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Constitutional foundations of Hungarian tax law

I. THE TAXATION CLAUSE

The Fundamental Law of Hungary and the decisions of the Constitutional Court which has limited fiscal powers under the law in force,¹ create the basic rules of taxation. The thesis examines the constitutional basis of taxation, which includes at least two conditions. The first is the definition of the taxing power, i.e. who has the right to decide on the imposition of a tax or, more widely, fiscal revenues; this implies the definition of the level of the source of tax law. The second is the definition of taxation as an obligation and its conditions, the most basic of which is the principle of ability to pay. These conditions create the content and limits of the power to tax.

The starting point is the tax-related provisions of the Fundamental Law. The Fundamental Law grants the power to legislate on taxation to the *Országgyűlés*, as the unicameral National Assembly is named.² According to Article I(3) of the Fundamental Law, “The rules for fundamental rights and obligations shall be laid down in an Act.”

Taxation is defined as a fundamental obligation in Article XXX, quoted below. Consequently, tax legislation in Hungary is one-tiered, being made possible by Act, except for the limited taxing rights of local governments,³ and the setting of fees.⁴ Article XXX of the Fundamental Law defines taxation as a fundamental obligation and defines the purpose and limits of taxation:

“(1) Everyone shall contribute to covering common needs according to his or her capabilities and to his or her participation in the economy. (2) For persons raising children, the extent of their contribution to covering common needs must be determined while taking the costs of raising children into consideration.”

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¹ Art. 36(4) of Fundamental Law of Hungary (Fundamental Law).

² Art. I(3) and XXX of Fundamental Law of Hungary.

³ Art. 32(1)*b*) of Fundamental Law of Hungary.

⁴ 29. § of Act CXCV of 2011 on the Economic Stability of Hungary (Stability Act).

I have examined the conceptual elements of the definition of tax liability in my habilitation thesis separately and in their entirety and determined the meaning I attribute to the above provision of the Fundamental Law on the basis of its text, the explanatory memorandum, the decisions of the Constitutional Court, the literature and the necessary historical and comparative legal analysis.

This article is divided into three main structural units. Chapter II addresses the question of who decides on tax law, i.e. who may make the rules governing taxation. Chapter III clarifies the meaning of the ability-to-pay principle. In Chapter IV, the so-called unorthodox tax reform is addressed.

II. THE POWER TO TAX

Competence as a legal concept refers to the organ of the state that has the power to decide on a matter under the jurisdiction of that state. Legal scholars argue that the precondition of the legitimacy of tax rules is the prior consent of taxpayers, as a main rule via their representatives in Parliament; this is called input legitimacy. To support this claim, they cite historical situations in which the lack of consensus or, even more so, the obligation to pay imposed on taxpayers led to social movements, uprisings, revolutions, and wars of independence. A typical reference point is the claim made during the North American War of Independence – or, more precisely, earlier in the Enlightenment intellectual movement⁵ – ‘no taxation without representation’.⁶ In this section, I review how the participation of taxpayers in the decision-making process has evolved throughout Hungarian history until the present day in an EU and global context, occasionally referring to other jurisdictions if the context requires. The historical overview also sheds light on the forms of subordination that have emerged in history and the forms of distribution of economic resources they have generated.

1. Historical models of the power balance in Hungary

a) Considering the European scene after the collapse of the Roman Empire, the observer may conclude that the collapse of the Roman state, based on a strict fiscal system and an extensive bureaucracy, led to the disappearance of the all-encompassing (abstract) state and its replacement by a patrimonial system organised on a tribal basis,

⁵ E.g. G. Hamza, *Characteristic Features of the Constitution of the United States of America*, (2024) 72 (8) *Belügyi Szemle*, (1495–1512) 1498–1499.

