In 1990, the Hungarian system of local governance was substantially changed, with a recognition of the principles of local autonomy and the reassertion of historical local rights. The Act on Local Self Government (1990) eliminated 1523 local councils that had acted as agents for the central government in a system of nineteen county councils. Further, local governments were given responsibilities on an exceptional scale (Davey and Peteri, 1998). Hungary’s municipal tax system has also experienced radical changes since 1992. The previous system was replaced with one that made it possible for the majority of local taxes to be imposed on non-residents. The use of the Business Tax by local governments became widespread. At the same time, most municipalities terminated taxes on residential properties, with the consequence of enhanced political popularity for local officials. Since then, the need for local revenue as restraints on transfers were imposed by the national government drove many to reinstate the Building Tax, Plot Tax or the Communal Tax. Towards the end of the 1990s, property taxation has been pushed into the spotlight again, as local governments search for more revenues. Many municipalities continue levying size-based Building Taxes on business properties and Communal Taxes (the most widespread land-based tax in Hungary) on residential properties to generate revenues. However, as there is no statutory requirement to levy local taxes, tax policy, and administrative practices vary widely from one municipality to the next.

I. The Structure of Local Government

Hungary is a unitary state and a parliamentary republic. There are 3,156 local governments, 2,844 of which have a population of under 5,000 inhabitants. There are 19 counties and four types of communal entities in Hungary. These are: 2,920 less populated communities (36.8%); 173 cities (24.2%); 20 large cities with county rights (19.5%); and Budapest, the capital with nearly 2,000,000 inhabitants, which is divided into 23 districts with special status (19.5%). (Population shares in brackets).

The Act on Local Governments (LXV 1990) sets out provisions for county and local government and determines the basic principles of the separation of central and local affairs. Local governments constitute a system in which there are no hierarchical relations. Their decisions are subject to revision only by the Constitutional Court or, if there is a breach of the law, by the local courts. Generally state bodies have only normative control over local governments. Parliament regulates the legal status, exclusive tasks and functions, mandatory organs, guarantees of operation, financial means and basic rules of the economic management of local governments. It also regulates the legal status of the representatives of the local government, the order of the elections, and their rights and duties.

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1 Prepared by Almos Tassonyi, Ontario Ministry of Finance, Toronto. This paper is partly based on earlier work done with Akos Szalai for the Canadian Urban Institute with the assistance of the Canadian International Development Agency. It does not reflect the official position of the Ontario Ministry of Finance.

2 See Bird, Ebel, Wallich (1995)

Local governments are legal entities and may pass by-laws. Their tasks and functions are the responsibility of the representative body headed by the mayor. Local governments may voluntarily undertake any local matter not covered by legal provisions and not within the responsibility of another authority. There is also a widely held view that limitations on either the revenue or expenditure side of the municipal budget would be an improper intervention in local affairs on the part of the national government.

With respect to taxation, county governments are not entitled to levy local taxes. Their fiscal resources are based on revenues other than levying direct local taxes. Local governments dispose of their own property and manage their budgetary revenues and expenses independently. Between 1991 and 1997, the revenues of local governments grew significantly (in nominal terms) and the share of local own-source taxes went from 2.45% to 9.31% of the total revenues of local governments. Estimates for 2001 indicate that local own source taxes for 2001 will reach 13.6% of total local government revenues.

