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## The fight against tax fraud in Hungary

Tax fraud is a negative concomitant phenomenon known for a long time of most human societies. Where a tax system works, tax fraud occurs, since this category was defined by Platon 2500 years ago.<sup>1</sup> The rate of the tax fraud might be affected by several social, legal, and economical factor, such as the complexity of the tax system, the extent of tax burden, the wasteful appropriation of public funds, the lack of legitimacy of the ruling class, the corrupt operation of the tax administration, or the extent of black market.<sup>2</sup> The inclination of compliance of the taxpayers shows different characteristics in every state, because taxation, as well as the system and operation of the tax system are culturally determined. The Hungarian fight against tax fraud might be also instructive for the countries having a changing economical and social structure. In Hungary, tax fraud existed only in a rather vestigial form during the socialist times, because there was not an operating general tax system that covered all the natural persons and legal persons and all contracts. There were only a few private enterprises and undertakings, who were burdened with individually levied taxes, and the companies of the state sector fulfilled their budgetary payments according to unique tax assessment. The economical changes that enforced the market mechanisms and the establishment of the developed tax system began before the political changes that altered the Hungarian society in 1990. As a result of the first stage of the privatization that began in 1987, the private enterprises and undertakings could appear.<sup>3</sup> Their existence and operation enforced the radical reform of the structure of the public funds and the monetary system.<sup>4</sup> The two-tier banking system, in the center with the Hungarian National Bank (Magyar Nemzeti Bank, MNB), and on the lower

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<sup>1</sup> ALM – JACKSON – MCKEE: *Deterrence and Beyond. Why People Pay Taxes*. Editor Slemrod. The University of Michigan, 1992, 315. p.

<sup>2</sup> LEWIS, A.: *The Psychology of taxation*. Oxford, 1982.

<sup>3</sup> KELEMEN DÁNIEL: A részvénytársaság Magyarországon. [The Ltd in Hungary] *PhD Tanulmányok* 5. PTE-ÁJK. Pécs, 2006, 235. p.

<sup>4</sup> MONORI GÁBOR: „*New ventures in Transitional Economies Comparative Legal System in America and Hungary.*” The Significance of the Last Decade/Papers to commemorate the thirtieth anniversary of the Pécs Faculty of Business and Economic. (Edited by Gábor Rekettye). 2000, 373–399. p.

level with the commercial banks and financial institutions that were able to finance the development needs of the shaping private sector. In that situation, the development of the modern tax system became a significant priority. This economical and social pressure extorted the establishment of the tax system in 1986–1987 among the socialist countries for the first time. Hungary, being ahead with 8 to 10 years among most of the surrounding countries, issued and introduced the value added tax, the corporate taxation, and the taxation of natural persons on 1 January 1988. These changes shocked the people, despite that the government tried to compensate the loss of the income derived from the new taxes, and also tried to make the people prepared for the operation of the new types of taxes. The taxpayers, so the people, understood hardly their new obligations, since they did not have any knowledge of taxation. As Hungarian taxpayers did not have any experience related to taxation for 50 years, these cyclic obligations (for instance tax return, tax prepayment, VAT assessment) in considerable changed their lives of the taxpayers. The establishment of the Hungarian revenue office in 1987 was not supported by a legal regulation of taxation, containing detailed instructions, and this caused further difficulty. This came into force only in 1991 via the Act XCI of 1990.

