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ROMANIAN AND HUNGARIAN FISCAL SYSTEMS. REGULATIONS AND FISCAL APPARATUS

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Abstract: *Romania and Hungary had to face the challenges determined by the transition to the new political, economic and social systems and to set up fiscal systems and fiscal administrations to ensure the public revenues necessary to cover public expenditures.*

Key words: *taxes, fees, fiscal system, fiscal apparatus, reform.*

1. Introduction

Romania and Hungary, two neighboring countries which both belonged to the Easter Block, after 1990 started their journey on the road of building democracy, free market economy and the state of Law. Both countries started a waste process of reforms in all fields, including the public finances and taxation.

Hungary, a free and a proud country, is located in Central Europe, influenced by the progressive Western culture, and Romania, freed from a bloody and cruel dictatorship, located in the north of the Balkan Peninsula, influenced by multiple cultures, being the borderline of eastern and western Europe, both being part, each with its own particularities, of the great European culture.

The process of Reforms initiated after 1990 had the same purpose in both countries, but the means and ways often were different. This explains the fact why the outcome was also different. While it was a common topic that Romania delayed the process of Reform, Hungry instead was considered the leader of reforms compared with the rest of the former communist countries. The outcome of the reforms made it possible, that both countries were accepted to become members of the big European family, the EU and also NATO members.

The changes taken place in Economy reflected itself in fiscal legislation, level and structure of fiscality, but also in the structure of fiscal apparatus and public administration. In the following paragraphs we shall present a comparative study of the two fiscal systems in the view of financial and fiscal regulation and the fiscal apparatus which assures all fiscal activities.

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2. Romanian fiscal system

2.1. The evolution of the Romanian fiscal system

As it is well-known, in order to satisfy the general needs of the society, the state needs to assure an income, the important part of this income has its source in form of taxes and tax revenues which the state imposes on citizens and companies or, what we commonly call, taxes. These represent the main means of assuring this revenues, which are used for public expenses. Beside these sources which fuels the state budget, in some states, as well in Romania, there are contributions for special funds destined to cover certain public spending, funds that are constituted and regulated by special laws.

We can define the *fiscal system* or *fiscality* as representing the total taxes, tax revenues and contributions imposed on citizens and companies, income that fuels the public budget (Şaguna, Şova, 2008, p. 10-12). The number and the type of taxes in a given state which form the fiscal system depends on the economic, social and political situation the that state.

In Romania, right after the Revolution in 1989, it was initiated the legal frame for private ownership of industries and enterprises, adopting measures to stimulate this new type of economy, breaking up the state ownership, started forming a free market economy and attracting foreign investments and capital. In the same way, for the agriculture areas, it was created the legal framework for private ownership and enterprise. There were a series of laws adopted, for example, restructuring the economic units owned by the state such as state enterprises and trade companies; introducing the Commercial Register, functioning as a public organization which assures the registration of companies Ltd-s, the free entrepreneurs list who has as objective production and trade in a free market economy (Cărpenaru, 2007, p. 96-98); the establishment and functioning of the companies; exercise of competition; organizing and keeping accounts of the companies; the status and ownership of land properties; capital market; the activity of Banking institutions; insurance.

The Romanian fiscal system was forced to adapt itself to this tremendous effort to pass from a planned central economy to a free market economy. For this purpose, the *Romanian Constitution* of 1991, reviewed in 2003, provides in article 56, 1st paragraph the obligations of citizens to contribute trough taxes and income taxes to the public expenses. There were adopted a series of changes in fiscal legislation, introducing different taxes for tax payers and for certain types of activities, all taking into account the new economic reality.

The great numbers of changes in fiscal regulations and the high rate of frequency of these changes caused a series of difficulties in knowing all that and made it difficult to apply this regulations equally for everyone, creating an atmosphere of mistrust and uncertainty for all the investors concerning the fate of their investments, no matter if they were Romanian investors or foreigners. The conclusion is that a concentrated fiscal Code would be of great help for the taxpayers and for the economy as a whole as well. By the end of the year 2003 were adopted by the Romanian legislator the Fiscal Code and the Fiscal Procedure Code. The changes that had been taken place in the Romanian economy and connecting it to the European and worldwide economy determined other changes, so that in 2015 there were new Codes introduced and those of 2003 abolished.