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Revenues of Local Governments in 1991, 1997 and 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Revenues of Local Governments in 1991,1997 and 2001</td>
</tr>
<tr>
<td></td>
<td>1991 Revenues</td>
</tr>
<tr>
<td></td>
<td>(Million HUF)</td>
</tr>
<tr>
<td>Own Revenues</td>
<td>61,156</td>
</tr>
<tr>
<td>of which own taxes</td>
<td>9,478</td>
</tr>
<tr>
<td>other own revenues</td>
<td>51,678</td>
</tr>
<tr>
<td>Shared Revenues</td>
<td>47,019</td>
</tr>
<tr>
<td>Governmental Grants</td>
<td>190,672</td>
</tr>
<tr>
<td>of which Normative Grants</td>
<td>148,528</td>
</tr>
<tr>
<td>Transfer from other public authorities</td>
<td>68,722</td>
</tr>
<tr>
<td>of which social security fund transfers</td>
<td>67,087</td>
</tr>
<tr>
<td>Capital revenues</td>
<td>15,095</td>
</tr>
<tr>
<td>Debt</td>
<td>1,064</td>
</tr>
<tr>
<td>Other revenues</td>
<td>2,792</td>
</tr>
<tr>
<td>Total</td>
<td>386,520</td>
</tr>
</tbody>
</table>

II. The Current Tax System

Local taxes are regulated by the Law on Local Taxes (Act C.1990). At a statutory level, the national government only regulates the general framework of local taxes. Municipal governments are empowered to decide which of the available local tax types to introduce and to determine the rates within legal limits.

Local governments are entitled to introduce taxes on property, communal taxes, and local business taxes. Within local government jurisdiction, tax liability applies to real property and related rights of financial value, to employment, to temporary residency, and to the pursuit of an entrepreneurial activity defined in the Act.

The right of taxation of local governments includes the right:

- to introduce any or all of the taxes set in the Act, and to repeal or amend taxes already in effect. However, any amendment instituted during the year may not increase the tax obligations of taxpayers arising during the same calendar year;
- to establish the date of introduction and the period of levying a tax (for a definite or indefinite period);
- to define the tax rates with due consideration of local characteristics, the financial requirements of the local government, and the capacity of taxpayers, in observation of the upper limits (maximum tax) prescribed by the Act.

The following restrictions apply, however:

- in respect to any particular taxable item, taxpayers may only be ordered to pay one type of tax as selected by the local government;
- within the sphere of taxes levied on property, the taxes should be assessed in a consolidated form, either as an itemized sum, or on the basis of the adjusted market value;
- no tax rate may be introduced above the maximum tax;
- district governments may not utilize taxes introduced by the City Council of Budapest until the repeal of such taxes. (Hogye, 2000, p.231)
Table 2. Local taxes collected by Hungarian local governments, 1998

<table>
<thead>
<tr>
<th>Tax type</th>
<th>Number of local governments</th>
<th>Tax revenue (billion HUF)</th>
<th>Proportion (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property tax</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>housing</td>
<td>215</td>
<td>13 522*</td>
<td>10.0*</td>
</tr>
<tr>
<td>non-housing</td>
<td>633</td>
<td>1 958</td>
<td>1.5</td>
</tr>
<tr>
<td>Plot</td>
<td>388</td>
<td>1 958</td>
<td>1.5</td>
</tr>
<tr>
<td>Communal tax</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>private</td>
<td>1 525</td>
<td>2 443</td>
<td>1.8</td>
</tr>
<tr>
<td>Corporate</td>
<td>825</td>
<td>1 161</td>
<td>0.9</td>
</tr>
<tr>
<td>Tourism tax</td>
<td>482</td>
<td>2 115</td>
<td>1.6</td>
</tr>
<tr>
<td>Business tax</td>
<td>2527</td>
<td>113 652</td>
<td>84.3</td>
</tr>
<tr>
<td>Total</td>
<td>2 672</td>
<td>134 851</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Ön Kor Kép (March, 1999) Balas and Kovacs, 1999, p.7
Note: * The two types of taxes on structures taken together

The Act on Local Taxes provides the authority for the six types of taxes that can be levied by local governments.

Local Business Tax

This tax is levied by most local governments and is not a land-based tax. The tax base for business activities is the net sales revenues of products sold or services provided, less the purchase value of the goods sold, and the value of services provided by subcontracts, and less material costs. The taxable base is the net value of goods sold and services rendered (excluding VAT), less consumption tax paid. The tax rate may not exceed 0.014 (1.4%) times the business entity’s taxable base. In 1998, this tax raised approximately 84% of the total local taxes levied.

