

The opinion of the Hungarian authorities regarding Petition No 1557/2009

The President of the European Parliament's Committee on Petitions requested the opinion of the Hungarian authorities regarding Izabella Győrvári Mészárosné's petition number 1557/2009 submitted in representation of Vállalkozások Érdekvédelmi Szövetsége [Enterprise Interest Representation Association] (hereinafter: petition). In response to the request regarding the petition, we are providing the following opinion of the Hungarian government.

From our perspective, none of the issues or problems raised in the petition suggest the liability of the State of Hungary for having breached EU legislation.

Vállalkozások Érdekvédelmi Szövetsége (hereinafter: VÉSZ), which compiled the petition, lists the factors that afflicted the Hungarian construction sector in 2009. In its written resolution regarding the contents of the petition, the European Commission stated that the Hungarian regulative environment and the ongoing practices of the authorities do not infringe on EU legislation; in addition, the majority of the areas dealt with by the petition fall under the scope of the Member State.

Despite all the above, our opinion is that VÉSZ was justified in raising some of these issues in 2009. Thus, the new Hungarian government that took office in 2010 has taken numerous measures in the past year and a half to solve or mitigate these issues. In addition to an analysis of the current situation of the various problematic areas raised in the petition, our opinion also includes an overview of these measures.

On the issues of chain debts; orders placed without coverage; and fraudulent bankruptcies in general

Chain debts and non-payments resulting from fraudulent entrepreneurial conduct pose serious problems for SMEs in the construction sector. However, the mitigation of these problems requires complex measures affecting numerous areas.

In the interest of decreasing chain debts, a package of measures is currently being prepared with the aim of helping small and medium-sized enterprises at the end of a debt chain to recover their debts. The package could significantly speed up the court proceedings initiated for the payment of invoices, and the conditions providing for the drawdown of bank guarantees could be revised. It would also be possible to manage the financial settlement of the value added tax (hereinafter: VAT) on illegally unpaid contractor invoices; to further develop the chamber's register of contractors that helps filter out abuse; to make certain provisions of Act IV of 1978 on the Criminal Code (hereinafter: Criminal Code) more stringent in the interest of sanctioning non-paying proprietors; to ensure the continued development of the construction trustee; and to introduce electronic construction logs.

Several pieces of legislation were already amended in 2011 to curb fraudulent business conduct. Based on the amendment of Act V of 2006 on Public Company Information, Company Registration and Winding-up Proceedings (hereinafter: the Company Registration Act), the rules for publishing reports in accordance with the Act on Accounting became more stringent as of 1 January 2012. If a company fails to submit its report to the company information service, the tax authority can impose a fine of up to HUF 500 000 already at the time of sending its first notice. In the case of the reports to be published following 1 April 2012, the company information service automatically harmonises the identification data submitted by the company (company registration number, VAT number) with the data in the company register.

In the case of foreign companies, the registration of the foreign company has to be certified once again.

In order to speed up the removal from the market of shell companies that have no funds and are no longer in operation, the chapter of the Company Registration Act dealing with dissolution has been

supplemented with a new type of proceeding called involuntary dissolution. In addition, the rules of Act XLIX of 1991 on Bankruptcy and Liquidation Proceedings (hereinafter: the Bankruptcy Act) on simplified dissolution procedures have also been amended. Courts can rule that the executives and members with majority influence of shell companies have unlimited and joint and several liability for the company's debts, and that they cannot be members or executives of certain other business associations. The amendment of Act IV of 2006 on Business Associations raises from 3 to 5 years the prohibition pertaining to the executives of 'phantom companies' that have been terminated by the Registrar of Companies in the course of judicial supervisory proceedings. The amendment not only increases the time of the prohibition, but also expands the scope of the prohibition to include those persons who were the sole members or members with majority shares in the phantom company during the termination proceedings. Furthermore, the prohibition also states that for a period of 5 years these persons cannot set up companies or acquire shares in companies if this would lead to their becoming sole or majority owners.

On the obligation to pay VAT on sales also applicable to uncollectible debts resulting from chain debts

In the interest of the proper operation of the European Union's internal market, harmonised Community regulations pertaining to VAT are in place, transposed for Hungary in the Value Added Tax Act. Community regulations (Council Directive 2006/112/EC, as severally amended (hereinafter: VAT Directive)) were created with a view to results and not with a cash flow approach: the various obligations and rights are related to actual performance rather than to payment events that can be easily or even arbitrarily scheduled. As a result, the general rule for tax payment obligations is that the sale takes place at the time of the transaction, regardless of whether the value of the transaction is paid or not. Article 66 of the VAT Directive provides a possibility for derogation from the general provisions, which the Hungarian VAT regulations chose not to make use of. Furthermore, in the case of the customer's total or partial non-payment, Article 90 paragraphs (1) and (2) of the VAT Directive provides a possibility for Member States to refrain from reducing the taxable amount, thus the Hungarian regulation is not contrary to Community legislation.

