



## **Summary**

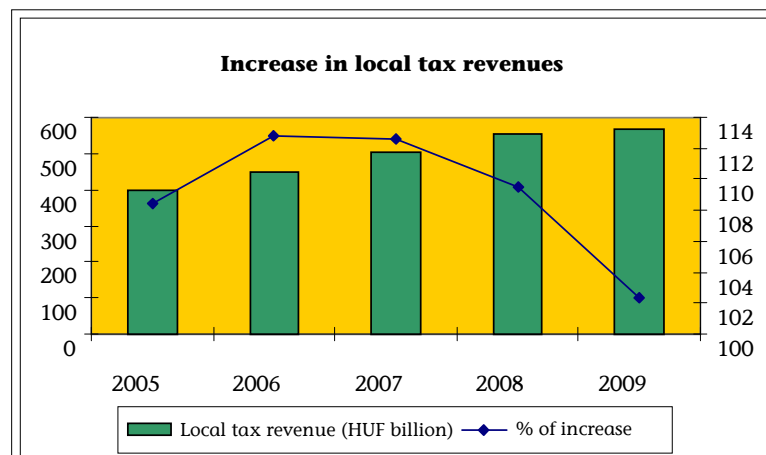
### **of the Audit on the Enforcement of Efficiency and Effectiveness in the System of Local Taxes (1031)**

The State Audit Office of Hungary (SAO) completed the audit on the enforcement of efficiency and effectiveness in the system of local taxes; the information on the findings of the audit is presented below:

**The objective of the audit** was to assess the impact of central and local tax policy decisions, regularity audit, professional supervision on local taxation and that of local tax policy on revenues, as well as to evaluate the efficiency and effectiveness of the tax administration of local governments. The SAO carried out on-site audits at the ministry responsible for tax policy, at five regional state administration offices, at six county offices and at 31 local governments. The audit covered the period 2006-2009, but the SAO took into account the changes of 2010 as well.

#### **Main findings:**

Due to the lack of harmony between the tasks and resources of local governments, an increasing part of the mandatory tasks is financed by the revenues of local governments and within this, by local tax revenues. The importance of local tax revenues increased, one-fifth of the budget of local governments is constituted by taxes collected by the 3130 local government tax authorities.



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The 'ceiling effect' prevailed: the reserves in local tax revenues are close to depletion.

EU regulations were enforced already prior to EU accession in the legal regulation of local taxes; after the accession, a few legal harmonisation requirements were fulfilled.

Legislation related to the local tax system was characterised by inconsistency in the audited period. Thus, the annually occurring legal amendments, lacking a medium-term concept relating to the restructuring of the local tax system, were accepted based on changing ideas. A part of the legislation relating to local government taxation was revoked (for example, suspension of the business tax, the relocation of tasks related to the business tax to the Hungarian Tax and Financial Control Administration), another part was repealed by the Constitutional Court (luxury tax and regulations related to taxation based on calculated value regarding real estate taxes).

The frequent change of central tax policy decisions resulted in a high degree of uncertainty and a short-term view in the tax policy of local governments and in the planning of revenues. The Act LXV of 1990 on Local Self-Governments stipulates the inclusion of the local tax policy objectives in the medium-term economic programme; however, it was not performed by 42% of the audited local governments.

The local governments amended their regulation pursuant to EU legal harmonisation (regulations ensuring local tax allowances and tax exemption for an indefinite period and later for a definite period, until 31 December 2007, were repealed).

In the period 2006-2008, regularity audits carried out by public administration offices contributed to the improvement of the quality of local legislation. The regularity audits of local tax regulations detected recurrent deficiencies because of the local legislation infringing the provisions of Act C of 1990 on Local Taxes and Act XCII of 2003 on the Rules of Taxation, and not following their changes.

The level of local tax administration differs due to the high number of tax codes and tax authorities. The professional expertise and technical conditions of the tax authorities of local governments of the capital city of Budapest, towns with county status and greater towns, which collect 93% of local taxes, are of high level, while in villages they are deficient. In the last two years, due to the deficiencies in professional preparedness the decision had to be changed or the

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procedure had to be conducted again in the case of every second legal remedy out of the 356 of the audited local governments.

The planning of the business tax capacity was characterised by uncertainty because of the factors influencing the tax base. Contrary to the budget acts, the planning was not based on actual figures, but on the estimate of the local government, making the exact claim of the subsidy mitigating income disparities more difficult. The non-payment of a greater taxpayer meant great risk in budgetary management, especially in smaller settlements.

In relation to the budget and final accounts regulation, half of the audited local governments did not present the indirect subsidy – arising from allowances, exemptions and tax reliefs for reasons of equity – or presented it without a written justification, contrary to the provisions of the Act on Public Finances.

Pursuant to the Act XX of 1991 on the Sphere of Responsibilities and Competence of Local Governments and Their Agencies, Commissioners of the Republic and Certain Central Subordinated Agencies, the body of representatives audits the activities of the tax authority through the report of the town clerk, but three-quarters of the audited local governments did not take this opportunity.

Nearly 40% of the town clerks did not adequately regulate the internal controls of tax administration based on Act XXXVIII of 1992 on Public Finances. The audit trail containing the control activities was not prepared, and some elements of tax administration and activities were omitted from the regulations.

Upon evaluating tax collection, execution, and tax audit on the basis of efficiency and effectiveness indicators, the State Audit Office of Hungary experienced extremely great dispersion. The situation is more favourable at local governments with high tax capacity, while in villages efficiency and effectiveness is still at a low level.

In the period 2006-2009, the cost-effectiveness of both tax collection and tax execution improved: the expenditure per HUF 100 revenue, with regard to tax collection, decreased by 10%, and concerning tax execution, by 3%. Tax collection also became more effective, since 4% more was collected from HUF 100 levied tax in 2009. However, the effectiveness of tax execution deteriorated, because the rate of bad debt increased by one-third.

Based on the on-site audit, we recommended the Government to:

- initiate the adoption of a medium-term tax policy concept by the National Assembly in order to facilitate the financial management and stability of

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- local governments, the secure planning of their revenues and the complementing of their economic programme with tax policy objectives,
- initiate the introduction of a calculation method of the tax capacity related to the mitigation of income disparities in the budget appropriation bill, based on the actual data of business tax revenues,  
*The budget appropriation bill of the year 2011 already includes this new method, accepting the recommendation of the SAO.*
  - promote the more professional and more efficient task management in local tax administration.