Communal Tax on Private Individuals (Poll Tax)

Communal taxes may be levied on individuals owning dwellings or plots of land. The tax may not exceed HUF 12,000 per dwelling or plot per year. Garzon (1998) comments that from a revenue perspective, the communal tax on dwellings partially substitutes for taxes on real estate. Over 60 per cent of the local taxing jurisdictions used this tax but its yield is less than 2 per cent of total local taxes levied.

Communal Tax on Entrepreneurs (Payroll Tax)

Communal taxes may be levied on entrepreneurs who have a seat or permanent establishment within a municipality. The tax base is the average number of people employed. The annual maximum rate of tax is HUF 2,000 per employee.

Land Parcel Tax (Plot Tax) (Tax On Undeveloped Plots or Vacant Urban Land)

This tax can be levied on the owner of undeveloped parcels of land situated in central areas within the area of jurisdiction of a local government. It is essentially on the unimproved value of land plots larger in size than the average in a municipality, as set out in the master plan. The Act also provides detailed specifications on exemptions. The local government may choose to use either the actual area of the parcel as calculated in square meters or the adjusted market value of the parcel as the tax base. The annual maximum rate of tax is HUF 200/sq.m.,
or 3 per cent of the adjusted “corrected” market value. “Corrected” or “adjusted” market value is 50 per cent of the market value as determined by the local government as set out in the Act on Local Taxes (1990). (Garzon, 1998, p.5; Balas, Kovacs, 1999, p.17) In 1998, this tax raised approximately 1.5 per cent of local taxes levied.

**Building Tax**

Tax can be levied on the owners of all types of buildings. The local government may choose to use either the useful surface area or the adjusted market value of the building as the tax base. The annual maximum rate of the tax is HUF 900/square metre or 3 per cent of the adjusted market value. 4 Virtually every municipality that uses this tax appears to employ the area basis. 5

The Act sets out buildings which are exempt from this tax, including temporary residential dwellings, premises used for the purposes of social welfare, health care, child care and educational institutions, buildings owned by budgetary organizations, public service and religious organizations, etc.

**Tourism Tax**

The tourism tax may be levied on non-residential individuals who spend more than 48 hours in a municipality, or who own a holiday dwelling which does not qualify as a permanent home. The tax base is the number of guest nights spent, or the lodging fee for a guest night, or the net floor space of the building. The upper limit of the rate of tax is HUF 300 per person and per guest night, or 4 per cent of the lodging fee; or HUF 900/square metre payable annually for the building.

**Exemptions**

Municipalities have unlimited rights to employ tax-exemptions and tax-allowances. However, the ‘Law on Local Taxes’ terminated all previous tax exemptions except for the ‘House-Tax’ exemption, which shelters many houses from the Building Tax but not from the Communal Tax which has a lower capacity to generate revenue. Although the House-tax was terminated in 1991, before then local councils could give 30-year exemptions for new houses, a practice that will continue to reduce the tax base for years to come. Partly for this reason, the Communal Tax on residential properties is more popular with municipalities.

**Historical Background**

With the exception of the business tax, these local taxes essentially extended the pre-existing tax system of the old regime. The new localities were given the power to levy any or all of these taxes. Bird and Wallich (1992) describe the transitional arrangements for 1991, noting the expectation that municipalities would chose to maintain nominal revenues.

