COMPARATIVE OVERVIEW OF THE ECONOMIC AND TAX SYSTEMS IN POLAND AND HUNGARY BEFORE THE COVID-19 EPIDEMIC*

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In the wake of crises, tax policy typically plays an increasingly important role within fiscal policy as a way of dealing with the growing budget deficit. The role of the stabilisation and redistributive functions of public finances is significantly enhanced by the recession. However, before drawing conclusions on the changes in the tax regimes in Hungary and Poland, following the COVID-19 epidemic and the Russian-Ukrainian war, it is worth shedding light on the similarities and differences in the economies and tax systems of the two countries.

Keywords
Tax policy, COVID-19 epidemic crisis, Hungary, Poland

1. Introduction

In the wake of crises, tax policy typically plays an increasingly important role within fiscal policy as a way of dealing with the growing budget deficit. The role of the stabilisation and redistributive functions of public finances is significantly enhanced by the recession. However, before drawing conclusions on the changes in the tax regimes in Hungary and Poland − which are also members of the Visegrad Cooperation −, following the COVID-19 epidemic and the Russian-Ukrainian war, it is worth shedding light on the similarities and differences in the economies and tax systems of the two countries.

Both countries joined the European Union in 2004, but while Poland has a population of 38 million and a surface area of 322 000 km, our country has a population of 10 million and a surface area of 93 000 km. The two countries also have similar political systems, except that in Poland the President of the Republic is directly elected by the electorate and the parliament is bicameral.

2. Overview of the central tax systems in Hungary and Poland

In Hungary and Poland, central taxes can only be introduced by law by the national parliament. In both countries, local governments are empowered by law to levy local taxes, the revenue from which accrues to the local government, within the limits of the law.

The types of central taxes introduced are the same (as in the other EU Member States), thus facilitating comparison. Looking ahead to 2020, the following conclusions can be drawn about the tax systems in the two countries.

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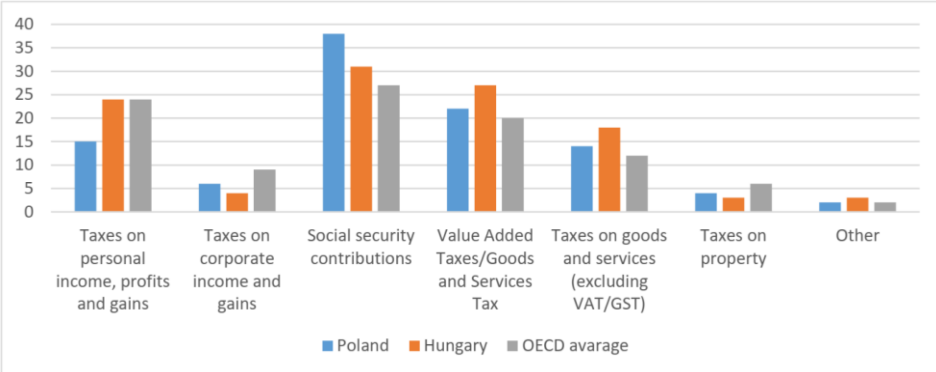
Figure 1: Comparison of main central taxes in 2020 (% of GDP)



Source: OECD (2022)

Figure 1 shows that the central budget in Hungary has low revenues from personal income, social and property taxes, while VAT revenues are much higher than not only Poland but also the OECD average.

VAT revenue in Poland is also high and property and corporate taxes are below the OECD average. This shows that there are similar shifts within the tax systems of the two countries.

Table 1 below indicates the differences and similarities between the two countries in terms of the main tax rates.

