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TAXATION AND EMOBILITY – ALTERNATIVES IN THE FIELD OF TAX TREATMENT OF COMPANY CARS IN HUNGARY

I. Foreword

In 2015, world leaders pronounced that after a quick negotiation, an ambitious agreement was managed to be established in Paris by nearly 200 countries. The main goal of the Paris Agreement¹ is to hold the increase in global average temperature well below 2 degrees Celsius (i.e. above the pre-industrial level).²

The approach of the Kyoto Agreement was changed, where the main aim was to limit the emission of Greenhouse Gases (GHG). On the contrary, the Paris Agreement focuses on the results of the efforts of the Parties. It must be underlined that however the implementation of the agreement is based upon equity and the principle of common responsibility, the responsibilities and the respective capabilities are differentiated in light of the different national circumstances. Thus, in the progress of environmental protection under the Paris Agreement, fulfilling the accepted commitments should be considered pretty seriously.

II. Introduction

According to the data of the European Automobile Manufacturers Association (ACEA), 13.7 billion cars have been registered in the EU 28 and the increase of the number of the registered cars can reach 9.3 % compared to the previous year.³ Hungary shows a more dynamic increase in this field with 19 %.⁴ Furthermore, there are 256.1 million passenger cars on Europe's routes, which is a significant contribution to the GHG emission of this sector.

¹ The 2015 UN Climate Change Conference took place in Paris and that was the 21st Conference of the Parties to the 1992 UN Framework Convention on Climate Change. The Conference negotiated the Paris Agreement which aimed to limiting the global warming to less than 2 degrees Celsius. This goal is linked to the reduction of the level of the GHG emission and compared to the level of the GHG emission in 1990.

² Paris Agreement 2015 Article 2. Paragraph 1.

³ The Automobile Industry Pocket Guide 2017-2018.

⁴ Calculating mine. Based on the official report of the number of the new registered passenger cars, sorted by manufacturers. Retrieved from the Official Website of the Hungarian Central Statistical Office (http://www.ksh.hu/docs/hun/xstadat/xstadat_evkozi/e_ode001b.html, (21.07.2017.)).

Similar historical booms on the market of the passenger cars had significant environmental and other social impacts as well. The numbers of passenger cars used for commuting results in congestion and heavy traffic and the wear-and-tear of the public roads cause more and more accidents including injuries and damages on the routes, while neutral tax treatment allows the employer to reduce the costs of wages by shifting the remunerations to pretty generous tax-rated fringe benefits. This competitive advantage of larger firms modifies the perspectives of capital-intensive companies to get better-qualified workers on the labor market and of course, means higher income for the employees.⁵ On the other hand, increasing local pollution, such as air, noise and also vibration, also should be taken into account as the root cause of the rising of other social costs.

This paper is concerned with the root causes of the development of the number of passenger cars and the increasing ratio of exhaust fumes.

Although all the OECD countries, except Mexico, levied income tax on the personal usage of company cars, Hungary shows a neutral treatment on such personal income in kind. This neutral tax policy also raises questions regarding the achievement of the environmental goals of the Paris Agreement in connection with GHG emission not only in connection with missing fiscal revenues.

III. Natural treatment of income taxation after personal usage of company cars in Hungary

Before 2009, company car tax as a personal income tax in kind was levied after the personal use of company cars.⁶

The tax base depended on the acquisition value of this kind of asset and the time of procurement. The base of this tax was separated, calculated upon the term since the acquisition thereof, and the lower tax base was to be considered after the 5th year of purchase. The tax was to be paid by the employer as the owner of the company car. After 2009 it was clarified, that company car tax should be considered as a special wealth tax and personal income tax (PIT) was not imposed anymore.⁷ According to the current regulation of PIT, the use of a motor vehicle supplied by a payer or non-resident legal person for private purposes, including the related road passes or tickets provided by the said payer or non-resident legal person, falls under exemption of taxation.⁸

It should be emphasized that there are narrow differences between the distortion created by tax loopholes, tax subsidies and direct government outlays.⁹ It also means that the exemption affects the whole system of income taxation of wages and causes inequality.

⁵ HARDING, MICHELLE: *Personal Tax Treatment of Company Cars and Commuting Expenses: Estimating the Fiscal and Environmental Costs*. OECD Taxation Working Papers No. 20., Paris, 2014. 9. p. (<http://dx.doi.org/10.1787/5jz14cg1s7vl-en> (21.07.2017.)).