The Fiscal Code defines in article 1: the legal frame concerning taxes, income taxes and revenues and the mandatory social expense contributions; the category of taxpayers who are obliged to pay them; the method of calculation and payment, as well as the procedure for amending taxes and other contributions. In the same time it authorizes the Ministry of Public Finace to elaborate the methodological norms, instructions and norms of applying the Fiscal Code and the laws ratifying conventions signed by Romania to avoid the double imposing of the taxes for the same citizen or company.

The Fiscal Procedure Code defines the legal frame of how to administer the taxes and income revenues, social contributions as forseen in the Fiscal Code. By administering the taxes we understand as it is described in article 1, the point 2 of the Fiscal Procedure Code, all type of activities carried out by the fiscal apparatus: the way they register, declaring the obligations, imposing them, collecting receivables, controlling receivables, judging and solving appeals against tax assesments, legal court appeals; assistance/guidance of taxpayers/payers, upon request or *ex officio*; application of sanctions under the law.

We can draw the conclusion that the Romanian Tax reform had in target the following objectives: creating a coerent fiscal system, which is efficient and stable; to eliminate discriminative criteriae and exceptions from paying taxes (direct taxes or indirect taxes), creating an even custom taxes on imports coming into the country, in accordance with the international treaties and regulations signed by Romania; developing the fiscal apparatus in collecting taxes, reducing the innerent costs of the system; the prevention and conbating tax evasion; respecting the commitment taken for the Association Agreement of Romania to the European Communities (1993), the Treaty to become a member of the European Union (2005), as well as other European rules.

2.2. Norms that regulates the financial and fiscal activities in Romania

The financial activities of the state in Romania is defined by the Romanian Constitution, the *Law of Public Finances*, the *Law of local public finance*, The Fiscal Code, the Fiscal Procedure Code as well as other norms given by the Government or other specialized instituion in the financial and banking field.

The lawful relationship which take place and ends during the procedure of collecting taxes and revenue taxes from contributors and companies or whoever owns real estate or other taxable values are regulated by the Constitution, the Fiscal Code, the Fiscal Procedure Code, the Civil Code, the Civil Procedure Code, special laws such as Law nr.241/2005 to fight against tax evasion, other norm imposed by the Government or other state institutions specialized in finances and taxes. It is worth noticing that in the Ministry of Public Finances is functioning a *Central Fiscal Commission*, who has the responsibility to make decisions concerning the implementing in uniformity the Fiscal Code and the Fiscal Procedure Code of Romania which are mandatory. The decisions of the Central Fiscal Commission, these are approved by the Ministry of Public Finances and are published in the Official Monitor of Romania and these decisions are mandatory.

In accordance of article 11 paragraph (11) of the Fiscal Code, concerning the value added tax (VAT) and excise, the national tax authorities of Romania have to take into account the decisions of the Court of Justice of the European Union.

In Romania there isn't a unique state budget in which all the taxes are collected, no matter if there are ordinary taxes, there is a *budget system* which is composed from a series of budgets foreseen by the Law of Public Finances nr. 500/2002.

2.3. Fiscal Apparatus

The tax activities cannot be materialized without the existence of a proper institutional tax structure, represented by the fiscal apparatus. This contains all the state tax and control organs, whose attributes are: to establish the quantity and type of the taxes, following up the collecting of these taxes, controlling the legality in this field (Șaguna, Șova, 2008, p. 19).

In Romania, the general manager of the public finances is the *Ministry of Public Finance*, in which works the *National Agency of Tax Administration*, which has a structure dispersed in the whole country, structures that assure the imposing and collecting taxes attributes, which in turn provides the State Public Budget. On the level of territorial structures (counties, cities, villages) there are organized specialized compartments which are administering the local interest taxes. In the National Agency of Tax Administration works the *Anti-fraud Division* which has the purpose to fight tax-evasion and to assure a high level of collecting taxes. In other words, the purpose of this Division is to impose respecting the Law by tax-payers. The National Agency of Tax Administration and its territorial structures, the specialized compartments and division of territorial structures represents in fact the fiscal state organs, named otherwise *state fiscal apparatus.*

The Control of respecting the laws regulating the financial activity of the State is assured by the *Court of Accounts of Romania*, an autonomous public institution who controls the way money are spent in public administration or, in other words, public expenses. In this frame, the *State Audit Authority* verifies how the European money, grants and funds received by Romania is spent.

