion of contributions." This amounts

⁵ Miklós Ligeti and Gyula Mucsi, *Opening the door to corruption in Hungary's sport financing*, TRANSPARENCY INTERNATIONAL (2016).

⁶ By Supreme Court, it is not meant that the Curia is equivalent in power or jurisdiction to the U.S. Supreme Court. The Curia does not have final say over constitutional matters and is now losing some of its jurisdiction in administrative matters due to the creation of a new Administrative Court.

⁷ Benjamin Novak, *Government refuses to comply with Curia order to release TAO data*, BUDAPEST BEACON (Jan. 29, 2018).

to the government handing over only 1.5 % of the data that the Curia ordered it to.⁸

Through the information that *was* obtained after the ruling and the information that was able to be gathered prior to this, a large portion of funds were directed to a few select projects and clubs. Estimates of totals as of April 2018 run approximately as follows. Over 522 billion forints have been donated to sports programs under TAO, which is approximately \$1.84 billion. Of this amount, just about half went to football generally.⁹ The distribution of this income is also far from even across the board, however.

In 2017, Transparency International estimated that Victor Orbán's team, Puskás Academy in Felcsút, had received 11.2 billion forints (approximately \$43 million), "more than 200 times what the average club receives"¹⁰ In April 2018, the Hungarian Spectrum, based on data received by another news organization, 24.hu, estimated that Puskás Academy has received 17.6 billion forints under TAO.¹¹ Puskás also is not alone in receiving large donations. MTK, a successful football club in Budapest, recently completed a new stadium funded, at least in part, by TAO donations for over

⁸ *Id.*

⁹ *Hungarian sports projects: formula for success or financial madness?* HUNGARIAN SPECTRUM (Apr. 7, 2018).

¹⁰ Justin Spike, *Curia: TAO Constitutes Public Money*, BUDAPEST BEACON (Oct. 25, 2017).

¹¹ *Id.*

\$25 million. MTK's president, Tamás Deutsch, is a prominent Fidesz member and is a representative at the European parliament.¹²

Is it possible that these organizations are simply a more attractive option for donations under TAO and the discrepancies in amounts received are a coincidence? There is evidence to suggest not. First, authorization from each sport's national federation is needed in order to receive donations under TAO. Transparency International suggests that the leeway provided to the federations and the lack of transparency in the process allows for corruptive practices to emerge in the authorization procedure. This is coupled by the fact that Viktor Orbán has a personal relationship with the head of the country's football federation.¹³ Secondly, Transparency International has hypothesized that public procurement is a mechanism that can and is used to divert funds to specified projects. When the government uses public funds to build projects, such as football stadiums, it could favor groups or contractors that donated to preferred programs.

For example, the stadium in Felcsút was built mainly on land owned by Orbán's wife, adjoining his family house. A large proportion of the construction work for the Felcsút stadium has been allocated to companies that belong to the interest group of this municipality's mayor and CEO of the Felcsút Foundation for the Promotion of Young Athletes, Lőrinc Mészáros, who is undisputedly one of Orbán's closest allies. Though almost

¹² David Goldblatt & Daniel Nolan, *Viktor Orbán's reckless football obsession* (Jan. 11, 2018).

¹³ Miklós Ligetiand & Gyula Mucsi, *Opening the door to corruption in Hungary's sport financing*, TRANSPARENCY INTERNATIONAL (2016).

bankrupt in 2007, he is now Hungary's 86th richest person, with a wealth of approximately HUF 8.4 billion.¹⁴

b. Corruption in the tax system

A very serious, though perhaps less political issue, is the problem of corruption within tax administration generally. If officials are willing to give preferential treatment to certain individuals or companies in exchange for personal kick-backs, concerns are raised, not only about the equity of such a system, but about the efficiency and overall productivity losses that result. These losses can be significant, though very difficult to calculate and Hungary is no exception.

Corruption in the Hungarian Tax system is thought to be rather restraining on those trying to operate within the country. According to the European Bank for Reconstruction and Development's *Business Environment and Enterprise Survey* (BEEPS), tax administration is "the top obstacle to doing business" within Hungary.¹⁵ The share of firms visited by tax officials is 56% which is significantly higher than the central European average of approximately 35%.¹⁶ What's more is that the trend on firms getting inspected is upward in Hungary, while it is decreasing in the region. The timeframe of this upward trend corresponds with Fidesz rise to power. This hurts Hungary's economy.

¹⁴ *Id.*

¹⁵ EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, BUSINESS ENVIRONMENT AND ENTERPRISE SURVEY V (2015).

¹⁶ *Id.*

Not only is it costly to repeatedly communicate with tax officials, but it makes navigating the business climate less certain. Senior management of foreign firms in Hungary spend 12.8% of their time dealing with government regulations, slightly above the average in the region of 12.3%.¹⁷

If tax administration corruption is a significant problem, however, it is not overly clear where and when exactly such problems arise. First, if and when companies do provide kickbacks to government officials, they are very unlikely to tell anyone about it. Especially companies that operate in the U.S. and subject to the F.C.P.A. have very huge incentives to hide this sort of behavior if they participate.¹⁸ Secondly, if tax corruption becomes commonplace enough, it can lead to a collapse of institutional integrity, incentivizing broad efforts to maintain the status quo. Some argue that this has taken place in Hungary.

