

Searching for “The missing part” - Where are the hidden tax bases?-

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Abstract

In this study the pervasive economic crisis from 2008 will be presented from the aspects of the strengthening of international cooperation in the field of taxation, tax evasion, and the intense combat against tax fraud. The current events suggest that the problem of the future sustainability of the tax system is getting into focus, which will be a substantial issue in the work of tax authorities, who have also become participants in the competition. The analytical framework takes national and international events into consideration and approaches the problem from two sides: competitiveness and fiscal sustainability. Also an overview will be given about the Hungarian responses to these challenges and with the help of a survey I try to analyze the reactions of the economic actors.

Keywords: Fiscal sustainability, international tax cooperation, Hungary

1. INTRODUCTION

1. *Overview and analyze the current efforts of the European Union (hereinafter EU) and the United States of America on getting back their missing tax revenues. This includes the identification of the European Union trials to improve the fiscal position of the member states, hereby the whole Community. United States' Foreign Account Tax Compliance Act will be reviewed as well.*
2. *Highlight some important Hungarian tax changes from the last years in the direction of cleaning the shadow economy and increasing tax revenues. I will present the basic characteristics of some part of Hungarian tax law, their modifications during the last years and some opinions about them.*
3. *Answer the detailed hypotheses below.*

The hypotheses are listed as follows:

- H1 The impact of the international efforts for getting back missing tax revenues can be seen in the Hungarian taxation policy.
- H2 In the domestic tax legislation value added tax is the major field where “best practices” against tax fraud can be found.

2. FRAMEWORK FOR THE ANALYSIS – THE ECONOMIC BACKGROUND AND LITERATURE

From 2009 to present a series of steps were taken at national and international levels, aimed to detect money hidden in tax havens and explore institutions of banking and tax secrecy in connection with tax avoidance transactions.

In 2013 the European Union published a vividly descriptive *video called “The missing part”*.

Figure 1. “The missing part”



Source: European Commission (2013): “The missing part”

This short film emphasizes with the help of everyday life examples that one fifth of public money in the EU is lost to tax fraud and tax evasion. The European Union seems to have a common interest since years to take action to get back this missing part. In the European Union there is an *automatic exchange of information* on savings. The exchange of information between national tax authorities is lively concerning value added tax (hereinafter VAT).

In connection with the global economic crisis, the demand of exploring absorbed tax bases came alive related also to countries with aggressive tax-strategy. Beyond the possibilities in the EU, in 2012, the Commission Recommendation on „measures intended to encourage third countries to apply *minimum standards of good governance in tax matters*” was adopted. The document stresses the need for transparency and exchange of information and defines potentially harmful tax measures (Európai Bizottság, 2012a). At the same time, the European Commission adopted a recommendation in connection with the aggressive tax

planning, which defined the concept and named some aggressive tax planning method (Európai Bizottság, 2012b). Also this year, an action plan was published, which proposed correction for the member states on their ineffective, “double no taxation” enabling conventions on double taxation (Európai Bizottság, 2012c). In the spring of 2013 the European Commission found the situation so alarming, that it aimed to prevent the income concealment in the Community, and - as a part of the Directive 2011/16/EU of the administrative cooperation in the field of taxation (hereinafter Directive 2011/16/EU) - it proposed automatic exchange of data on all sources of income (Európai Bizottság, 2013a). Austria and Luxembourg got under EU pressure again because until this meeting they did not adopt the directive on savings to their own domestic legal system. Since it became clear that they could not evade the long time cooperation, first Luxembourg, then Austria declared its readiness for change.

In spring 2014, the EU finally decided to amend the directive on savings. The member states’ financial institutions - beyond the current practice - are obliged not only to transmit the individual bank account holders’ information to the tax authorities, but the data of the owners behind offshore companies too, which are later sent to the concerned business owners’ tax authorities. Modifications were required to be transposed into the national legal systems by 1st January 2016, and the regulations will come into force from 2017. The 2014/48/EU directive lists the categories of organizations and arrangements, with the remark “trust or other similar legal arrangement governed by foreign law” for Hungary.

In October 2014 the European Council agreed on amending the Directive 2011/16/EU (European Commission, 2014). Based on the *Organisation for Economic Co-operation and Development* (hereinafter OECD) *2014 Common Reporting Standard* a first automatic exchange of information among EU tax administrations happened in 2017, except that in Austria the first reporting will take place in 2018.

In December 2014 directive 2014/107/EU was adopted which entered into force on 1 January 2016. This legal instrument widened the scope of that exchange in order to include interest, dividends and other types of income (European Council, 2015).