One of the most significant obstacles to the wider implementation of property taxation in

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4 According to Gabor Peteri and Mihaly Lados, “Local Property Taxation in Hungary,” in W. McCluskey, ed., *Property Tax: An International Comparative Review* (Aldershot, UK: Ashgate, 1999), p. 430, if value assessment is used, the “assessed value” is mandatorily set at 50% of the market value, reportedly because “it is reasoned by the legislators that to levy a tax based on full market price would be unfair, given that there have been relatively few market related transactions.” [Note added by editors]

5 Peteri and Lados, 1999, p. 431, assert that “the only exception is the municipality of Nyiregyhaza, which introduced a value based property tax for non-residential buildings. Here, the tax administration has a unique administrative arrangement where the tax department and the Fee Department [Duty Office] are part of the same organization sharing a common database system. This enables the municipality to be able to administer the ad valorem property tax because of the provision of adequate technical expertise.” [Note added by editors]
Hungary is that municipal taxation is not mandatory. About one-fifth of the municipalities do not levy any local taxes. Table 2 shows the extent of the differences in local tax policies.

The most significant local tax is the Business Tax. Generally, the largest cities (e.g. the cities with county status in Table 1) levy this tax, but many small municipalities try to avoid using it.

**Agricultural Land**

The tax treatment of agricultural land appears to be optional at the local level. In Jaszberenyi, buildings up to 100 square meters used for agricultural production were exempted from building taxes. The exemption was widened as the Act was modified. Farmers running small-scale businesses with net sales of up to HUF250,000 are exempted from the communal tax on business (Hogye, 2000, p. 237).

**Table 3: Local Taxation in the Cities with County Status, 1998**

<table>
<thead>
<tr>
<th></th>
<th>Business Tax</th>
<th>Building Tax</th>
<th>Plot Tax</th>
<th>Communal Tax</th>
<th>Number of taxpayers</th>
<th>Revenue (thousand HUF)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Békéscsaba</td>
<td>5,921</td>
<td>2.246</td>
<td>Bus. 4,501</td>
<td></td>
<td>931,000</td>
<td>121,000</td>
</tr>
<tr>
<td>Debrecen</td>
<td>20,828</td>
<td>22,226</td>
<td>984</td>
<td>15,601</td>
<td>2,506,000</td>
<td>290,000</td>
</tr>
<tr>
<td>Dunakeszi</td>
<td>2,085</td>
<td></td>
<td></td>
<td></td>
<td>2,409,042</td>
<td></td>
</tr>
<tr>
<td>Eger</td>
<td>3,686</td>
<td>7,901</td>
<td>487</td>
<td>22,090</td>
<td>827,038</td>
<td>65,892</td>
</tr>
<tr>
<td>Győr</td>
<td>2,772</td>
<td>12,540</td>
<td></td>
<td></td>
<td>2,381,965</td>
<td>190,581</td>
</tr>
<tr>
<td>Hódmezővásárhely</td>
<td>2,514</td>
<td>238</td>
<td>76</td>
<td>12,240</td>
<td>526,132</td>
<td>78,351</td>
</tr>
<tr>
<td>Kaposvár</td>
<td>7,368</td>
<td>2,161</td>
<td>.310</td>
<td>23,812</td>
<td>781,349</td>
<td>95,572</td>
</tr>
<tr>
<td>Kecskemét</td>
<td>4,000</td>
<td>5,900</td>
<td></td>
<td>8,300</td>
<td>1,255,298</td>
<td>170,000</td>
</tr>
<tr>
<td>Miskolc</td>
<td>4,112</td>
<td>15,915</td>
<td></td>
<td></td>
<td>2,330,928</td>
<td>216,080</td>
</tr>
<tr>
<td>Nagykároly (1997)</td>
<td>2,718</td>
<td>2,835</td>
<td>Bus. 2,220</td>
<td></td>
<td>422,779</td>
<td>137,385</td>
</tr>
<tr>
<td>Nyíregyháza</td>
<td>4,097</td>
<td>1,222</td>
<td></td>
<td></td>
<td>1,468,309</td>
<td>140,596</td>
</tr>
<tr>
<td>Salgótarján</td>
<td>3,368</td>
<td>675</td>
<td>Bus. 3,596</td>
<td></td>
<td>553,916</td>
<td>136,500</td>
</tr>
<tr>
<td>Szeged</td>
<td>6,025</td>
<td></td>
<td>4,408</td>
<td></td>
<td>869,600</td>
<td></td>
</tr>
<tr>
<td>Székesfehérvár</td>
<td>4,671</td>
<td>20,005</td>
<td></td>
<td></td>
<td>2,618,267</td>
<td>94,000</td>
</tr>
<tr>
<td>Szolnok</td>
<td>8,758</td>
<td>9,074</td>
<td></td>
<td></td>
<td>2,201,215</td>
<td>16,000</td>
</tr>
<tr>
<td>Szombathely</td>
<td>6,148</td>
<td>877</td>
<td></td>
<td></td>
<td>1,278,594</td>
<td>145,968</td>
</tr>
<tr>
<td>Tatabánya</td>
<td>3,849</td>
<td>8,348</td>
<td></td>
<td></td>
<td>1,431,330</td>
<td>110,000</td>
</tr>
<tr>
<td>Veszprém</td>
<td>4,335</td>
<td>6,998</td>
<td>Bus. 3,356</td>
<td></td>
<td>545,698</td>
<td>84,700</td>
</tr>
<tr>
<td>Zalaegerszeg</td>
<td>1,887</td>
<td>7,882</td>
<td></td>
<td></td>
<td>1,009,990</td>
<td>295,140</td>
</tr>
</tbody>
</table>