Table 1: Tax rates in Poland and Hungary in 2023

	Poland	Hungary
Personal income tax (PIT)	▪ Under 120,000 PLN: 12% ▪ Above 120,000 PLN: 10,800 PLN + 32%	15%
Corporate tax	▪ Standard key:19% ▪ Small taxpayers and new businesses, in the first year of business: 9%	9%
Value added taxes (VAT)	▪ Standard key: 23% ▪ Discount key: 8% and 5%	▪ Standard key: 27% ▪ Discount key: 18% and 5%

Social security contributions (pension contributions, health insurance contributions, labour market contributions)	22,71%	18,5%

Source: author's compilation

2.1 Personal income tax

The personal income tax in Poland is progressive, which is more in line with vertical equity, while the Hungarian linear personal income tax rate is more in line with horizontal equity. The basic tax rates applicable in Poland are 12% and 32%. The 12% rate applies if the tax base does not exceed PLN 120 000, while the 32% rate applies if the tax base exceeds this amount. The 12% tax rate is reduced by an additional degressive tax reduction of PLN 3,600.

In Hungary, individuals are subject to a personal income tax of 15% on their income. Since 2010, this tax has been linear, although it could be considered as a multiple-rate tax due to exemptions granted in recent years (e.g. under-25 tax exemption, tax relief for four or more children). However, since the rules that have been established (e.g. family tax allowance) still tend to favour the higher income bracket, it cannot be said that the rules are closer to vertical equity. It is also worth noting that tax rules serving the government's preferences (e.g. linear tax rates for personal income tax and corporate tax, guarantees for family tax allowances) have been laid down in a two-thirds law, making it difficult to modify them later and adapt them to the economic environment, but increasing the predictability of the tax system.

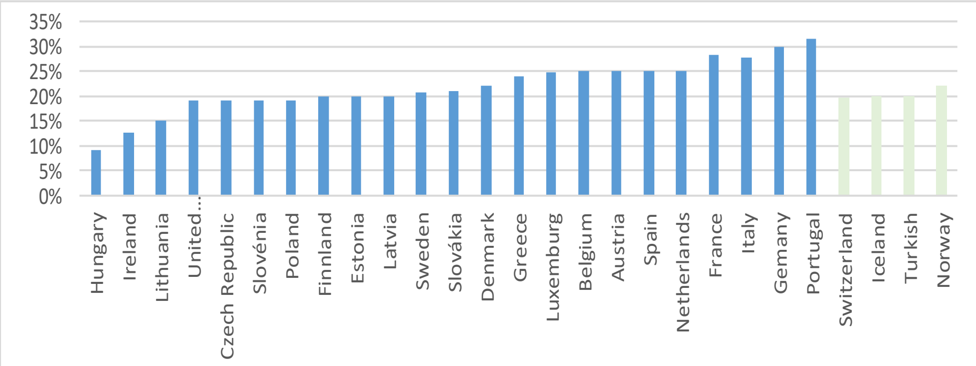
Overall, it appears that by 2020, the tax burden on individuals in Poland had fallen compared to the rest of the European Union, ranking 14th in the EU, up from 16th in 2019 and 17th in 2018. The ranking reflects the fact that individual taxpayers in this country were able to keep on average 72% of their net salary after deductions, compared to 73% for the EU as a whole. In comparison, Hungary ranked 22nd, with 67% of income retained in the year analysed (Revenue Statistics 2022).

2.1 Corporate tax

In both countries, corporate tax is levied on legal entities carrying out business activities. Their taxation is regulated by law. In Poland, the tax rate is 19% of the tax base, but for taxpayers whose income in a tax year does not exceed €2 million, it is only 9%. Furthermore, a reduced tax rate of 5% has been set for the taxation of profits from intellectual property rights ("IP box").

In Hungary, the corporate tax rate is 9%, which for both countries is based on the net income earned by companies in the exercise of their business activities, usually in a financial year.