The transposition of Directive 2011/7/EU on combating late payment in commercial transactions is currently in progress, and will be implemented in part when the new Act on the Civil Code is passed.

Between 1993 and 1996, Hungarian VAT regulations contained a provision on waiving the tax payment obligation on uncollectible debts. However, this led to numerous cases of abuse and tax fraud, thus a decision was made to do away with this provision. The general introduction of the old rule would not be expedient, especially considering, among other things, that the provision that linked reclaiming VAT to the payment of the purchase invoice was repealed since the submission of the petition. Another reason is, unfortunately, a rather common tax fraud method that involves, as *one* of its central elements, actions that cause the liquidation of the company. If the provision is enacted, the VAT content of the invoice issued to a company that has become insolvent does not have to be paid, or it can be reclaimed by decreasing the taxable amount. However, it would not be possible to collect this same tax from an insolvent company that is subject to liquidation proceedings and which had already exercised its right to deduct and reclaim VAT in the tax period corresponding to the performance date. According to our standpoint, this would only lead to more abuse.

Furthermore, based on the experience, waiving the tax payment obligation did not significantly influence the prevalence of chain debts, as it has no effect on customers' willingness to pay. Vendors' finances would also improve only marginally, as the value corresponding to the VAT base would still be unpaid. In addition, such a measure would result in the state unduly assuming part of the inherent business risk, which would not serve the development of a suitable business environment.

On reverse charges

The VAT Directive provides for reverse charges in only a limited number of cases, which does not include the sale of construction materials. Such a measure cannot be introduced in the interest of improving corporate liquidity. Furthermore, exercising the right of reverse charging in the tax return filed for the settlement period is a unique characteristic of the VAT system that cannot be changed in view of potential liquidity problems of the taxpayers involved in the reverse charge transaction. (Even the VAT Directive does not provide a possibility for Member States to apply derogations to the general rules of tax deductions and tax returns because of potential liquidity difficulties of the taxpayers involved in reverse charge transactions.)

On the time-consuming nature of VAT refunds

Companies have to pay the amount of VAT due on their sales – decreased by the amount of VAT paid on their purchases – per tax return periods. As a general rule, companies submit VAT returns quarterly; micro-enterprises must submit annual, and larger companies, monthly returns. Act XCII of 2003 on the Rules of Taxation (hereinafter: Taxation Act) provides a possibility for companies to choose to submit returns more frequently (especially if the company regularly claims VAT refunds – if it is in the process of implementing an investment or if the VAT payable on its sales is lower than the VAT reclaimed on its purchases). This possibility provides companies with well-balanced conditions: they can compare the additional administrative burden involved in more frequent returns with the advantages of cash flow, and choose the solution that is the most advantageous for them. As of September 2011, invoice payment is no longer a precondition of reclaiming VAT on them. However, to combat VAT fraud (to provide a longer period for auditing), the Act established a general deadline of 75 days for the tax refund as of 1 February 2012. However, a measure was introduced simultaneously in order to encourage payment, providing for a deadline significantly shorter (30 days for amounts below, and 45 days for amounts over HUF 1 million) than the general deadline in cases where the taxpayer has settled the invoices in full on which VAT is reclaimed.

On the application of a reduced VAT rate in certain EU Member States (i.e. Belgium and Spain) for the construction or refurbishment of homes (page 22 of the petition):

Based on the analyses we are aware of (i.e. the European Commission's 2003 report on the Experimental Application of a Reduced Rate of VAT to Certain Labour-Intensive Services (COM(2003) 309) and Copenhagen Economics' 2009 analysis entitled Reduced VAT for Environmentally Friendly Products), VAT rate reduction is a very low-efficiency instrument in terms of the achievement of various economic or socio-political targets. At the same time, the reduction of the VAT rate is not necessarily reflected in consumer prices, but can result in significant decreases in budgetary revenue, which would be counterproductive to the current aspirations aimed at state budget consolidation.

On tax authority proceedings

During the course of its audits, the Hungarian Tax and Customs Office proceeds in accordance with the provisions of the Taxation Act, including respect for taxpayer's rights. In its proceedings, the authority also applies preventive sanctions if it uncovers infringements, during the course of which it is however obligated to proceed equitably, to the extent allowed by relevant legislation and the specific circumstances. In addition, the tax authority also proceeds equitably by decreasing the tax owed and approving payment facilitation if the conditions stipulated by relevant legislation are met. However, if the tax authority uncovers a crime, it is obligated to take the necessary measures, of course without discrimination and by treating all taxpayers equally.