2.4. The principles of taxation in Romanian

There are major differences in approaching the fiscal phenomenon in Romania, devised by the succeding Governments leading the country in the last 30ty years, differences generated by different economy concepts, who were the backbone of the differents Governments and political concepts. So, if the social-democratic doctrine promoted the principle of equal imposing of taxes, having the direct consquence of creating a system which imposed a gradual level of taxes, *Progressive tax system* taking into account the size of the incomes, the liberal doctrine promoted the principle of equality in taxes, *Singel level tax system*, no matter the size of the income obtained, promoting a system which applied a *unique quota of tax*, no matter what income was obtained. Even the alliances formed by different political parties kept the unique quota of the taxe, this subject became a *tabu*, not discussed, not changed, beeing the basic condition of economic growth.

The Fiscal Code adopted in 2003 had promoted the following principles of imposing tax: measures taken concerning taxes must be neutral regardless of the type of investors and capital; the certainty of imposing or taxes must be defined clear, that influences laws which must be clear, not leaving room for interpretation; equity in imposing taxes, so the quantum of tax must be proportional with the incomes obtained or the estate, shares obtained, promoting progressive approach of fiscal system used; tax efficiency, so the public budgets must be fueled constantly, without interruptions. The changes that followed the 2004 elections had political influence as well, the progressive imposing was changed into *the singular level tax system*, imposing a 16% unique tax quota, the Fiscal Code being modified starting with 2005, the same quota was applied on incomes obtained and revenues obtained, these measures were tried in the same time with other measures imposed to enforce the discipline in fiscality.

The 2015 Fiscal Code uses the same fiscal principles as presented before, adding another principle, the principle of predictability of taxation, which assures the stability of taxes and mandatory contributions for a period of time at least for 1 year, during that time *can not be introduced or increasing* new types of taxes and mandatory obligations. *The unique tax quota was kept until today, which is 10% with a few exceptions.*

3. Hungarian Fiscal System

3.1. The evaluation of the Hungarian fiscal system

In the late 1980's and early 1990's, the Hungarian economic and political systems were in a state of transition. The Hungarian tax reform during this transition period is interesting because Hungary was the first country in Central-Eastern Europe to attempt such a comprehensive fiscal reform. This made the implementation of the reform more challenging. A second complication that makes the Hungarian tax reform interesting is that the Hungarian tax reform was initiated and implemented before other important structural changes in the Hungarian economic system were complete. For example, the first legislation that addressed the privatization of previously state-owned enterprises was not passed until 1989 and did not come into effect until the middle of 1990. This was well after the initial and most dramatic Hungarian tax reform of 1988 took place. Similarly, legislation regulating relationships between businesses did not come into effect until mid-1990. Nor was the Act on Accounting introduced until 1991. Because the tax reform was implemented before many of the other economic transitions were completed or even initiated, the reformed tax system was initially incompatible with the Hungarian economic system as a whole. This dissonance can help explain why Hungary experienced some difficulties in tax collection and enforcement immediately after the reform, but it can also point to ways in which the tax reform was able to facilitate further economic reforms (Koltay, 1993, p.253).

Before the major overhaul of the Hungarian tax system in 1988, two thirds of Hungarian tax revenue came from taxes paid by state-owned enterprises. This was very different from the tax systems of Western Europe where direct taxes on individual households constituted a larger percentage of tax revenue than those on businesses. This sharp contrast pointed to just how dramatic of a transformation the Hungarian tax system would need in order to emulate its counterparts in Western Europe. Additionally, such a heavy reliance on taxes from state-owned enterprises would not be sustainable as privatization occurred.

Early on in its transition, the Hungarian legislature enacted Act No. V on Value Added Tax, Act No. VI on Income Tax, and Act No. IX on Corporate Profits Tax which all became effective on January 1, 1988.

The *Hungarian value added tax* was implemented based on the value added taxes found in European Union countries. Most goods and services were taxed at the standard rate of 25%, some services (including the transportation of goods, repairs, and tourism) were taxed at a middle tier of 15%, and basic consumer goods (including food, public transportation, and books) were not taxed. Other exceptions to the tax included housing, health, education, culture, and sport which were not subject to the tax. The introduction of the value added tax in Hungary required increased administration because Hungary did not previously have a general turnover tax. The implementation of this tax despite the required administration was justified by a desire to eventually join the European Union.