⁶ Section 70 Act CXVII of 1995 on Personal Income Tax.

⁷ The modifying Act placed the regulation related to company cars tax into the Chapter IV Act LXXXII of 1991 on vehicles tax. Naturally, company car tax shall be considered in dealing with the current topic, but here, it must be underlined that the subject of the income taxation is different from it.

⁸ Subparagraph 3 paragraph (2) Section 238 of Act LXXXI of 2008 on Modifying of Certain Acts on Tax and Contributions.

⁹ PECHMAN, JOSEPH A.: *Tax Reform: Theory and Practice*. Economic Perspectives. (1) 1987. 13. p.

In Hungary, the revenues from wages constitute a consolidated tax base with the average tax rate¹⁰ of 33,5 percent.¹¹

Certain incomes after such revenues are taxed separately, including fringe benefits, which are subject to higher tax rates. In such environments, the importance of tax-free remuneration is high, thus capital-intensive employers, which can provide company cars for personal purposes or other diversified remuneration, obtain huge competitive advantage on the labor market thereby. Furthermore, it is an incentive for both employer and employee to shift the costs of the wages in the direction to the tax-free solution. That is why small individual entrepreneurs also choose this method to make themselves more desirable for employees.

On the employee's side, the system differentiates between workers from the point of view of commuting expenses to and from work. While the usage of private cars for commuting purposes is bound by strict conditions for tax exemption, e.g. location of residency and maximum rate of the reimbursement of 15 HUF per kilometers¹², employees can use the company cars for the same purposes without paying taxes. What's more, if an expense of reimbursement after the usage of private cars for commuting to and from work does not meet these additional criteria, the amount of reimbursement in excess is considered as income from wages.¹³ Besides this, the tax-free reimbursement of the expenses of public transportation for commuting purposes is also limited to 86 percent of purchase value of tickets and passes. The system of personal income taxation in Hungary does not encourage employees to choose public transportation to commute. It is also not questionable that higher-waged employees benefit from this because they can afford to operate a private car to commute and higher-paid executives are offered to get company cars for personal purposes.

Obviously, the tax environment in Hungary is against both the principle of horizontal and vertical equity and reduces the efficiency of the tax.¹⁴ One of the most important criteria of the conception of 'good tax' is horizontal equity, by which it is granted that similarly, not identically, 'well-off' individuals shall face the same tax burden.¹⁵ Well, it is easy to see that those employees for whom company cars for personal usage are offered by the employer pay PIT differently than others who receive remuneration in the same value. On the other hand, in terms of equity, individuals who have greater ability to pay taxes (with more wealth, resource access, and income) shall pay more in proportion to their income (vertical equity).¹⁶

As the incentives on both sides of the employer and employee are drivers for everyone to use company cars for personal purposes, the efficiency of the income taxation in Hungary is questionable. Additionally, *subjects are in the 'vertical inequity' condition as they are*

¹⁰ Average tax rate covers the PIT tax rate of 15 % and the social security contributions rate of 18,5 %.

¹¹ Section 24 Act CXVII of 1995 on Personal Income Tax.

¹² Subparagraph (2) Section 25 Act CXVII of 1995 on Personal Income Tax.

¹³ Subparagraph (3) Section 25 Act CXVII of 1995 on Personal Income Tax.

¹⁴ HARDING 2014, 9. p.

¹⁵ ELKINS, DAVID: *Horizontal Equity as a Principle of Tax Theory*. Yale Law & Policy Review. Vol. 24: No. 1, Article 3. 2006. (<http://digitalcommons.law.yale.edu/ylpr/vol24/iss1/3> (07.21. 2017.)).

¹⁶ GREEN, RONALD M.: *Ethics and Taxation: A Theoretical Framework*. The Journal of Religious Ethics, Vol. 12, No. 2 1984. pp. 146-161.

significantly more likely to fully evade taxes than in the 'equity condition',¹⁷ thus the lower-qualified workers with low salaries may get into a moral and economic crisis as a result of taxation policy.

What are the elements of income received from the personal use of company cars? How can we define the revenues from it?