In November 2013, a Hungarian Tax inspector, András Horváth, came forward with allegations of systematic corruption with respect to the Hungarian value-added tax (VAT), and that these corruptive practices had been going on for years (prior to Fidesz's rise to power). Though they have recently lowered the tax for some goods, Hungary's

¹⁷ *Id.*

¹⁸ The FCPA is an anti-corruption law in the U.S. that imposes significant penalties on companies that bribe foreign officials.

VAT is extremely high at 27%. This creates large incentives for businesses to try and circumnavigate the tax and provides bargaining power for officials to abuse the system.¹⁹ Horváth argued that, after becoming suspicious in 2011 about some of Hungary's National tax and Customs Authority (NAV's) treatment of the value added tax in certain situations, he began to do independent research.²⁰ According to Horváth, "companies in Hungary and neighboring Eastern European countries have used illegitimate VAT refunds in 'carousel transactions' in which conspirators sell goods to each other across borders and fraudulently claim reimbursement from the tax authority for VAT that they never actually paid."²¹ Horváth blamed officials in the NAV for personally taking payments in return for allowing these schemes and estimated that these workarounds cost Hungarian tax payers over a trillion forints (\$4 billion) a year.²²

As one might predict, Horváth received heavy pushback from NAV after coming forward. His home was searched for more records, he

¹⁹ Charlie Dunmore & Marton Dunai, *Exclusive: Hungary losing 1 billion euros a year from food VAT fraud*, REUTERS (Jun 7, 2012).

²⁰ Anita Komuves, *No Regrets*, ORGANIZED CRIME AND CORRUPTION REPORTING PROJECT (Dec. 9, 2017).

²¹ *Hungary: Whistleblower Alleges Corruption in VAT Fraud*, HETQ (Nov 13, 2013).

²² EURODAD, FIFTY SHADES OF TAX DODGING (2015).

was black listed from public employment for the next 3 years,²³ and was later questioned for illegally obtaining tax records.²⁴

Consequences from Horváth's disclosure were limited, however, though some minor ramifications did result. NAV and Hungarian police both conducted investigations into the problems alleged by Horváth. While the NAV found no evidence of wrong doing,²⁵ the police found evidence of criminal wrong doing in one instance. NAV did not pursue remedies in the case.²⁶ Mostly, the police report said, Horváth's discussion was structured around structural deficiencies in the way NAV conducted audits, not actionable claims.²⁷ The State Audit Office of Hungary also looked into NAV's activities from 2009-2013 and "revealed a number of deficiencies in the rules and regulations of the organization and pointed out that, in several instances, NAV had not adhered to its own policies on oversight."²⁸ Furthermore, Ildikó Vida, head of NAV at the time of Horváth's statements was put on a U.S. corruption list that bans individuals from entering the U.S.²⁹

III. SOCIAL POLICY

²³ Anita Komuves, *No Regrets*, ORGANIZED CRIME AND CORRUPTION REPORTING PROJECT (Dec. 9, 2017).

²⁴ Justin Spike, *"This is what a whistleblower's honesty is worth in Hungary"*, BUDAPEST BEACON (Jan 20, 2017).

²⁵ EURODAD, FIFTY SHADES OF TAX DODGING (2015).

²⁶ *Police investigation into NAV finds evidence of criminal wrongdoing in only one case*, BUDAPEST BEACON (Dec. 17, 2016).

²⁷ *Id.*

²⁸ EURODAD, FIFTY SHADES OF TAX DODGING (2015).

²⁹ Máté Hajba & Casey Given, *Continued Corruption In Hungary*, FORBES (Nov. 14, 2014).

The way tax incentivizes behavior is straightforward. It alters behavior by making one option more or less expensive than its alternatives. If the government taxes oil consumption and offers tax breaks to solar energy, solar energy becomes relatively less expensive for consumers and they purchase more solar energy. This carries through to more personal decisions as well. When Cook County installed a soda tax of 1% per fluid ounce, for example, Costco's 9 Cook County locations "saw a 34 percent decline in sales of beverages affected by the tax."³⁰ Furthermore, the stores located just outside of Cook County and the soda tax's purview saw a similarly sized *increase* in sales.³¹ The soda example may be relatively trivial (unless you ask store owners), but it shows how powerful a tool tax can be if the government wants to alter behavior.

a. Fertility rates and tax rates

Though not exclusively through the use of taxation, Viktor Orbán has used this rationale to put into place tax incentives and subsidies encouraging more children. He announced his "seven-point family protection action plan" in his State of the Nation address on February 10, 2019.³² First, the new system provides for "preferential loans" for women under the age of 40 who marry. This loan is significant at 10 million forints. Second, Orbán's plan expands Hungary's "CSOK" program by which families are eligible to receive significant grants towards the purchase of

³⁰ Greg Trotter and Becky Yerak, *Cook County retailers cheer soda tax repeal: 'This was a nightmare'*, CHICAGO TRIBUNE (Oct. 11, 2017).