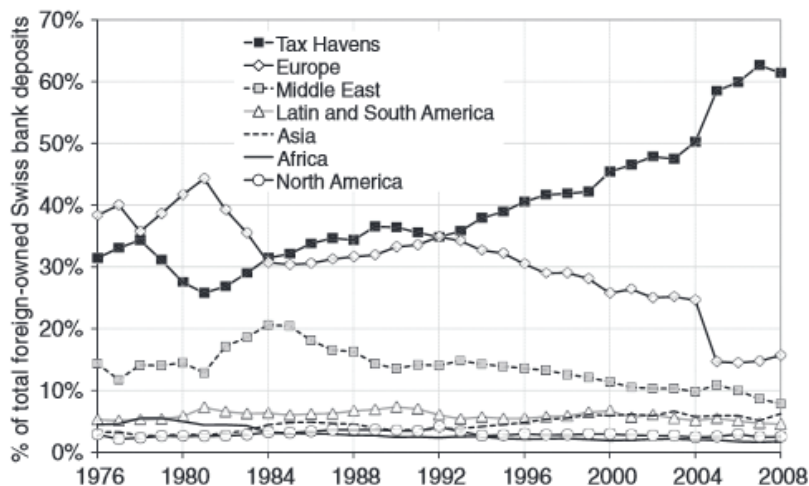
Due to the fiscal reasons Swiss bank secrecy came to the forefront as well.^[1] Bank secrecy was enacted in 1934^[2] in Switzerland which created the world’s major tax haven. Despite the high share of deposits assigned to tax havens most Swiss accounts probably are owned by Europeans.^[3]

[1] See e.g. Limpók (2014)

[2] Bundesgesetz über die Banken und Sparkassen vom 8. November 1934 in der Schweiz

[3] See Zucman (2013), p. 1333

Figure 2. Most Swiss accounts probably belong to Europeans



Source: Zucman, G., 2013, 1333

According to the Boston Consulting Group Switzerland remains the largest offshore center, with about 25% of total offshore wealth by the end of 2017, compared with 26% in 2012 (Boston Consulting Group, 2013). On 27th May, 2015 the *EU and Switzerland signed tax transparency agreement* which was described as „historic” by the European Commission. The agreement will come into effect from 2018 onwards and both sides will on an annual basis automatically exchange information on the financial accounts of each other’s residents. Information exchange includes the names, addresses, tax identification numbers and dates of birth of the residents, as well as other financial and account balance information (European Commission, 2015). The agreement fits to the 2014 global standards of the OECD^[4] and it is expected to improve the ability of member states to fight against tax evasion and tax avoidance. In 2015 and 2016 similar tax transparency agreements were signed between EU and tax havens Andorra, Liechtenstein, Monaco and San Marino.

Exchange of information is an excellent opportunity if it is used effectively. The numbers speak for themselves: from 2003, on the basis of mutual assistance in tax collection, more than tenfold of the amount of cross-border taxes were collected in the EU member states.^[5]

The *United States of America* also belongs to the top fighters for tax information exchange. *Foreign Account Tax Compliance Act* (hereinafter FATCA) is a

[4] OECD (2014): Standard for Automatic Exchange of Financial Account Information in Tax Matters

[5] Európai Bizottság (2013b): Küzdelem az adócsalás és az adókikerülés ellen - A Bizottság hozzájárulása a 2013. május 22-i Európai Tanács számára

special legal instrument enacted by the U.S. government in 2010. This “global tax act” aims at curbing tax evasion. U.S. citizens and tax residents are required to report their worldwide income to the American tax authority, namely Internal Revenue Service, whether they live in the United States or foreign land. If foreign financial institutions do not cooperate, their U.S.-based investment transactions are taxed with 30% withholding tax. According to the Joint Committee on Taxation, FATCA is expected to raise tax revenues of approximately 800 million USD per year for the U.S..^[6] From 2014 FATCA regulations began to be implemented in the foreign lands. In the next chapter I am going to certify this with data on Hungary.

It can be stated, that the overwhelming crisis from 2008 increases in parallel with the pursuit of international exchange of information in tax matters, and the fight against tax evasion and tax fraud were established. It is interesting to observe that there are more countries offering favorable tax treatment of foreign-owned companies.^[7]

The “top offshore scandal” from 2016 is the so called “Panama Papers”, the leak of 11,5 million files from the database of the world’s fourth biggest offshore firm, namely Mossack Fonseca. Among others the international giant banks, politicians, sports stars and celebrities are taking an active part in offshore business.^[8]

The offshore supply increases and demand for offshore facilities is unbroken. When one site becomes “dangerous”, there will be always another attractive option.