On the one side, the employee gets an asset which can be used for business and personal purposes. The income from the usage of company cars depends on the value of the vehicle, distance traveled and the direct costs of personal usage.¹⁸ As the employee is not forced to purchase the car from his/her own net salary, the price of the company car or the financing costs of leasing shall be considered as a part of capital costs. The capacity of the cylinder (ccm), the age and the state of the mechanical condition of the vehicle are the main factors to determine the value as well.

The expenses saved by the employees (after travel distances), are the second section of the revenues, because the pattern of travel habit of the drivers of the company cars shows differences from the drivers who use privately purchased and maintained vehicles. Additionally, an ability to use company cars for personal purposes changes the customs of the whole household and significantly increases traveled kilometers.¹⁹

Pursuant to the provisions on company taxation, the companies shall not be able to account the expenditures of the personal use of assets as a cost, thus it is necessary to register the use of company cars for personal and business purposes separately.²⁰ Probably, calculating the elements of revenues from the use of company cars for personal purposes is the simplest in this case. The third factor is the direct cost of usage, which is typically connected to fuel consumption, parking passes, amortization (wear-and-tear), and maintenance, especially mandatory insurance, expenses of MOT, costs of repairing, or even cleaning of the vehicle, etc.

It should be mentioned that in the OECD countries, the fiscal cost of the benefits from the personal use of company cars reach EUR 19.0 billion being a lower-bound estimation of OECD report.²¹ The same report stated that the mid-level of estimated untaxed benefit in Hungary can make EUR 419 million²² (equal to approximately HUF 129 billion²³). To compare these figures with the approximate HUF 1166 billion of central budgetary deficit²⁴, the untaxed benefit from the use of company cars for personal purposes cannot be considered as a marginal factor.

The OECD countries imposed an income tax in various ways. The simplest way to get fiscal revenues is to apply a flat tax, but it can hardly meet the requirements of

¹⁷ MASSIMO FINOCCHIARO CASTRO - ILDE RIZZO: *Tax compliance under horizontal and vertical equity conditions: An experimental approach*. Int Tax Public Finance. Springer Science+Business Media New York. 2014/21. 561. p.

¹⁸ HARDING 2014, 10. p.

¹⁹ SHIFTAN, YORAM - ALBERT, GILA - KEINAN, TAMAR: *The impact of company-car taxation policy on travel behavior*. Transport Policy (19) 2012. p. 142.

²⁰ Point f) Subparagraph (1) Section 8 Act LXXXI of 1996 on Company Tax and Dividend Tax.

²¹ HARDING 2014, 16. p.

²² HARDING 2014, 27. p.

²³ Convert into HUF mine with the average rate of 308 HUF/€.

²⁴ Point c) Subparagraph (1) Section 1 Act XC of 2017 on Central Budget in 2017 of Hungary.

environmental protection goals. The most sophisticated tax policies consider capital costs (with depreciation), traveled distances and direct costs to constitute the tax base of this fringe benefit.

IV. Prevailing provisions in favor of eMobility on company car taxation in Hungary

As it is mentioned above, there is hardly any difference between taxes and direct expenses of state subsidies, since state subsidies are also considered like negative taxes in the literature. Here it is only highlighted that there are existing state aid programs aimed at getting the purchase value of *eVehicles* (EV) lower in Hungary. Including the subsidy for the purchase of EVs, for 2020, the *Ányos Jedlik Plan* aims at reaching 30 000 EVs in Hungary. The other side of the program is given a financial leg to build electric charger stations across the country mostly from EU funds. In this chapter, a short overview will be given in the light of purchase, holding, and selling EVs in Hungary.

In the beginning, three taxes are consociated to *purchase EVs*.²⁵ Naturally, the most important issue for companies is the question of the deduction of *Value Added Tax* (VAT) after the supply of the EVs. In Hungary, unfortunately, there is no possibility to deduct the VAT²⁶, except for the purposes of resale.²⁷ In connection with purchase, *Environmental Protection Product Charges* (EPPC) shall be paid, aiming at preserving natural resources by reusing, recycling and recovering of harmful products and at generating funds to finance the efforts for the prevention and mitigation of potential damage to the environment.²⁸ To register and enter into service, two mandatory payments should be made in connection with passenger cars. After 2012, the rate of the *Motor Vehicle Registration Duty* (MVRD)²⁹ is 0 HUF per unit after Environmental Friendly Vehicle (EFVs)³⁰, including EVs, plug-in hybrids and vehicles with zero emission.³¹ After all transfer of assets with special rules on vehicles, a *capital transfer duty* (CTD) shall be collected. Since after 2016, the acquisition of ownership of an EFV, including EVs, is covered by an exemption,³² under which there is no duty payment after a recent purchase.