**Other Land Related Taxes and Legislation**

*Law on Duty on Property Transfer* (Land Transfer Tax)

Duties are payable on obtaining property by a gratis transfer (inheritance, donation) and when

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6 If the entrepreneur has permanent commercial activities in the areas of more than one jurisdiction, the tax base is divided.

7 In Hungary there is a two-tier municipal system which consists of local and county municipalities. The exceptions are cities with county right and Budapest, the capital. Most of these cities are the capital of the county. They have special functions which have to be fulfilled at the county level as well as within their boundaries.
property is obtained for a consideration (OECD, 1999, p.29). Generally the duty is based on the market value of the property. The County Duty Office (Illetek Hivatal) has the responsibility to determine the market value of the property being transferred. The Law on Local Taxation requires that the basis of assessment of an individual property in the case of ad valorem taxation should be calculated in the same manner. Further, municipalities also assess the value of some real property for certain legal purposes (and issue the so-called Tax Value Certification), but the Duty Office may revise this value specifically for the purpose of this tax.

With respect to property obtained for a consideration, the general tax rate is 10%. For residential property, it is 2% for the first four million forints (HUF) and 6% for the rest of its value.

The common feature of all types of tax on acquired property is that the tax is independent of the manner in which the property is obtained and the tax is to be paid by the beneficiary in proportion to the actual ownership ratio. The tax law provides for tax allowances and even exemptions from the tax obligations. The base calculation is specified in statute and cannot be deviated from by the duty office. The revenues from this duty are shared with the central government.

Law on Tax Administration

The administration of all taxes is governed by a single law. Because an ad valorem property tax is not yet in place, this law has been designed to suit the administration of other forms of taxation, especially income and sales taxation. In considering a broader implementation of property taxation, the key implication of this statute is the legal requirement that each Hungarian tax process is based solely on the information collected from the taxpayer’s tax returns. Although the municipality is entitled to some information on the ownership, physical parameters and the value of the property, the property may not be taxed and the tax base may not be determined unless the taxpayer files a tax return. A field investigation or “valuation process” may be conducted only as part of the tax audit process if the taxpayer does not submit the return or the administration suspects that the return contains false information.

Security of Personal Data

There is a general obligation applicable to the Hungarian taxation system that all data related to tax payment is confidential. Thus, the value of real property in the case of a duty process is ‘personal data’, so the local tax administration is not allowed to use this specific information to assess the value of a specific property.

Local Tax Administration

Among the impediments to the implementation of a local property tax system in Hungary is that the local tax administration generally does not have the capacity to administer such a tax. Some of the problems stem from gaps in the legislation and others from lack of experience in property taxation.