⁶ E.g. P. Essers (ed.), *History and Taxation* (IBFD, Amsterdam, 2022) (EATLP International Tax Series vol 20); Y. Edrey, *Constitutional Review and Tax Law: An Analytical Framework*, (2007) 56 (5) *American University Law Review*, (1187–1228) 1192–1193; W. Schön, *Taxation and Democracy*, (2019) 72 (2) *Tax Law Review*, 235–304.

in which private property and public property were not separated.⁷ The Hungarian state, founded (AD 1000) after the conquest (895), was integrated into medieval Europe, built on the ruins of the Roman Empire.

b) Different patterns of development have occurred in Europe. That is why the following question about the historical regions of Europe is important: “Where do the internal borders of Europe run?”⁸ Hungary, as a country of the semi-periphery, differed from the western part of Europe in economic terms as well as in the way society was organised.⁹ For instance, feudalism, as Ganshof defines it, was limited in location (west of the Rhine area) and duration (i.e. from the tenth to the thirteenth centuries), and its central institution was vassalage.¹⁰ Feudalism in this sense was never present in Hungary;¹¹ therefore, I will apply a more flexible interpretation of feudalism that covers Hungary in this context that spans the period from the establishment of the state (AD 1000) until 1848 (civil revolution and War of Independence). *In terms of taxation, this means that the feudal system of taxation prevailed until the middle of the 19th century.* The essence of Hungarian historical development may be summarised as that of a peripheral nation. The reasons for becoming a peripheral nation are the arrival of the Hungarians in the region five hundred years later than those of Western nations, the inorganic social development, rapid pattern adoption – following Western models instead of our ‘own’ way – determined primarily by foreign policy (the ‘squeeze’ of the German-Roman Empire and Byzantium) and the lack of historical antecedents. The above-mentioned reasons determined the characteristics of the Hungarians as members of a peripheral nation. The characteristics here mentioned are the imperative of convergence and integration, a forced position in terms of the division of labour – a country of agricultural products and mineral resources –, a conservative, feudal-type society that has persisted over time, an underdeveloped bourgeoisie, blind alleys of centralisation, failures in Western pattern following, and modernisation efforts sometimes imbued with a messianic sense of mission.¹² There is one aspect to highlight, which has determined both the historical development of the country and its tax system. This is the lost Battle of Mohács in 1526, which is a cornerstone of Hungarian

⁷ R. C. Van Caenegem, *An Historical Introduction to Western Constitutional Law* (Cambridge, 1985) 34–36.

⁸ J. Szűcs, The Three Historical Regions of Europe: An outline, (1983) 29 (2–4) *Acta Historica Academiae Scientiarum Hungaricae*, 131–184.

⁹ E.g., A. Gerschenkron, *Economic backwardness in historical perspective* (Harvard University Press, 1962); I. Wallerstein, *The Modern World-System I: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century* (Academic Press, 1974).

¹⁰ F. L. Ganshof, *Feudalism* (University of Toronto Press – MAA, 1996) XV–XVII, 65–67 and 70.

¹¹ Mezey B., Előszó, in Mezey B. (szerk.), *Magyar jogtörténet* (Osiris, Budapest, 2007) 10.

¹² Mezey B., A magyarság törzsi szerveződése és a nomád állammodell, in Mezey B. (szerk.), *Magyar alkotmánytörténet* (Osiris, Budapest, 2003) 17–22., 41–47.

history, the results of which were the division of the country into three parts for 150 years (until 1699, until the displacement of the Turks) and a period of extremely limited sovereignty, lasting 400 years under Habsburg rule. *Four centuries – including the civil revolution and the War of Independence in 1848/49 and the prosperous period of the Austro-Hungarian Monarchy (1867–1918), involving a real union – were about independence; independence from the Turks and the transnational Habsburg dynasty, which the country did not achieve until 1918.* However, independence came about under extraordinary, post-World War I circumstances that were almost unmanageable. The country found itself on a forced path that led to its participation in World War II, which was followed by the Soviet occupation. *Therefore, a valid interpretation of Hungarian history is one that recognises that one of the fundamental features is the continuous struggle for independence since 1526. This may help explain the Hungarian attitude to the attempts at federalism associated with the EU.*