3. SEARCHING FOR THE “MISSING PART” OF THE HUNGARIAN TAX REVENUES

In this section I will shortly describe some points of tax changes in the Hungarian tax law of the last few years focusing on state’s searching for the missing tax revenues. Interviews were made on taxation among companies, tax officers and individuals in Hungary with the purpose of collecting responses about the presented tax changes.

The black economy appears everywhere, but on different degrees. Its share in Hungary is above the European average, more than 22% (Schneider, 2013). According to the Central Statistical Office in 2014 the gross domestic product at current prices amounted to 32,179.666 billion HUF. On this ground, *the extent of the black economy in our country can exceed 7,079.53 billion HUF.*

[6] U.S. Joint Committee on Taxation (2010): JCX-6-10

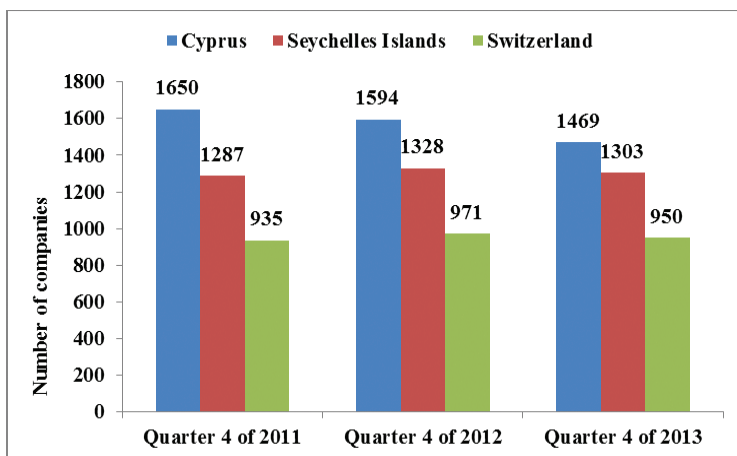
[7] UNCTAD (2013): World Investment Report, p. ix

[8] See e.g. ICIJ (2016): The Panama Papers

3.1. OFFSHORE AND TAX HAVENS

A number of studies came to the conclusion that tax and social security contributions are one of the main reasons for the black economy's existence (Schneider, 2012). Currently, it is also a problem in Hungary that a portion of the generated income land in tax havens through offshore businesses. According to a 2014 survey (Bisnode.hu, 2014) thousands of company owners are also active in tax havens. (See Figure 3.) In 2016 the 15 most popular offshore locations amongst Hungarian companies are the following: 1. Cyprus (1038 companies), 2. Seychelles-Islands (845 companies), 3. Switzerland (825 companies), 4. Luxembourg (486 companies), 5. Belize (402 companies), 6. Panama (398 companies), 7. Liechtenstein (363 companies), 8. Hong Kong (170 companies), 9. Marshall-Islands (145 companies), 10. Ireland (101 companies), 11. Malta (97 companies), 12. Gibraltar (69 companies), 13. Dominican Republic (62 companies), 14. Singapore (53 companies), 15. United Arab Emirates (52 companies) (Várkonyi, 2016).

Figure 3. The number of Hungarian companies owned by a firm operating in offshore country 2011-2013



Source: Bisnode.hu 2014

It can be concluded that the use of offshore companies in Hungary is ever-popular. In 2013 the hundred highest dividends that were allocated outside Hungary landed in 25 different locations around the world, including 12 places that are typically or mostly used for tax relief (Logisztikama.hu, 2014). In the first quarter of 2015 brokerage scandals filled the headlines in Hungary. Among others many Hungarian small investor were affected by the bankruptcies of Hungarian brokerage firms Buda-Cash, Hungária Securities and Quaestor. For a little while offshore and tax havens became a priority topic because the concerned companies used these tax planning opportunities as well.

Responding individuals, the “average people” were neither thinking about the potential offshore background of their financial institution nor they were aware of the consequences of financing by offshore and tax havens. It could be stated that offshore and tax havens were a “mysterious business” that they cannot follow.

3.2. EXCHANGE OF INFORMATION

Within the Hungarian tax audits there is an increasing proportion of those checks which are based on the request of foreign tax authorities, concerning the taxation of companies and individuals. As mentioned before, in the European Union there exists an automatic exchange of information on savings. According to the National Tax and Customs Authority of Hungary (hereinafter NTCA) – while the European Union member states provided data for the NTCA on the ground of the directive on savings – 16,000 Hungarian citizens had a bank account in 2012. The state tax authority has launched 620 investigations and a 173 million HUF tax deficiency was revealed, which requires more than a billion HUF non-tax revenues according to the legislation (Portfolio.hu, 2014).