The main characteristics of the Hungarian tax system from its establishment were the complexity, the low level of taxation knowledge and awareness, and the high rate of withdrawal compared to incomes. According to certain estimations, the amount of untaxed income in Hungary reached 50 billion HUF in 1990, so 7.8% of the tax and customs revenues, meaning 2.4% of the GDP.<sup>5</sup> According to other researchers, the ratio of the untaxed incomes at the beginning of the 90's had been doubled until the middle of the decade. In Hungary the magnitude of the hidden-untaxed economy reached 20% of the GDP in 1988, then, in 1990, 1.3% of the GDP. According to two co-authors (Harsányiné – Fritzné), in this period 17–25% of the annual expense of the Hungarian families, altogether about 3.5–4 billion USD was realized in the black market. Others (e.g. Sík 2000, J. Semlyén – Tóth 2004) believe that, parallel with the economic growth, the decrease of the attractiveness and rate of the hidden economy in the national economy could be experienced between 1998 and 2000, due to the increasing incomes and the increasing economic importance of the large multinational and medium-sized companies within the entire economy.<sup>6</sup> The number of taxpayers increased dramatically, and making the work of the tax authorities even more difficult. In 1988, before the political changes, there were 394,053 registered taxpayers; and eight years later (in 1996) this number grew to its tenfold, to 3,876,620. However, the staff increase of the tax office workers did not follow the increasing number of taxpayers:

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<sup>5</sup> SZATMÁRI LÁSZLÓ: Néhány gondolat az adókikerülés okairól. [The scores of Tax avoidance] *Pénzügyi Szemle*, 1994/3, 215. p.

<sup>6</sup> NAGY IMRE ZOLTÁN: Adócsalás és adónyomozás. [Tax fraud and Tax investigation] *Pénzügyi Szemle*, 1991/1, 12–13. p.

even in 2000 the tax authorities had less than 15,000 hired employees. Additionally, in the 90's the internal migration of labor within the tax authority was incredibly high, having the estimated extend of 8–10%. The continuously changing, inexperienced and underpaid apparatus time could have demolished the effectiveness of the best tax legislation as well. However, the situation on the area of tax legislation was not good either, since Hungarian tax legislation made voluntary tax compliance more difficult, due to its continuous changes. It was a big default of the Hungarian parliament that the tax norms formed in a period of political changes, did not react on the problems related to tax compliance, because these problems were considered as only temporary phenomena that will disappear if the real market conditions develop. However, reality disproved this approach. The famous jurist, Gábor Földes, when examining the tax administration of the 90's, found out that the instruments of the Hungarian law against tax evasion are primitive. This situation has been changed in the 90's by the enforcement of the principle of 'content prior to the form' included in the act on the rules of taxation, and the definition of the requirement of the principle of good faith.

### *The criminal regulation of taxation*

One of the characteristics of the struggle against tax fraud in Hungary is that both the tax authorities and the criminal law tries to take a stand against it on two separate levels. On one hand the tax authorities defined in Article 10 of Act XCII. of 2003, can proceed during the inquiry of the taxation discipline.<sup>7</sup> Four tax authorities operate presently In Hungary with separate powers. These are the tax and financial control administration, the customs and finance guard, the county and metropolitan duties offices, and, regarding to local taxes, the clerks of the local governments. Chapter 6 of the referred act defines precisely the rules of the competence and power. The state tax authority (Hungarian Tax and Financial Control Administration, Adó- és Pénzügyi Ellenőrzési Hivatal, APEH) proceeds in cases related to tax, claiming tax refund, budgetary subsidies, and other public debts to be collected the same way as taxes. The second tax authority, the customs and finance guard shall proceed primarily in cases in respect of customs, registration duties, excise taxation, and taxation of imported products. The municipal tax authority proceeds in respect of cases in connection with local taxes, motor vehicle tax, and taxation of income derived from arable land lease. The fourth tax authority consists of the county and metropolitan revenue offices (altogether 20) that proceed regarding duties on transfer of property. It is typical for the taxation related work of the APEH and the customs and finance guard that their task is not investigation work, but

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<sup>7</sup> *Pénzügyi Jog.* [The Tax Law] (Szerk. Földes Gábor). Osiris Kiadó, Budapest, 2003.