c) After outlining the context, the historical roots of the decision-making models on taxation are next summarised. The state emerged from the *community of blood kinship* through conquest, as a power construction. *The key element of the transformation of the development of the constitution in the Middle Ages was the liberation, or if one prefers, wrenching away, of the individual from the ties of the extended family, the bloodline, which made possible the development of new forms of subordination to the rising powers, and ultimately to the ruler.* This new form of subordination in Western Europe was typically a contractual relationship, based on vassalage. *The restructuring of property relations was important both for the establishment of a patrimonial monarchy based on the dominion and for the creation of a property basis for the Church.*¹³ Land ownership was not merely the economic basis of power, but a precondition of power. In Hungary, the king had full sovereignty, and administration was patriarchal.¹⁴ Law-making was the right of the king.¹⁵

The revenue system of the patrimonial state was based on the revenues collected by the king as a landowner, such as crops handed over, taxes and the obligatory labour service ('robot'). The public law-based regales were insignificant, playing almost no role.¹⁶ The notion of public-law-based tax was unknown in the period of patrimonial kingship.¹⁷

¹³ Bónis Gy., *Hűbériség és rendiség a középkori magyar jogban* (Osiris, Budapest, 2003) (Millenniumi magyar történelem – Historikusok) 24–26.

¹⁴ Mezey, A magyarság törzsi szerveződése és a nomád állammodell, 17–22., 48; Bónis, *Hűbériség és rendiség a középkori magyar jogban*, 80.

¹⁵ Bónis, *Hűbériség és rendiség a középkori magyar jogban*, 80.; Ferdinandy G., *A magyar alkotmány történelmi fejlődése* (Franklin Társulat, Budapest, 1906) 23.

¹⁶ Hóman B., I. A magyar királyság háztartása és pénzügyigazgatása 1000–1322-ig, in Hóman B., *A magyar királyság pénzügyei és gazdaságpolitikája Károly Róbert korában* (Budavári Tudományos Társaság, Budapest, 1921).

¹⁷ Bónis, *Hűbériség és rendiség a középkori magyar jogban*, 82.

d) The system of patrimonial kingship was undermined by the donation of lands to the nobility; royal land ownership declined significantly. *It was in the 13th century that the transformation of the patrimonial state into a state based on the power balance between the king and the estates began, reaching its full development by the 15th century.*¹⁸ Seeking new resources, the ruler, as a novice financial power, at first approached taxation in a random and inventive way, which led to conflicts.¹⁹ As concerns the relationship of the king and the estates, the whole feudal period was about the defence of the constitution and the primal rights of the nobility, among them their tax-exempt status until 1848. In 1222, the rights of the nobility were confirmed in the Golden Bull, a document like the English Magna Carta of 1215 or the Constitution of Leon of 1188. Several such confirmations have been concluded over time. In the power struggles with the monarch in the period of the Estates, the most powerful weapon of the Estates was the *Országgyűlés*, primarily because of the right to raise taxes,²⁰ although the public law position and authority of the Act was incidental in that period; its importance increased in the 19th century.²¹

The Habsburg dynasty – a strong multinational power beside the “temporary” Turk occupation – brought a new quality to the political system of Hungary after 1526. The iconic events during their rule involved the defence of the own public law structure of the country.²² There were three significant dates (1547, 1687, 1723) when the king confirmed the Constitution of Hungary, which included a tax exemption for the nobility in exchange for the recognition of the kingship, and at last in 1723, of the female line of descent. In this way, the monarchy was transformed from an elective monarchy to a hereditary monarchy in exchange for the recognition and confirmation of the primordial rights of the nobility, including to tax exemption.²³ This compromise was the basis of the tax-free status of the nobility until the civil revolution in 1848.

Bálint Hóman divides the *revenue system of medieval public finances* into three parts: revenues based on ownership (dominion), revenues collected by sovereign right (regale), and revenues voluntarily offered (tax). As he writes, *income collected under landlord or royal sovereignty was not considered tax(es) in the medieval view, because the*

¹⁸ Mezey B., *Öszve-szövetkeztetett Szövetségünknek kötele – A jogalkotás alkotmányos keretei a Rákóczi-szabadságharcban* (Gondolat, Budapest, 2009) 94.