Identification of the Tax Base The current local tax system in Hungary is based on the principle of self-identification. Taxpayers have the obligation to register and report their tax obligations to the local tax administration. In practice, the responsibility of self-registration is not fully effective as not all owners comply. Consequently, the number of potential local taxpayers or taxable assets is generally unknown (Kopanyi et al, 2000, p.26).

The determination of tax liabilities also entails a verification of the self-assessment submitted by the taxpayer for the particular tax. For the current tax on buildings and on idle urban land
(plots) the verification of the size of the properties rather than their market value is required. This verification has to be done at least once in the field. It appears that verification is required upon notification to the tax authority of a change to the property rather than on an annual basis.

In 1999, of 3200 local governments, only two municipalities used market valuation data in determining local taxes levied on business properties. There appear to be both legal and bureaucratic impediments to the use of market value information used for land transfer tax purposes as the basis of the plot tax or the tax on buildings.

*The Assessment Method*

Municipalities do not have enough experts to appraise the value of all properties in their districts. While manpower issues can be resolved through training or contracts with outside assistance, the central government currently does not provide municipalities with enough information or legislative authority to make these assessments either. In Hungarian legislation, the use of the term ‘market value’ is not a sufficient basis for the introduction of mass appraisal techniques for several reasons including the fact that the legislation does not recognize that market value may in reality change from month to month and the law does not define the date of the base. (Szalai and Tassonyi, 2000) The Law on Duty also requires that valuation be based on the sales comparison method, but in Hungary there is no tradition of property taxation so that an understanding of the technical issues involved in making comparisons is lacking (what does ‘similarity’ mean, how are different properties to be compared, etc.).

*Administration of Information*

The information to support a fiscal cadastre or mass appraisal on a consistent nation-wide basis is fragmented between the two levels of government. The legal cadastre is managed by the Land Offices, which are deconcentrated agencies of the Ministry of Agriculture. They are organized by counties, with 109 local units under the county offices plus 22 district offices in the capital. The property information comprises the owner’s identification, use of the property for both land and buildings, and legal information. The information is categorized by parcel numbers and maps. A digitalisation program is underway. No information on value is retained by these offices (Davey and Peteri, 1998, p. 95). At the local level, the Duty Offices (Illetek Hivatal) keep records of transactions. The nineteen county Duty Offices and the 23 offices in the capital operate within the local government administration, under the direction of the County Notary. Information is gathered on the value of transactions (sales, inheritance or gifts) and work is done on valuations. However, the Duty Office may not provide the municipalities with precise information on the actual prices because of the legislative provisions around confidentiality. Tax departments and technical departments within local administrations also have access to property information. The tax departments collect information on residential units. Technical departments maintain registers of building permits, local master plans for land-use zoning and information on public utility infrastructure. Unfortunately, these data bases are usually not integrated.

*Incomplete Tax Returns* Given the lack of a governmental inventory process, citizens should...
probably be required to provide information about the physical parameters of the real property, but it is unlikely that each citizen will be able to correctly complete a very detailed tax return containing detailed questions. Municipalities also lack the personnel to make field inspections (tax control process) of each property in the immediate future.

**Lack of Control Databases** Municipalities have very little information that can serve as the basis for picking out ‘false and suspicious’ tax returns. Although local Building Offices have collected the main parameters of each building built or renovated since January 1st 1998, as part of the process of building permit documentation, this data has often not been stored in a computerised database, and the older information is incomplete and not readily available.

**Collection Issues**

**Arrears and Penalties**

Tax arrears, according to a recent study (Garzon, 1999 as cited in Kopanyi et al. 2000) fluctuate broadly from one municipality to another, ranging from 11 percent of current local tax revenues to 2 percent. However, arrears in this context refers only to those taxpayers who have made partial payments of their tax obligations. They do not include the arrears of those who are registered but have made no payments at all, or those who have not even registered. Therefore, the potential magnitude of unpaid tax obligations is greater than the arrears reported by the cities.