focusing on the taxation documents related to the public payment obligations they analyze whether the taxpayer fulfills his tax liability, and if yes then by what means. Their audit is focusing mainly on the formal fulfillment, and they proceed in case of misdemeanors of lesser degree (late fulfillment, failure of fulfilling the obligation of issuing an invoice, etc.). In the operative Hungarian system, the tax administration also has an independent system of sanctions that is separated from criminal law. These are itemized one by one by the act's chapter 8 called legal consequences. The chapter in question mentions default penalty, self-revision surcharge, tax penalty, default fine, and the "measures" (e.g. confiscation, closing of premises). However, these sanctions are not criminal sanctions, but sanctions of tax law that are established by the authority in a resolution. These legal consequences might be applied only in case of misdemeanors of lesser degree, but can not be applied in case of more serious misdemeanors. The more serious violation of law is reported by the Hungarian Tax and Financial Control Administration (APEH) or the Hungarian customs and finance guard, so these authorities pass the case to the investigating bodies (the police and the public prosecutor's office) proceeding in criminal law cases. The criminal procedure, so the second level of the struggle against tax fraud, starts at this point. Any person is subject to Article 310 of the Hungarian Criminal Code (Act IV of 1978), who, in front of the authority, declares false or conceals fact (data) that is important regarding to the tax liability, and with this or other misleading conduct reduces the extent of the tax revenue, so commits misdemeanor, is guilty of tax fraud. The punishment is 3 years of imprisonment because of felonious tort, if the tax revenue decreases significantly due to the crime. This statutory provision was extended in 1997 by the legislator to the social security contribution and the superannuation tax as well. This means that in Hungary tax fraud may be committed not just on the harm of the narrowly defined taxes, but of other public debts as well. The number of the transpired tax frauds was around 200 cases a year in the beginning of the 90's, that increased up to 480 in 1993, and 953 until 1997. In 1998 more than 5000 cases became known, and this number changed to 1731 in 1999. The considerable increase of 1998 appeared because the special investigating and crime preventing body of the revenue office commenced its operation. This body, having large investigating powers, could conduct an effective reconnoitering work. Unfortunately this organization was abolished in 2000.<sup>8</sup>

By studying the forms of the criminal conduct of tax fraud, it can be stated that the type of the committed crimes changed significantly in the last 15 years. Such a criminal class came into existence in the beginning of the 90's that conducted its illegal activities in an organized manner, by following the changing of the tax, customs, foreign exchange, and excise regulations, using

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<sup>8</sup> MÉSZÁROS BENCE: A fedett nyomozó szabályozásának és alkalmazásának aktuális kérdései. [The rule of the covered tracker] *Belügyi Szemle*, 2005/2. 67–80. p.

excellent experts, and sometimes infiltrating into the political system and public administration.<sup>9</sup>

Between 1988 and 2002, during the first years of the Hungarian tax system, only a couple of dozen crimes occurred, and these were related to taxation of lower importance. The turning point came with the Act LXXIV of 1992 that regulated the VAT refund comprehensively. A new criminal conduct was specified as applying for VAT refund after a fictitious invoice by establishing fictive enterprises. This conduct was qualified by the court order no. 1993/218 simply as fraud, so not as tax fraud, in which the illegitimate application for VAT refund was established. Another typical form of commission was the following: a not registered enterprise applied for postponed customs allowance with false data, then imported oil products in a huge quantity, and did not pay the related fees (e.g. customs, sales tax, VAT, excises, duties). After immediately having sold these products, the owners (shareholders) and employees of the company disappeared, obviously without paying the public debts later either. In this period no excise code or customs code existed in Hungary, and there was no provisions against money laundering in force either, and this supported the commitment of the above referred crimes. Due to the inaccurate regulation of the excise act that came into effect in 1993, in the middle of the 90's the organized criminals became interested in excise goods again, and they took advantage of the legal situation that the oil used for the motor vehicles could be also used for heating and was available for the people for a much lower price. The significant difference between the price of the diesel oil and the volume of tax of the heating oil offered an extremely huge profit for the organized crime. Several hundred thousand tons of diesel oil were bought as heating oil by farmers, contractors, and carriers, but also by municipalities, and in some cases by the military and the ambulance as well. In order to cover these activities, so-called 'invoice factories' appeared in 1994, covering the illegal sale by issuing fictitious invoices. According to the experts, between 1995 and 1996, in the heyday of the oil counterfeit and oil fraud, the Hungarian state suffered a damage of several billion HUF. The number of the investigated misuse of excise was 396 in 1995, 447 in 1996, and was decreased to 10 cases in 1997. Due to the organized and effective measures of the authorities, the criminals had to look for another area of crime after 1996. Therefore, based on the storage capacity of the oil counterfeit, the crime altered, and by violating the rules and provisions of the excise act, wine counterfeit started when a beverage similar to wine but of a poor quality was produced from artificial and other materials, without using fruits, therefore it being harmful to health as well. The vestigial forms of this criminal activity may be experienced nowadays as well. The target of the criminals of Hungarian tax fraud changed completely after Hungary joined the European Union in 2004,