To enforce FATCA, Hungary and the United States of America signed a bilateral agreement in 2014, ratified with Act 19 of 2014 (hereinafter FATCA Act). For all Hungarian financial institutions is obligatory the execution of the FATCA Act. The financial institutions have to register with the U.S. tax authority and then they receive the Global Intermediary Identification Number. 30th June 2015 is the date of the first FATCA reporting to the National Tax and Customs Authority of Hungary. The NTCA is transferring the required data to the Internal Revenue Service.

3.3. VAT, IN PARTICULAR THE ELECTRONIC TRADE AND TRANSPORT CONTROL SYSTEM

In Hungary the tax fraud connected to value added taxation is a very common issue. It is a fact that Hungary has the highest standard rate of value added tax in the European Union with 27%.^[9] VAT fraud “may be motivated” by this high standard rate, however, our decreasing, but still high public debt can be an obstacle of lowering the standard rate.

In 2012 preventing value added tax fraud the Hungarian government made a decision that about 400 thousand cash registers would be fitted with a device that would establish a direct online connection with the NTCA (Kormany.hu, 2012). According to the data of the Hungarian Central Statistical Office the revenue effects of the *online cash registers* were positive, so the regulation has helped to whiten the economy. Motivated by the success, in 2015 the government decided to *involve new actors from the commercial sector*. Since September 2016 among

[9] European Commission (2016): VAT Rates Applied in the Member states of the European Union

others automotive and motorcycle repair shops, discotheque operators and plastic surgeons have been required to be connected to NTCA through the online cash register system. From 1 January 2017 taxi drivers and currency exchange providers were obligatory to use electronic tills as well.^[10]

Not only businesses but also individuals emphasized in their opinion that they were sure the mechanism will help to clean the shadow economy. They think the sectors newly concerned are also risky from VAT point of view; consequently the regulation might be a positive effect on VAT revenue. Businesses gave positive feedback about the expected financial support from state to the exchange of machines.

In 2006 the Hungarian tax law established the application of *reverse charge taxation* as an anti-fraud measure in the field of value added tax.^[11] The method has proved successful in several fields, e.g., certain services relating to immovable property and agriculture. In May 2015 the Austrian, Bulgarian, Czech, Slovak and Hungarian ministers of finance had a meeting in Vienna where they discussed *joint action* against VAT fraud, such as the extension of the reverse charge mechanism. They would like to get the green light from the authorities in Brussels to the common use of the method.

In Hungary, the loss in fiscal revenues due to the so-called “carousel-fraud” in VAT is estimated by 1.5-2 billion EUR annually (Kormany.hu, 2015). In “carousel-fraud” fraudulent companies are interposed in a supply chain trading within the EU in order to disappear with VAT on the transactions. Over the past years several networks involving VAT fraud were eliminated. In 2015 a new goods delivery control system, namely *Electronic Trade and Transport Control System* (hereinafter EKAER) entered into force pursuant to the Act XCII of 2003 on the rules of taxation. The purpose of the system is minimizing VAT fraud in the road transport. Goods moving within Hungary and also goods transported on public roads between Hungary and the member states of the EU are checked. Defined data related to transport have to be registered in a central electronic system before starting the transport and the arrival has to be registered as well. The potentially risky products are listed which includes, e.g., foodstuff, clothing, gravel and chippings.

From the aspect of competitiveness, administrative burden on businesses is also an important factor taken into consideration by investment decisions. EKAER increases this business burden. However, from the aspect of whitening the economy the initiation of the method might be inevitable. The system - despite all of the weaknesses of the regulation - was very welcomed among tax officers working on monitoring.

On the basis of the reviewed economic situation, tax regulations and the answers of the Hungarian respondents, hypothesis, 1 and 2 are confirmed.

[10] Regulation of the Ministry for National Economy 9/2016. (III. 25.)

[11] See VAT Act

CONCLUSIONS

The 2008 financial and economic crisis played strong impact on tax policies worldwide, in the EU beside the tax competition the tax harmonization as well. Some member states, as Hungary are still facing budgetary consolidation needs. Certain tax changes are aimed at reducing the public deficits.

However *in the last few years tax competition got a new dimension*. Tax revenue has chance to grow if economy grows too. *Tax revenue has chance to grow if tax fraud will be suppressed*. Countries around the world are struggling for tax base. Hungary’s strategy seems to be suitable, since 2011 the tax revenues are increasing. (See Table 1.) Any possible complex implementation of the automatic exchange of information poses new challenges for the Hungarian system.