Figure 2: Corporate tax rate in the EU



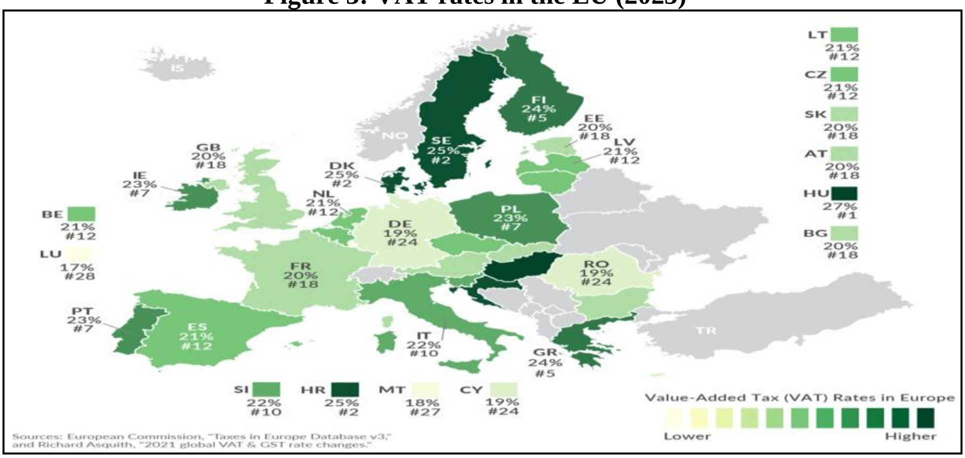
Source: OECD (2023)

Hungary has the lowest corporate tax rate in the EU, while Poland is in 4th (lowest) place along with several other countries. Despite the restrictive role of EU fiscal rules, tax policy is a matter for the sovereign decision of the Member States. There are some taxes for which uniform rules have been adopted, but these are more common in the case of indirect taxes (e.g. VAT, excise duties), while for direct taxes, especially income taxes, Member States find it difficult to abandon one of their main weapons of competitiveness, namely the definition of tax policy.

2.3 Value added taxes

Poland and Hungary meet the EU's VAT rate requirements. As it is an indirect tax, the EU can harmonise the main rules more easily. Under EU rules, the tax rate must be above 15%.

Figure 3: VAT rates in the EU (2023)



Source: European Commission

Figure 3 above clearly shows that Hungary has the highest VAT rate in Europe, ahead of Sweden, Croatia and France. The European Parliament also had some ambitions to harmonise the VAT rate, with a proposal in 2018 to cap it at 25%, but this was ultimately not adopted. In Poland, a VAT rate of 23% puts the country in the middle of the range. However, further harmonisation is needed to modernise the VAT system and to avoid VAT fraud, which has been made easier by digitalisation. This is also highlighted in the Commission's 2022 report, which found that Member States lost almost €93 billion in VAT revenue in 2020 because of these problems (European Commission 2022).

3. After the 2008 global economic crisis

3.1 Special taxes

In Hungary, the role of special taxes was introduced after the global economic crisis of 2008 to address the high budget deficit (Laczkó 2015) and the recession, and since then they have become an integral part of our tax system.

As the table below shows, after 2008, both countries' budget deficits exceeded the EU's 3.6% of GDP target, and the countries were subject to an excessive deficit procedure to remedy the situation. This mechanism was lifted in 2013 for Hungary and in 2014 for Poland (European Commission 2023).

Table 2: General government deficit (-) and surplus (+) (2007-2018) (% of GDP)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Hungary	–5,0	–3,7	–4,7	–4,4	–5,2	–2,3	–2,5	–2,8	–2,0	–1,8	–2,4	–2,3
Poland	–1,9	–3,6	–7,3	–7,4	–4,9	–3,7	–4,2	–3,6	–2,6	–2,4	–1,5	–0,2
EU 28	0,1	–1,1	–5,4	–4,1	–4,3	–4,3	–3,1	–3,1	–2,4	–2,4	–0,7	–0,7

Source: KSH

In 2011, the level of special taxes in Hungary exceeded that of corporate tax, which is interesting because while the former only affects certain sectors, the latter applies to all businesses in general. Special taxes in 2011 already included bank tax, special tax on credit institutions, sectoral special taxes (retail tax between 2010 and 2012), public health product tax and accident tax, and a year later telecommunications tax. At that time, most of the sector-specific taxes concerned the financial sector, which had generated large revenues through state subsidies in the wake of the 2008 global economic crisis. The so-called bank tax was introduced in almost all EU countries because Member States, with the commission’s approval, used public money to support the sector to deal with the crisis and the sector made visible profits as a result.