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<sup>9</sup> HAUTZINGER ZOLTÁN: *A magyar nyomozó hatóságok és nemzetközi együttműködési lehetőségei.* [The Hungarian investigator authority] Slovensko a Európska Unia. Bratislava, 2006.

and the number of tax fraud decreased accordingly. Although fictitious invoicing and sales without an invoice have not ended, but, because of the improving technological system of records, now it is more difficult to operate systems subject to tax evasion. However, the smuggling (illegal importation) of excise goods to the European Union via Hungary has risen, focusing particularly on tobacco and alcoholic products.

To sum up, it can be stated that the Hungarian taxation experience of the last 15 years is that the improving living conditions, the measures against money laundering, the continual tax-cuts, and the improvement of the standards of the tax administration can be used together more effectively against the phenomena of tax fraud and black market, than criminal law could react alone.

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AZ ADÓCSALÁS ELLENI KÜZDELEM MAGYARORSZÁGON

(Összefoglalás)

Az adócsalás több mint 2500 éves jelenség, amely minden állam kísérő jelensége, ahol bármifajta adóztatás működik. A magyarországi adócsalás elleni küzdelem rendszerváltás utáni korszakát vizsgálva megállapítható, hogy az 1990-es évek elején sem a közigazgatás, sem a politika nem fordított kiemelt figyelmet e feladatra, úgy vélték ez csupán a piactudomány kialakulásához kapcsolódó átmeneti probléma. Az 1987-ben beinduló privatizáció és a jogi háttér átalakulása modern adórendszer kialakulása egy jól felépített adóigazgatást igényelt volna. Ennek ellenére az első adóigazgatás rendjéről szóló 1990. évi XCI. törvény az adóreformokat követően három évvel jelent meg. A jelentős mértékű fekete gazdaság, az olajszökítés, a csökkenő állami bevételek és az adózók növekvő száma a 90-es évek közepén ráirányította a figyelmet az adóigazgatás hatékonyságának problémájára és az adócsalás elleni küzdelemre. A büntető törvénykönyv is reagált ezekre a kihívásokra és a Btk. 310. §-a meghatározta az adócsalás fogalmát. Ezzel egy időben megszülettek azok az alapvető törvények, mint a jelenleg is hatályos áfa és szja törvény, valamint megszületett az első jövedéki törvény és az évtized végére az adóigazgatás alapelvei közé olyan új elemek kerültek be, mint a szerződések tartalom szerinti elbírálása. A hatékonyabb jogalkotás és az 1998-ban létrehozott speciális adónyomozó szervezet munkájának hatására az adócsalás jelensége nem szűnt meg, csupán átalakult, e bűncselekmény elkövetői egyre felkészültebbé és szervezettebbé váltak, és az általuk okozott károk nagysága jelentős mértékben napjainkra sem csökkent. A 2003. évi erőteljes jogalkotási hullámban új jövedéki, vám- és adóigazgatási törvények születtek és szigorították a közpénzek felhasználásának rendszerét is. Ennek ellenére az adócsalás és a feketegazdaság nagyságrendje érzékelhetően nem csökkent és ugyanúgy kihívást jelent napjainkban az adóigazgatás és a politika számára, mint a rendszerváltás időszakában.