Table 1. Tax revenues collected by the NTCA of Hungary (2011-2015)

	2011	2012	2013	2014	2015
Tax revenues (HUF billion)	9.323,8	10.218	10.722,6	11.486,7	12.337,8

Source: Nemzeti Adó- és Vámhivatal 2011, 2012, 2013, 2014, 2015

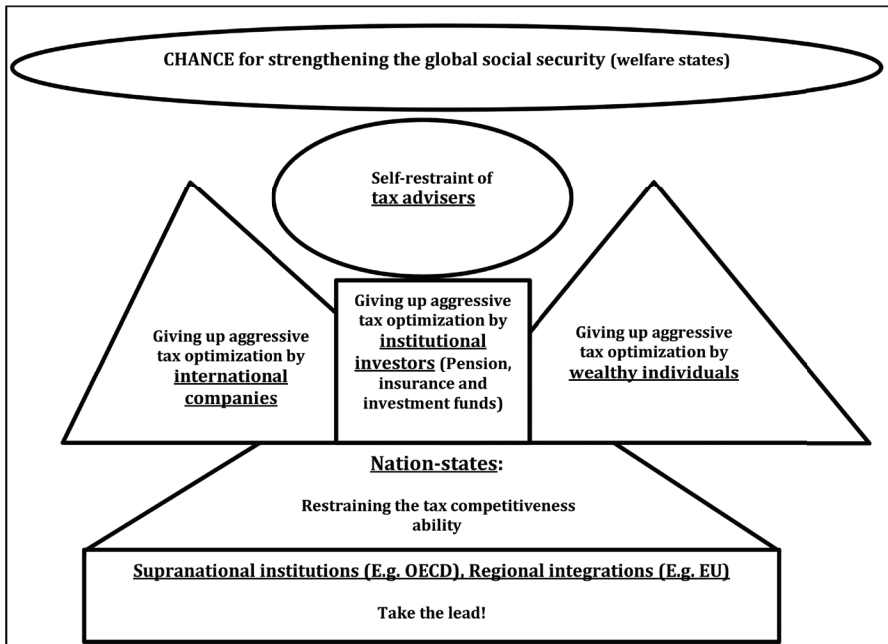
Besides encouraging foreign direct investments *the fight against tax fraud and tax evasion became a common issue with more and more joint actions*.

What is certain is that Europe’s welfare systems cannot be kept up financially on a long run under the same public-financial circumstances. This can be justified by a number of factors, including demographic problems, but I believe that the biggest nail in the welfare state’s coffin is the existence and flourishing of tax haven-like locations. Europe must not only find the answers to its own problems. An influx of refugees is waiting for a better fate in many countries of the continent.

One of the principles of taxation is utility, which means everyone should be taxed in proportion to the consumption of public goods. Many tax avoiders consume the public goods in developed countries that operate with higher tax rates, but shirk from paying tax burdens for their production. In a relatively short period of time, I would require huge changes in the world economy’s legislative approach to deliver the results of the international goals that were formulated on international levels in the past years.

To bring forward changes setting up value sequence, realigning interests and self-restraint would be necessary on every level, which tax policy aspect I illustrate with an “angel model”. (See Figure 4. and read more about the model in Limpók, 2014, 108-111.)

Figure 4. The „angel” of tax policy changes at the beginning of the 21th century



Source: Limpók, 2014

We face a future full of challenges, and today a *sustainable tax policy* – defined by the author years ago – would be an essential element of the often mentioned sustainable development. Sustainable tax policy

- *takes solidarity into account between generations.* The duty of solving the subsequently manifesting problems in public finance, society and social status caused by today’s inconvenient tax policy, is passed to the future generations by today’s men, which contradicts the principle of solidarity between generations.
- On the other hand, *it takes intra-generational solidarity into account.* The world’s problems can be traced back to many tax avoidance reasons, for example the tax payments of the self-employed are reducing in many countries. The mindset of the society must be changed, and awareness must be raised, that financing public needs and maintaining the social system cannot be a burden only of the “wage earners”. Improving the quality of public services can also increase the willingness to pay taxes.
- Third, it *takes solidarity into account between countries.* The well-being of offshore areas depends on the favorable tax policy, but this undermines the tax base of other states. Finding the balance in the future is a global-level task.
- Creating this sustainable tax policy may seem like a utopia, but as consumers of public goods, it is all of our interest, and we cannot leave it behind.

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