The *personal income tax* was the second new tax that was introduced by the 1988 reform. The revenues from the personal income tax were distributed to local governments primarily because the 1988 tax reform abandoned local taxes (including property taxes). The Hungarian personal income tax taxed all income (no matter its source) from each individual (i.e. the tax was calculated on an individual basis rather than on a household basis) according to a standard, progressive tax table (Koltay, 1993, p. 254)

Although the Hungarian personal income tax was modelled on personal income taxes found in countries in Western Europe, the tax was not as successful in Hungary as anticipated. This can largely be attributed to a failure of the Hungarian government to consider how tax policies might discourage work effort and thus reduce the tax base and reduce overall tax revenue. The Hungarian tax had higher marginal tax rates, steeper progression, and narrower income brackets than its western counterparts. In 1988, there were eleven different income brackets, and the highest tax rate was 60%. The combination of these factors resulted in the creation of too high a tax burden for many Hungarians. Furthermore, the system hardly considered factors such as the number of dependents relying on an individual's income. This policy further increased the tax burden on Hungarian families. These systematic flaws were attempted to be corrected by yearly changes in the income brackets and tax rates, but change was slow and the refusal to introduce tax reduction based on the number of dependents contributed to a reduction in the tax base (Koltay, 1993, p. 255).

The *tax on corporate profits* that was introduced in 1988 was designed to replace the tax on state-owned enterprises. In 1988, the tax was set at 50% of corporate profits, but this was lowered to 40% in 1990. Like the personal income tax, there were several problems with the corporate profits tax when it was first implemented. The first problem was that, at the time this tax was enacted, there was no unified system of accounting in Hungary. Hungary's first Act on Accounting was not introduced until 1991. Without a uniform system of accounting, there was no uniform way to measure corporate profits. This made the measurement and enforcement of the corporate profits tax extremely difficult. A second problem with the corporate income tax was that this tax introduced a systematic discrimination against private businesses in favour of state-owned businesses. As of 1988, privatization had not officially begun and there were still a significant number of state-owned enterprises. However, taxing a privately-owned business at the same rate as a state-owned business did not have an equal effect on each type of business. The privately-owned businesses were normally expected to pay out a portion of their after-tax profits to their owners, while the state-owned businesses had no such requirement. Such a system impairs the progress of privatization because it allows the state-owned enterprises to remain in a more favourable financial position than similarly situated privately-owned businesses. This problem was addressed in 1990 by the introduction of an obligatory payment for state-owned enterprises. This elimination of the initial discrimination against privately-owned businesses helped encourage the privatization of Hungarian businesses. A third problem with the corporate income tax was the persistence of the double taxation of corporate profit distributions. Corporate profits were taxed first at the corporate rate and then at the personal income tax rate after being distributed to owners as income. This policy also impairs privatization because it makes it less attractive to privately own a business (Koltay, 1993, p. 254).

After the tax reform we can summarize the other reforms mainly concerned the following areas of financial law:

a) the drafting of the Duties Act (1986),
b) reform of the financial institution system: from a monolithic banking system to a two - tier one transition to the banking system (1986),
c) tax law reform (1988),
d) securities law reform - emergence of a stock exchange (1990),
e) public finance reform (Act XXXVIII of 1992),
f) Reform of financial control (1989).

The process has been facilitated by a number of pieces of legislation in other areas, such as: introduction of a law on companies; which abolished state property exclusivity and paved the way for private property and companies organized on this basis and freedom of enterprise: the Law on the Protection of Foreign Investments, the Law on the Transformation of State-Owned Enterprises; privatization legislation and in 1991 legislation on accounting, compensation and financial reorganization.

The 1988 reform of the tax system, with the introduction of the laws on personal income tax, value added tax and corporate income tax, created a "renaissance of tax law", ie tax law became a dominant area of financial law in the field of substantive law. But also by extending the scope of the taxable person: the obligation to pay tax on income or the indirect tax on the turnover of goods has become commonplace. Act XCI of 1990 on the System of Taxation, which provides a uniform treatment of the system of collection and payment of central and local taxes, both for individuals and business entities. Although the tax legislation is amended almost every year, its appearance is enormous, plays a role their significance in financial law is indisputable.

The ongoing public finance reform and *Act XXXVIII of 1992 on public finances* can also be considered an important stage in the reform process. The Public Finance Act replaced the Public Finance Act. In financial legislation, the unification of the order of public finances, the budget, the management of local governments and budgetary bodies has been a great achievement compared to the Law on Public Finances. The law consolidates the procedural rules for the adoption of both the substantive and the budget into a legal unit, together with the definition of the general principles of public finance management and the order of control over the use of public funds. Public finance reform is not a complete process, but it is certainly a major step in the transformation of financial law. The Public Finance Act laid down the principles of the rule of law and democratic legislation.