¹⁹ Hegedűs L., A magyar egyenes adózás kifejlődése (Az Árpádok és az Anjouk), (1900) 24 *Közgazdasági Szemle*, 190–208., 202; Baráth T., A magyar állam adóügye 1605–1648. (Első közlemény), (1929) (4–6) *Századok*, 607–655., 609.

²⁰ Ember Gy., Magyarország közigazgatása 1711–1865, (1983) (1–2) *Levéltári Közlemények*, 3.

²¹ Mezey, *Öszve-szövetkeztetett Szövetségünknek kötele*, 92–93.; Varga Cs., *A kodifikáció mint társadalmi-történelmi jelenség* (Akadémiai Kiadó, Budapest, 1979).

²² E.g. Mezey B., Feudális állammodellek Magyarországon, in Mezey B. (szerk.), *Magyar alkotmány-történet* (Osiris, Budapest, 2003) 65.

²³ Concha Gy., *A kilenczvenes évek reformeszméi és előzményei* (Franklin Társulat, Budapest, 1885) 5–6; Acts I-II of 1723.

income treated as tax was based on voluntary contribution. Accordingly, he divided revenues into ordinary and extraordinary revenues, the latter being taxes.²⁴ This division is also used by authors who analyse later periods, such as the 16th and 18th centuries.²⁵ *In the 17th century, ordinary revenues accounted for about 70 percent of state revenues.*²⁶ *This is a significant shift from the proportions that existed in the patrimonial monarchy.*

e) The next moment to be referred to here is the post-revolution *bourgeois state*, created mostly in the nineteenth century, although earlier variants – such as those in England – existed. The parliaments – and therefore the whole political system – of new bourgeois nation states were rather oligarchic since voting rights were allocated to a small fraction of society.²⁷ The Third Estate took over the power positions of the absolutistic state, and its political purposes can be described in two key words: *constitutionalism and parliamentarianism*. The first excluded arbitrariness and, in substance, created the rule of law, while the second created a regime where power is derived from and accountable to the electorate.²⁸

In Hungary, the bourgeois revolution erupted in 1848, which turned into a fight for the country's independence; the Habsburg dynasty was dethroned in 1849. The War of Independence was defeated with Russian assistance. From 1849 until 1867, Hungary was an occupied country, and its former statehood was abolished. This situation was ended by the Compromise of 1867, which resulted in the creation of the Austro-Hungarian Monarchy as a real union, which ceased to exist in the autumn of 1918 when a revolution broke out and the People's Republic was proclaimed. In 1920, the name of the state was changed back to the Kingdom of Hungary, which existed as a kingdom without a king until 1945. Although the country was independent in public law terms, it was occupied by the German army on 19 March 1944, and from 1945 it was effectively under Soviet occupation until the elections in 1990.

f) Looking for an answer to our question – i.e. *who decided on tax law* during the century and a half between 1848 and 1990 outlined above – there are *three essential questions to be answered*. The first is what source of law is necessary for taxation. The second is the extent to which Hungarian statehood was sovereign, i.e. to what degree external factors influenced decisions. The third is what proportion of citizens in the given political community were entitled to vote.

²⁴ Hóman B., *A magyar királyság pénzügyei és gazdaságpolitikája Károly Róbert korában* (Budavári Tudományos Társaság, Budapest, 1921).

²⁵ Baráth, A magyar állam adóügye 1605–1648, 607–609; Nagy I., A Magyar Kamara adóigazgatási tevékenysége a XVI–XVII. században, (1995) 66 (1–2) *Levéltári Közlemények*, 29–51.

²⁶ Baráth, A magyar állam adóügye 1605–1648, 607–608.

²⁷ Caenegem, *An Historical Introduction to Western Constitutional Law*, 194–195.; Concha Gy., *Újkori alkotmányok*, I. kötet, (Eggenberger, Budapest, 1884).

²⁸ Caenegem, *An Historical Introduction to Western Constitutional Law*, 194.