The *Company Car Tax* (CCT) is imposed after holding and using passenger cars if any expenditure or cost is accounted after their use. It is good news, that holding and using an EV, as a kind of EFVs, has been covered by tax exemption since 2016.³³ Despite

²⁵ Electric and Hybrid Passenger Cars are covered by the *terminus technicus* of Environmental Friendly Vehicles (EFVs) and Electric Vehicles.

²⁶ Point d) Subparagraph (1) Section 124 Act CXXXVII of 2007 on Value Added Tax.

²⁷ Point a) Subparagraph (1) Section 125 Act CXXXVII of 2007 on Value Added Tax.

²⁸ Subparagraph (3) Section 1 Act LXXXV of 2011 on Environmental Protection Product Charges.

²⁹ Act CX of 2003 on Motor Vehicle Registration Duty.

³⁰ According to the Point 9 Section 18 Act LXXXII on Vehicle Tax and Point 8 Part I Schedule of the Act CX of 2003 on Motor Vehicle Registration Duty, EVs, plug-in hybrids and vehicles with zero-emissions are covered by the *terminus technicus* of Environmental Friendly Vehicle.

³¹ Schedule 1 Act CLVI of 2011 on Modifying Certain Acts on Taxation and other Related Acts.

³² Point w) Subparagraph (1) Section 26 Act XCIII of 1990 on Duties.

³³ Subparagraph (1) Section 17/A Act LXXXII on Vehicle Tax.

this, VAT applied at the preceding stage may not be deducted related to the supply of any goods in connection with the operation or maintenance of a passenger car, including EVs.³⁴ Furthermore, deduction of VAT applied at the preceding stage after any service used in connection with the operation or maintenance of them is limited to 50 percent of the VAT.³⁵ On the other hand, local governments are empowered to provide further exemptions for local parking fees.³⁶

Hungary does not levy special taxes on *selling company cars*, but a confusing situation occurs if the company buys a used car from an individual who is taxable in connection with VAT and the company intends to sell this used car in the future. The VAT is paid in the previous stage of taxation after the car, while the individual is not authorized to deduct VAT. Despite the tax-free purchase being permitted for a company, at the stage of selling this used car it also taxable regarding VAT, because the tax exemption is only available if the purchase is connected to a title related to non-deduction, not to a title of tax exemption.³⁷ In this way, VAT is collected twice after the same goods and VAT shall be paid again, while the buyer of the company neither has the right to deduct the VAT paid at that stage.

V. Conclusions

It should be stated that the Government of Hungary made ambitious steps to decrease the emissions of passenger cars by offering tax reliefs after EVs/EFVs and direct state subsidies for purchasing them. Considering the absence of imposing PIT after fringe benefits arising from the use of company cars for personal purposes, it also should be emphasized that tax policy makers shall consider that lower-waged citizens are facing the higher burden of taxation in the proportion of their income. To avoid deepening social impacts of diversified tax policy challenging horizontal equity, personal income tax shall be levied on these revenues in kind at least based on a travel distance measure.

The possibility of deduction of any VAT paid in the previous stage in connection with the purchase of EVs can also be an effective incentive.

As the examples of Norway and the UK show us, the number of EVs/EFVs could be increased on the routes of Hungary by imposing additional taxes on the use of fossil fueled vehicles and offering tax exemptions and other incentives for EVs/EFVs. Furthermore, additional technical solutions could accompany EVs to make the production and consumption of electric power more efficient. As all EVs have relatively huge batteries, they can be considered a significant part of the decentralized system of the storage of electric energy. Since the most important question related to the production of solar energy is the storage of electric power, EVs hand in hand with electric public transportation are to play an important role in Vehicle-to-Grid (V2G) solutions as well.

³⁴ Point c) Subparagraph (1) Section 124 Act CXXVII of 2007 on Value Added Tax.

³⁵ Subparagraph (4) Section 124 Act CXXVII of 2007 on Value Added Tax.

³⁶ Subparagraph (4) Section 15/A Act I of 1988 on Road Transport.

³⁷ Point b) Section 87 Act CXXVII of 2007 on Value Added Tax.

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