The law stipulates that: - who can be obliged and on what grounds the state can establish payment obligations, - payment obligations affecting a wide range of individuals can only be established and changed by law, - the principle of public burden-bearing, i.e. progressive income centralization, increasing income in proportion to increasing income public expenditure, - the principle of generality, i.e. the starting point for those who use public services to contribute according to their income and wealth, - the principle of the separation of central and local management, and the promotion of self-sufficiency for local governments (Erdős, 2004, p. 217-221).

3.2. The Fundamental Law of Hungary from financial law point of view

After 20 years, in the early 2010-s, the most of the financial regulations were changed. The first step was the Fundamental Law of Hungary, which contains the rules of the public funds, too. (Article 36. Public Funds) These rules are the following: The National Assembly adopts an *Act on the central budget* and on the implementation of the central budget for each year. The Government submits the legislative proposal on the central budget and on the implementation of the central budget to the National Assembly within the period determined in an Act. The legislative proposal on the central budget and on its implementation contains state expenditures and revenues in the same structure, in a transparent manner and in reasonable detail. By the adoption of the Act on the central budget, the National Assembly authorises the Government to collect the revenues and to disburse the expenditures determined in that Act. Pursuant to Article 37 the Government is obliged to implement the central budget in a lawful and expedient manner, with efficient management of public funds and by ensuring transparency.

The Article 38 of the Fundamental Law details, that the property of the State and of local governments shall be national assets. The management and protection of national assets shall aim at serving the public interest, meeting common needs and preserving natural resources, as well as at taking into account the needs of future generations.

Very important from financial law point of view law the Article 39, too, which details, that support or contractual payments from the central budget may only be granted to organisations of which the ownership structure, the organisation and the activity aimed at the use of the support is transparent. Public funds and national assets shall be managed according to the principles of transparency and the purity of public life. Data relating to public funds and national assets shall be data of public interest.

From the institutional point of view, we mention that the *Hungarian National Bank* performs the supervision of the financial intermediary system. Also, the *State Audit Office* is the organ of the National Assembly responsible for financial and economic audit. The State Audit Office carries out its audits according to the criteria of lawfulness, expediency and efficiency. Not least, as an organ supporting the legislative activity of the National Assembly, the *Fiscal Council* examines the feasibility of the central budget. The Fiscal Council takes part in the preparation of the Act on the central budget, is required for the adoption of the Act on the central budget. The members of the Fiscal Council are the President of the Fiscal Council, the Governor of the Hungarian National Bank and the President of the State Audit Office.

3.3. Taxation in Hungary

Taxation in Hungary is divided into central and local levels. While central taxes constitute the revenues of the state budget, local taxes are due to the municipalities.

Central taxes may be divided into general and special categories based on their intended purpose. General taxes include the traditional tax types (corporate income tax, value added tax, personal income tax) while special taxes include the tax types levied on specific industries/sectors (income tax of energy utilities, levies on financial organisations, credit institution contribution, energy tax, public utility tax, telecommunication tax, advertisement tax, public health product tax).

Levying and determining the rate of local taxes (the material ones being local business tax, land tax, building tax) falls within the competence of the individual municipalities.

In Hungary, the general rule applicable to taxation is the principle of self-assessment. Enterprises and individuals are required to assess, declare and pay their taxes themselves. Beside self-assessment, in certain cases, the authority may charge or levy taxes based on filing. For example, tax is charged in the case of VAT on imports of goods, registration tax, local communal tax and building tax, while it is levied in the case of duty on the transfer of property and procedural stamp duty.

Stamp duties and contributions also play an important role in the system of equal tax treatment.

In the Hungarian tax policy regime, central taxes are being shifted from income to consumption and from general taxes to special levies.

Hungary, as a member of the European Union, has a harmonised value added tax, customs and excise regime. In the operation of its tax system, the country tries to make sure that its domestic tax administration complies with the requirements of the European Union, the OECD and BEPS. (https://doingbusinessinhungary.com/taxation)

4. **Conclusions**

Each of the two states has established its own fiscal system by adopting laws, establishing institutions, modifying competencies, adapting to changes or anticipating them.

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