The first two questions are discussed together, as the Hungarian public perception of the Habsburgs' rule was that it was an occupation, a rule by a foreign power. The legislative power was shared between the *Országgyűlés* and the crown, meaning that the validity of an act required the consent of both parties as last provided for in Act XII of 1790–91.²⁹ The last feudal *Országgyűlés* in 1848 adopted thirty-one resolutions that laid the foundations for the bourgeois transformation, which became acts by royal assent on 11 April 1848. The necessary level of legal source of the budget and the creation of the public debt were clearly defined in the laws.³⁰ Although the grounds for universal, equal and proportionate taxation were also laid down, the legal source of taxation was not clearly defined. After the dethronement, the *Országgyűlés* passed an act – alone – on the new, modern tax system in 1949, but this did not come into force due to the defeat in the War of Independence.³¹

Following the defeat in the War of Independence, legislative powers were redefined under the system of absolutism from 1849 to 1867, and Hungary lost its fiscal sovereignty. The modern Austrian tax system of the time was introduced in 1850 and 1851 by imperial decrees or orders issued with imperial approval. 1867 was the year of the Compromise, the establishment of the Austro-Hungarian monarchy. Under the 1867 Compromise, foreign affairs, military affairs and their finances became common affairs. Each year, a committee appointed by the two parliaments decided jointly on the proportion of the costs to be borne, and in the absence of agreement, the two parliaments, and ultimately the monarch himself, decided.³² The Act of Compromise identified customs revenue as a direct source of financing for common affairs.³³ Domestic finances belonged to the competence of the Hungarian *Országgyűlés*. According to Article 17 of the Act of Compromise, taxes should be decided by the *Országgyűlés*; the form of the decision was not an act, but a resolution. Contrary to this wording, the reality was different; tax statutes were decided in the form of an act. The reason was that a secret agreement was reached between the monarch and the Hungarian leaders to maintain the King's right of assent, which was included in a

²⁹ Beér J. and Csizmadia A., *Az 1848/49. évi népképviselői országgyűlés – Bevezetés*, in Beér J. (szerk.), *Az 1848/49. évi népképviselői országgyűlés* (Akadémiai Kiadó, Budapest, 1954) (3–113) 92. and 446.; Récsi E., *Magyarország közjoga, amint 1848. előtt és 1848-ban fennállott* (Pfeifer Ferdinánd, Buda-Pest, 1861) 439–442; Moór Gy., *A különböző jogforrások, azok egyensúlya és rendfokozata a magyar jogrendszerben*, (1932) 13 (5) *Magyar Jogi Szemle*, (145–154) 149; Gratz G., *A dualizmus kora. Magyarország története, 1867–1918. I* (Magyar Szemle Társaság, Budapest, 1934) 11–12.

³⁰ 37. § Act III of 1848; Magyar Z., *A magyar állam költségvetési joga* (Stúdium, Budapest, 1923) (OGYH reprint, Budapest, 2010) 30.

³¹ Act VII. of 1949; Beér and Csizmadia, *Az 1848/49. évi népképviselői országgyűlés – Bevezetés*, 3–113., 92. and 446.

³² 18–22. § of Act XII of 1867 on the relations of common interest between the countries of the Hungarian Crown and the other countries under the reign of His Majesty, and the manner of their settlement (Act on Compromise).

³³ 64. § Act of Compromise.

secret resolution of the Council of Ministers.³⁴ The monarch did not abandon his right to assent, but Hungarian politicians could not publicly acknowledge this. For the rest of the capitalist era, the legal sources for taxation were acts. However, the terms of the League of Nations loan for post-World War I stabilisation included significant budget and taxation constraints.³⁵ Therefore, the room for consideration of tax policy and legislation of the *Országgyűlés* of the formally sovereign state of the Hungarian Kingdom was narrow.