Sanctions for non-payment are strict. The first step is to levy a penalty or fine related to the delay in payment. A failure to pay after a certain period may result in an immediate collection of the total tax due or the initiation of the process to withdraw a business licence. For communal and building taxes, the possible sanctions are the garnishment of benefits, wages, and pensions, or the confiscation of mobile assets. In cases involving large amounts of tax arrears, the taxpayer’s property can be mortgaged or the local government can file a foreclosure request. In practice, these sanctions have rarely been used in any of the cities that have been the subject of comparative studies.

**Enforcement** The problem of enforcement remains unsolved in the case of taxes on residents. At present, a large percentage of unpaid taxes relate to local businesses. This fact should make enforcement easier because the companies are required to inform the tax administration of their bank practices and in many cases they have assets such as vehicles that can be seized. However, non-businesses do not have to register their bank accounts with the tax administration and do not always have high-value ‘movable’ properties to be seized. The seizure of the (movable and immovable) properties of non-payers (physically or by securing a lien) should serve as an adequate enforcement mechanism. Garnishing from personal income should be made easier and the municipalities should get information about the employer of the taxpayers from the social contribution databases (from the Central Tax Office). Stopping PIT-repayment could also be employed.

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9 The administration has the right to stop payment from this account until they pay the tax.

10 It seems that the seizure of movable properties is a well-functioning tool especially in case of vehicles.

11 Stopping the company tax-repayment is a well-functioning method in order to collect the unpaid Business Receipts Tax.
V. Tasks for National Legislation

Property tax policy has three main components: (i) the definition of tax liability (who pays taxes, on what basis and with which ‘rates’), (ii) the assessment method and (iii) mitigation issues. This section summarises the tasks of central legislation and municipalities in the policy-making and administrative process.

Tax liability

Taxpayer Current legislation defines the owners of each parcel of local real property as the taxpayer in the case of building, parcel and tourism tax. In the case of the Communal Tax the taxpayer is the private owner of the residential property and the tenant of a dwelling not owned by a private person (e.g. municipal flats).12

Rates Some studies have suggested that there is capacity within the existing system to increase the tax yield from land and property based taxation. Garzon (1998) summarizes the situation in six municipalities in which rates vary between 8 per cent and 33 per cent of the maximum rate set by the legislation. Other studies suggest similar patterns for different municipalities (Hogye, 2000, p.233-236). A significant feature of the Hungarian local tax system that will have to be confronted is the lack of a mandatory tax. The relative cost of maintaining an up to date assessment base is significant, and centralised assessment would be desirable, so a local property tax is only worth implementing when all municipalities have to implement it.

Market Value (Capital value) Experience in Hungary stresses that a simple legal declaration of market value is not enough.

National vs. local assessment

Current Hungarian law defines assessment as a local task. This seems to be one of the main impediments to the implementation of an ad valorem property taxation system. In the Hungarian case, it is rational to keep the assessment function under the control of the central government. This is also likely to be a more economical solution – there is evidence of economies of scale in property assessment.13 This solution is also likely to be less vulnerable to local political pressure; in many cases local assessors may face political pressure to undervalue the property of politically important owners. The centralisation of this function can also provide direct information for tax-base equalisation as well.

Current Hungarian Legislation as the New Form of Allocation of Responsibility

In 1996, the Ministry of Finance drafted an amendment to the Law on Local Taxes. The goal of the legislative proposal was to introduce an ad valorem local property tax. The draft bill defined a range of average unit values for eleven types of residential and commercial property

12 The other option would be that the first liability is on the occupier (tenant) in the absence of owner-occupancy. Although such a change could have a positive effect in Hungary, as owners would have an incentive to inform the tax authority about their rental contracts (currently, most rental income is in the grey economy as owners try to evade income taxation), but as there are more tenants than owners, administrative costs would likely increase.