³¹ *Id.*

³² <https://visegradpost.com/en/2019/02/11/prime-minister-viktor-orbans-state-of-the-nation-address-full-speech/>

homes. The program, passed originally in 2016 also reduced the value add tax on newly built homes from 27% to 5%.³³ Orbán's new seven-point plan expands this tax reduction to the purchase of existing homes as well. The plan's fourth prong is to extend a tax credit on mortgages for family, which originally provided a credit of one million forints upon the birth of a families third child and continued to provide for a one-million-forint break for each child thereafter. Now, the credit will start at the second child and will be bumped up to 4 million forints for the third child. Furthermore, families with four or more children will be exempt from personal income taxes *for life*. Fifth, the plan grants money for the purchase of the seven seat cars for families with 3 children. Sixth, the program expands Hungary's "Creché" facilities (state sponsored day cares) and lastly allows the allowances provided to be assumed by grandparents instead of parents upon election.

So why is the Hungarian pursuing such an aggressive and presumably expensive policy? The answer is also provided in Orbán's 2019 State of the Nation Address. Before unveiling the seven-point plan, Orbán discussed the population problem facing Europe generally, and Hungary in particular: low fertility rates. The European average fertility rate is 1.58, while in Hungary, this number is at 1.45, substantially below the replacement rate.³⁴ Concerns over a declining and aging population are certainly well founded as there can be serious structural concerns with such a situation. But, as Victor Orbán put it, there are two ways to solve this problem:

³³ <http://abouthungary.hu/issues/putting-families-at-the-core-the-family-housing-support-program-csok/>

³⁴ *Hungary tries for baby boom with tax breaks and loan forgiveness*, BBC (Feb. 11, 2019).

[p]eople in the West are responding to this with immigration: they say that the shortfall should be made up by immigrants, and then the numbers will be in order. Hungarians see this in a different light. We do not need numbers, but Hungarian children. In our minds, immigration means surrender.³⁵

Therefore, the motivation behind the seven-point plan tax incentives is not solely to increase the population, though that is certainly the underlying issue. The subtler reason is to increase the population *without admitting immigrants* into Hungary. The Fidesz party views cultural dilution to be a significant threat to Hungarians' way of life. While other countries may be fine accepting this, "[t]he fate of such peoples is slow but certain obliteration, until they become a mere cloud of dust on the highway of nations."³⁶

b. The tax man and the ad man

In 2015, at the request of the EU, Hungary suspended a progressive tax on advertising companies that is based off their advertising revenue. The following year, the EU published a decision against the original form of the tax because of a violation of state aid rules.³⁷ What was the issue? In its opinion, the Commission argued that, through the tax's progressive rates, it unduly favored smaller companies, violating EU state aid rules. There has been speculation that the Hungarian Government structured the tax this way in an attempt to force out large, multi-national corporations who distribute content

³⁵ <https://visegradpost.com/en/2019/02/11/prime-minister-viktor-orbans-state-of-the-nation-address-full-speech/>

³⁶ *Id.*

³⁷ KGG PARTNERS, THE HUNGARIAN ADVERTISEMENT TAX IS CONTRARY TO THE EU LAW.

in Hungary. For example, the original tax was written such that “only RTL (a multi-national media company headquartered in Luxembourg), which commands the highest ad revenue in the nation, was paying 40 percent of [the income received under the advertising tax].”³⁸ Theoretically, this was part of a state effort to have better command over the news and other content consumed by Hungarians.

Since the original advertising tax was struck down, however, there have been more developments. In May 2017, the Hungarian Parliament approved a new advertising tax, raising the rate from 5.3% to 7.5% and altering the structure of the tax.³⁹ Now, instead of having a progressive rate structure, the tax exempts companies with less than 100 million forints in revenue (roughly \$315,000).⁴⁰ This is presumably done in order to avoid the state aid rules that plagued the first version of the tax. Through the EU’s “de minimis’ regulation, which holds that state support doesn’t violate EU state aid rules provided it remains below 200,000 euros (\$222,000) over a three-year period,”⁴¹ Hungary has navigated state aid rules while providing for tax advantages for smaller, Hungarian media companies.

IV. CONCLUSION

³⁸ Allison Langley, *Hungary’s RTL faces tough taxes*, COLUMBIA J. REV. (Feb. 9, 2015).

³⁹ Jan Stojaspal, *Hungary Raises Advertisement Tax to Overcome State Aid Issues*, BLOOMBERG (May 18, 2017).

⁴⁰ *Id.*

⁴¹ *Id.*

While the topic of taxation is often discussed due to its impact on economic conditions and government revenues, tax can have a much broader influence than is appreciated at first glance. This paper attempted to highlight how, in Hungary, it has been used to create personal returns for its administrators, incentivize certain social policies, and impact discourse. These are just a few examples, but are illustrative of the broad consequences that can occur as a result of tax policy and application.