Regarding *voting rights as the third essential criterion for tax legislation*, the Hungarian domestic political community widened after the Civil Revolution. Act V of 1848 regulated the right to vote in accordance with the new social model based on equal rights, although political rights were far from equal. The Act linked the right to vote to the age of 20 but did not grant it to women. It contained further restrictions, such as a wealth and income census and limitations on the propertyless and those under a kind of 'paternal power'. In 1874, there was a reform of electoral law³⁶ which served as the basis for elections for more than thirty years. Under the new system, 6.5 percent of the population had the right to vote.³⁷ According to the Act, people with tax debts were not allowed to exercise their voting rights.³⁸ After the country regained state sovereignty, the electoral system was regulated by decree in 1919,³⁹ under which 40% of citizens were entitled to vote in 1920.⁴⁰ The next electoral law was passed in 1922 in the form of a ministerial decree which resulted in a decrease in the proportion of citizens entitled to vote to 29.8%. In 1925, the rules of the last decree were republished in the form of an act⁴¹ that further decreased the proportion of entitled citizens to 26.8%. In 1935, 33.7% of citizens were entitled to vote. The proportion was similar at the last interwar election in 1939.⁴²

As these are parts of Hungarian history, one must remember that in dictatorial circumstances, the consent of the people is not a precondition for taking personal assets. On 19 March 1944, the German armed forces occupied the country. According

³⁴ M.E. resolution 64 of 1867; Sarlós B., *Közigazgatás és hatalmpolitika a dualizmus rendszerében* (Akadémiai Kiadó, Budapest, 1976) 33–34; Wiener I., A többségi elv és a bizalmi kérdés a dualizmus kormányzati rendszerében, (2007) (3) *Jogtörténeti Szemle*, (68–88) 68; Kárbin Á., Szuverén volt-e az Osztrák–Magyar Monarchia Magyarországa bizonyos nemzetközi gazdasági szerződések és a királyi vétó tekintetében? (2019) (3–4) *Jogtörténeti Szemle*, 64–66.

³⁵ Act IV of 1924 on the Rebalancing of Public Finances.

³⁶ Act XXXIII of 1874 on the modification and supplementation of Act V of 1848 and Act II of Transylvania (az 1848:V. törvénycikk és az erdélyi II. törvénycikk módosításáról és kiegészítéséről).

³⁷ Gratz, *A dualizmus kora*, 138.

³⁸ 12. § 5. of Act XXXIII of 1874.

³⁹ Prime Ministerial decree no 5985 of 1919 (1919. évi 5985. M.E. sz. rendelet).

⁴⁰ Dezső M., A választási rendszer, in Kukorelli I. (szerk.), *Alkotmánytan. I. Alapfogalmak, alkotmányos intézmények* (Osiris, Budapest, 2007) 217.

⁴¹ Act XXVI. of 1925.

⁴² The data of the elections available: Hubai L., *Magyarország XX. századi választási atlasza 1920–2000, I. kötet. A választások története és politikai geográfiája* (Napvilág Kiadó, Budapest, 2001) 43., 57., 65.

to the minutes of the 19 March 1944 government (Crown Council) meeting, headed by the head of state, Miklós Horthy, Adolf Hitler told the latter during their meeting in Germany on 18 March 1944, that German troops would march into Hungary since German leaders had lost their confidence in Hungary and wanted to keep the hinterland safe. To avoid social upheaval, Hitler insisted on Miklós Horthy keeping his position as head of state; otherwise, in the case of civil commotion, Romanian, Croatian and Slovakian armies would also invade Hungary besides the German troops. Miklós Horthy kept his position, the government resigned, and a new government led by Döme Sztójay took over the leadership.⁴³ On 29 March, the new government, in its first meeting, passed a decree on the confiscation of the property of Jewish people living in Hungary.⁴⁴ The confiscated assets were taken out of the country by the German army in the so-called ‘golden train’, composed of 77 wagons. On 11 May 1945, the train was seized by the American army.⁴⁵ World War II ended in Hungary on 4 April 1945, and the first democratic elections in Hungarian history were held in November of that year, the last until 1990; the country was occupied in the years in between. Private property was nationalised. The market economy, and with it, tax as a means of financing the state, essentially disappeared. Tax served an administrative purpose, as part of a pre-planned set of rules for regulating the economy and distributing income.