In 2015, fifteen special taxes were already in force [energy tax, credit institutions' levy, energy suppliers' income tax, special tax on financial institutions, telecommunications tax ("telephone tax") (Siklós 2016), utilities tax, financial transaction tax, insurance tax, advertising tax, special tax on distributors and investment funds, health contribution of tobacco companies, taxes on the pharmaceutical industry, public health product tax and accident tax]. Compared to the previous period, the energy sector, along with credit institutions, has become the most heavily taxed sector in 2015 (Horváth, Bartha & Lovas 2023).

In the case of Hungary's special taxes, the Commission has repeatedly found them to be illegal state aid because of their selective nature, which the Court of Justice of the European Union has subsequently declared compatible with the internal market. A good example of the latter is when Hungary introduced a progressive tax on the revenue from the publication of advertisements by a law that entered into force on 15 August 2014. This tax, which was based on the net turnover of those who published advertising in Hungary, initially consisted of six tax rates, later reduced to two, and allowed taxpayers whose pre-tax result in 2013 was negative or zero to reduce their tax base by 50% of their accumulated losses from previous years. In its decision of November 2016, the Commission considered the tax measure adopted to constitute incompatible state aid, mainly because of its progressive structure, and ordered the immediate and effective recovery of the aid granted from the beneficiaries. Hungary referred the matter to the General Court, which ruled that the Commission's decision should be annulled, and the Court of Justice on appeal came to the same conclusion.

Poland makes less use of this instrument of state intervention, as we will see later, and instead tends to regulate the main central taxes. However, in the last decade, there have been examples of this country introducing special taxes for certain sectors with higher profits. Poland (similarly to a measure previously applied in our country between 2010-2012) introduced a special tax in the retail sector with a law that entered into force on 1 September 2016. This tax consisted of two tax bands, with a tax rate of 0.8% applied to the part of the turnover between PLN 17 million and PLN 170 million and a tax rate of 1.4% applied to the part of the turnover above the latter amount. In its September 2017 decision, the Commission considered the tax measures adopted to be incompatible with the internal market, mainly because of their progressive structure. Poland referred the matter to the General Court, which annulled the Commission's decision, and the Court of Justice on appeal reached a similar conclusion. The country waited for the Court's decision and applied the tax from 2021.

The other special tax worth highlighting in Poland is the bank tax introduced on 1 February 2016. After 2008, most sector-specific taxes have been levied on the financial sector, where companies have gained a lot of revenue through state support in the wake of the 2008 global economic crisis. The so-called bank tax was introduced in almost all EU countries because Member States, with the Commission’s approval, used public money to support the sector to tackle the crisis and the sector made visible profits as a result. It can also be seen that, compared to the 15 EU Member States that have introduced this type of tax, our country is one of the first and Poland one of the last.

Table 3: Introduction of a bank tax in each Member State

Country	Year	Tax base	Tax rate	Allocation
Austria	2011	Total liabilities net of equity and insured deposits	0-0,085%	Central budget
Belgium	2012	Total liabilities net of equity and insured deposits	0,035%	Central budget
Cyprus	2011	Total liabilities net of equity	0,09%	Financial stabilization fund revenue
France	2011	Minimal amount of own funds required to comply with coverage ratio	0,25%	Central budget
Germany	2011	Total liabilities net of equity and insured deposits	0-0,6%	Financial stabilization fund revenue
Hungary	2010	Total assets net of interbank loans	0,15%-0,53%	Central budget
Latvia	2011	Total liabilities net of equity and insured deposits	0,036%	Financial stabilization fund revenue
Netherland	2012	Total liabilities net of equity and insured deposits	0-0,044%	Central budget
Poland	2016	Total assets	0,0366%	Central budget

Source: author's compilation

3.2 The impact of the rule of law on crisis management

Following the global economic crisis of 2008, views in favour of state intervention have strengthened. In several EU Member States, we are witnessing a closure and voices against the EU have emerged.