Please note that in 2011, non-private taxpayers submitted a total of 65 940 applications for payment facilitation to the tax authority, which totalled HUF 194 767 million. The number of final decisions in 2011 amounted to 61 767, of which 19 % granted, 31 % partially granted, and 29 % rejected the application; 20 % terminated the proceedings and 1 % contained amendments falling within the

competence of the authority. According to the payment facilitation practice which has been in place for years, the tax authority generally grants the first application, unless there are grounds for disqualification. Taking only this into account, the proportion of final decisions granting the request (65-70 %) is significantly higher. Based on the final decisions in 2011, rejected applications involved a total of HUF 82 397 million, while approved applications covered HUF 103 600 million. Based on this data, the rate of approved applications among the affected taxpayers was 57 %. The data given above show that within the legal framework, the tax authority strived to help the affected taxpayers in all cases. We therefore feel that the comment included in the petition is unjustified.

In order to prevent tax revenue losses and the unauthorised use of budgetary support and VAT claims, the tax authority regularly audits taxpayers and other persons participating in the taxation system. During the course of such audits, the auditors, in line with the provisions of the Taxation Act, audit and establish whether the obligations set forth in the Taxation Act and other relevant laws have been fulfilled.

As can be seen from the data published annually, in 2009, the year the petition was submitted, resolutions of the second instance ordering the amendment of proceedings, the institution of new proceedings, or the termination of proceedings were passed in only 2.4 % of all resolutions brought in audits (91 284); the same ratio for 2010 was only 1.5 % (96 542). Taking into account all administrative resolutions, this ratio was 0.9 % in 2009 and 0.67 % in 2010. We believe that it follows from all of the above that the tax authority renders decisions that are professionally and legally fundamentally well founded.

Thus, the petition's finding that the tax authority brings unlawful decisions in the interest of fulfilling 'premium' conditions and later nullifies these decisions is decisively rejected, as – based on the above – this is not proven by either statistical data or the bodies responsible for the external auditing of the tax authority. We feel that the objections included in the petition pertaining to the proceedings of the tax authority are unfounded.

On the accessibility of funding sources available to SMEs through tendering

The new government was not satisfied with the amount of support available for small and medium-sized enterprises through tendering. Therefore, in addition to providing a new development policy framework for support systems, it restructured tenders, regrouped resources, simplified the procedure, and even sped up the payment process. In 2011, the Új Széchenyi Terv [New Széchenyi Plan] increased the funds allocated to supporting SME developments. In recent months it has also been possible to speed up the adjudgment and payment processes. Close to 44 % of the Gazdaságfejlesztési Operatív Program [Economic Development Operational Programme] was committed by the beginning of 2012, with payments exceeding 30 % of the overall budget.

On inadequate financing and the bank sector's general approach

The new government, too, is aware of the difficulties SMEs face when applying for bank financing. This is why its first measures after taking office included steps to remedy this situation, and since then it has taken several further steps in this direction. The government has taken the following measures during the past year and a half in the interest of motivating the provision of credit to small and medium-sized enterprises:

- The government's first measures included broadening the scope of the Széchenyi Kártya [Széchenyi Card] programme, previously used solely as a current account loan, for use in the sphere of liquid assets, finances for own funds in investments and tenders, and agriculture. In the framework of the new programme, the government provides support for interest and guarantee fees for the entire credit.
- The Új Széchenyi Terv included the development of a system of financial instrument conditions operated in accordance with the JEREMIE initiative funded from the Regional

Development Fund. The amounts of available credits were increased, new plans were introduced (i.e. combined microloans combining non-refundable and refundable grants), and former finance programmes were also given impetus. Compared to other Member States, JEREMIE-based financing in Hungary includes much higher amounts, and the allocated amounts have significantly sped up in the last year.

- The government increased the extent of the counter-indemnity payable by the state for guarantees provided for SME loans by the two large Hungarian guarantee organisations (Garantiqa Hitelgarancia Zrt. [Garantiqa Credit Guarantee Co. Ltd.] and Agrárvállalkozási Hitelgarancia Alapítvány [Rural Credit Guarantee Foundation]) from 70 % to 85 %.
- The government concluded an agreement with banks in December 2011, enabling banks that increased the value of outstanding MSME loans by 30 September 2012 to deduct the value of this increase from their 2012 bank tax base. The baseline for the calculation of the increase in the value of loans outstanding was 95 % of the value of loans outstanding on 30 September 2011.
- In addition to the above, the government is also considering the introduction of further financing instruments.

On the objection regarding financial reporting

The publication of financial reports is mandatory for all business entities registered at the Registrar of Companies, without exception. Companies deposit and publish their financial reports in one step, by electronic submission of the report and related documents. If they fail to do so, they will be liable to progressive penalties culminating in company liquidation, as defined by Article 174/A of the Taxation Act, applicable to all small and large companies subject to the Accounting Act, whether they are Hungarian or foreign-owned. The tax authority automatically verifies whether the obligation has been met, and the procedure is conducted in the case of all taxpayers, with no discrimination.

Budapest, 21 April 2012