13 Sjoquist and Walker (1999) found that a ten per cent increase in the volume of assessments reduces the average cost of assessment by approximately six per cent in Georgia where assessment is conducted at the county level.
in four types of local governments (large city, village, etc.) by counties. Within this range a local government decree would specify the unit value for the urban zones within the area of a municipality. There were 17 predetermined factors with a given multiplier, which could be used for modifying the sub-averages (age, utilities, building materials, etc.). The minimum and maximum rates are also defined by the draft law (0.5-1.5%). Two options were designed for deducting local property taxes (partially or totally) from the Personal Income Tax or from the PIT base (Davey and Peteri, 1998, 90-91). While the proposal was not presented to Parliament, it was tested on a sample of municipalities.

This legislative proposal tries to combine both a central and a local role in assessment: the central government would define the calculation method through the relative values of different types of property (within a class) while the local government would define the base or starting point value based on current real property prices. However this method has several disadvantages as well.

Local Political Debates

For example, this structure may induce municipal decisions to be politically biased providing representatives with a strong incentive to under-value the properties in their electoral districts and those of their party members.

Annual Reassessment

According to the proposal, the value of a basic property should be based on the actual market price. This would require frequent reassessment, a feature of the system that incurs higher administrative costs as a result. With every reassessment local governments will have no choice but to replay the political debates around the existing local taxes and the level of the local rates (Garzon, 1998, p.14).

Unique Values

According to the proposal, each property should have a unique calculated value, a system far more complicated and expensive (appeals, etc.) than the existing lump-sum tax. Many municipalities have already expressed their preference for the Communal Tax rather than the Building Tax because of its simplicity. The Bill, similar to the current legislation in the Law on Duty, does not distinguish between the assessment of residential and non-residential properties. This is unrealistic. The assessment methodology for residential and non-residential property varies considerably as there is usually a very limited market in industrial properties and thus various methods are used to obtain an estimate of value. Consequently, any assessment method which works using fixed price ratios as a method of comparison would lead to serious inequities in the assessment roll.

Tax Abatements for New Construction

Tax abatements are a special form of tax exemption when the municipality does not levy and collect tax on the higher value of property after the completion of an improvement. In Hungary there was a similar abatement program, the house-tax exemption for a 30-year period. Although such an exemption constrains the (disincentive) effect on investment, it

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To list some examples: Standard property: - 10-30 years old, brick, stone or concrete block construction, habitable, two room, one level or having an elevator if more than three stories. Rooming house-same characteristics but must have private bathrooms in one-quarter to two-thirds of the rooms, central heating. Offices are required to be centrally heated. Stores do not always have underground central heating, street access and the entrance and store space ratio -0.85-1.25. Manufacturing plant must have water and electricity but not gas. Lot values must reflect road access and access to water and electricity.
arguably makes the system unfair. Abatements also have the effect of exempting the part of hidden income invested in real property from the property tax and the owner does not contribute to the financing of the new infrastructure required by his/her new investment. The problem of investment incentives can be solved through a higher tax on vacant lands and increasing the period between reassessments. Another solution is to use supplementary assessments to update the assessment roll on a timely basis.

National vs. local relief

If the central government declares the ad valorem property tax to be mandatory, and other taxes are reduced to create tax room or an ability to pay for this tax, it is essential that some national tax relief policy be enacted as well. Such a central policy will be essential in order that Parliament accept the new tax structure. (A weakness of the current proposal is that it considers neither the issue of a national mitigation system nor the issue of reducing other taxes.)

Property Taxation and the Land Market

Property taxation is often portrayed as a tool to influence the real estate market to encourage efficient land use. However, the functioning of this effect may be hampered in Hungary due to several weaknesses in the current functioning of land markets: (i) the cost of real property transactions is relatively expensive, and (ii) the Hungarian financial market is not prepared to be involved in this market without a well-functioning mortgage system (or governmental guarantees of security of tenure and value). The real estate market may be too rigid to adjust to tax incentives. Nonetheless, Garzon (1998) suggests that more than 50% of housing units are privately owned and market transactions occur with frequency.

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