Hungary and Poland have been repeatedly subject to infringement proceedings by the Commission for breaches of a rule of law principle (e.g. judicial independence). Despite the fact that the Article 7 procedure was already established by the Amsterdam Treaty to protect the principles of Article 2 of the Treaty on the European Union (hereinafter TEU), it took a long time for the EU to use this instrument.

The European Parliament (EP) launched the procedure against Hungary. EU law gives the EP the power to set up committees to investigate breaches of Community law and suspected maladministration. On this basis, the Committee on Civil Liberties, Justice and Home Affairs has been asked to investigate and report to the EP on whether there is a risk of a breach of the rule of law in Hungary. In this context, the so-called Sargentini Report was drafted on 4 July 2018, which raised concerns about the rule of law situation in Hungary and was adopted by the EP on 12 September. MEPs criticised in particular the independence of the judiciary, freedom of expression, corruption, minority rights and the treatment of migrants and refugees.

In Poland, the Commission, in the context of the year-and-a-half-long Rule of Law Mechanism preventive procedure, concluded that there was a risk of "persistent and systemic" breaches of the rule of law in Poland and, as negotiations were not successful, decided to close the case in 2017. In March 2018, the EP adopted a resolution agreeing with the concerns expressed by the Commission about the state of the rule of law (in particular the separation of powers, the independence of the judiciary and the situation of fundamental rights) in Poland.

Table 4: Comparison of Article 7 proceedings in Hungary and Poland

	Hungary	Poland
Start of proceedings	12 September 2018	20 September 2017
Rule of law mechanism under Article 7 TEU	no	yes
Initiator of proceedings	European Parliament	European Commission
Background to the initiation of proceedings	The Sargentini report	European Parliament resolution
Grounds for initiating the procedure	independence of the judiciary, freedom of expression, corruption, minority rights and the treatment of migrants and refugees	separation of powers, independence of the judiciary and inadequate safeguarding of fundamental rights
Rights of the initiator	Parliament, as the initiator of the procedure, cannot participate in Council meetings because of its role in the institutional system	The Commission may attend Council meetings

Source: author's compilation

Article 7 proceedings are ongoing against Hungary and Poland. As this mechanism has not been used before, we do not know how long it will take and what the long-term consequences will be. For this reason, a mechanism for enhanced protection of the EU budget (separate from the Article 7 procedure) has been adopted in the conditionality regulation, which is in force from 2021. The conditionality regulation gives the EU significant tools to protect its financial interests, such as interruption of payment deadlines, suspension of payments and financial corrections. Under this act, the Council has suspended payments of EU funds in relation to Hungary. This is worth mentioning because Hungary has had to take into account the lack of financial resources when dealing with the COVID-19 epidemic and the recession caused by the Russian-Ukrainian war.

4. Conclusions

The two V4 countries shared many similarities prior to the COVID-19 outbreak. Both countries have right-wing governments, whose opposition to the European Union has been reflected in several aspects (e.g. rule of law procedure, principle of primacy). In my view, the measures introduced in response to the crises have been influenced by the rule of law mechanism to protect the budget (Hungary is deprived of EU funds) and by the interventionist policies of the ruling parties.

The tax systems of the two countries are also similar, as while income taxes are generally lower, VAT rates in both countries are above the EU average and property and environmental taxes are not significant. Both countries had problems with budget deficits following the global economic crisis of 2008, but the EU lifted the excessive deficit procedure for both countries and in the years leading up to the COVID-19 epidemic, fiscal balances were restored. Despite the similar tax structure, it can be observed, looking at the situation before 2020, that Hungary is quicker to resort to the instrument of special taxation (e.g. 15 special taxes in 2015), while in Poland it is not the main crisis management tool, as evidenced by the fact that the bank tax was only introduced in 2016, while the retail tax, despite its introduction in 2017, was only applied from 2021.

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