2. The constitutional framework of present days

a) The political system was transformed in 1990 with the first democratic elections. The first written constitution, reflecting the power structure of the time, was adopted in Hungary in 1949⁴⁶ at the beginning of the communist regime. As a result of the 1989 constitutional reform, only the title of this constitution remained unchanged.⁴⁷ In 1989, the text of the Constitution was amended to include Paragraph 70/I, which defined the tax liability, and also the provision on the level of the source of law – that is, cardinal law – for the regulation of fundamental rights and obligations.

The tax liability was defined as follows: “Article 70/I. All citizens of the Republic of Hungary have the obligation to contribute to public revenues in proportion [to] their income and wealth.”

⁴³ Magyar Nemzeti Levéltár (1000–2100) (Hungarian National Archives), *Minutes of the Government meetings 1867–1944*, available at: <https://www.eleveltar.hu/digitalis-tartalom?source=preservica&ref=5d1002a3-a71a-40e5-9bbc-5c3d2552fd9e> (last accessed: 31.12.2024.).

⁴⁴ 1944. évi 1.600. M. E. rendelet (Government decree on report and freezing of Jewish property).

⁴⁵ Tarján, T. M., 1945. május 11.: Az amerikai hadsereg birtokába kerül a magyar Aranyvonat, *Rubicon*, 11 May 1945, http://www.rubicon.hu/magyar/oldalak/1945_majus_11_az_amerikai_hadsereg_birtokaba_kerul_a_magyar_aranyvonat (last accessed: 31.12.2024.).

⁴⁶ Act XX of 1949 on the Constitution of the Hungarian People's Republic.

⁴⁷ Act XXI of 1989 on the Modification of the Constitution.

The level of the necessary source of the law was defined in Article 8: “8§ (2) Regulations pertaining to fundamental rights and obligation[s] are determined exclusively by cardinal law.”

The enactment of a cardinal law required a two-thirds majority. The reason for setting the level of the legal source was a lack of trust between the different political forces involved in the legislative work at the end of the socialist regime. It soon became clear that this requirement would paralyse the country,⁴⁸ therefore, a compromise was reached in the House.⁴⁹ A simple majority in the Legislature has been required to pass tax laws since 25 June 1990.

b) The current constitution is the Fundamental Law of Hungary, which, like the Constitution, gives the *Országgyűlés* the power to legislate on taxation as outlined in Chapter I, above. Among the constitutional rules on competence, mention needs to be made of Article 32, in which the *Országgyűlés* grants local governments the right to tax within the framework of an Act, that is, the Act on Local Taxes.⁵⁰

In conclusion, the Hungarian electoral rules ensure the preconditions for democratic decision-making and the *Országgyűlés* functions in accordance with democratic, rule-of-law norms. The rules of the Fundamental Law guarantee that fiscal revenues have a legal basis.

c) In agreement with one of the positions expressed in the literature, I consider the *decisions of the Constitutional Court* a – negative – source of law, since they constitute an annulment of the normative decisions of the legislative bodies.⁵¹

There have been two fundamental decisions that defined the limits of its jurisprudence on the area of fiscal revenues. The first was the refusal of *ex ante* norm control of tax bills, thereby avoiding direct involvement in the formulation of tax policy.⁵² In the other decision, in which the solution thus adopted became a regular formula in tax decisions, the Constitutional Court, like many other constitutional courts, ruled that the legislature may exercise a wide margin of appreciation in the enactment of tax legislation.⁵³ The application of the wide margin formula means that the Court put freedom before equality and formal equality before material equality.⁵⁴

⁴⁸ Act XLIX 1989; Constitutional Court Decision 5/1990. (IV. 9.).

⁴⁹ 1. § (3) of Act XL of 1990.

⁵⁰ Act C of 1990 on Local Taxes.

⁵¹ Jakab A., *A magyar jogrendszer szerkezete* (Dialóg Campus, Budapest and Pécs, 2007) 133.

⁵² Constitutional Court decision 31/1990. (XII. 18.); Balogh Zs., *Alkotmánybíráskodás egykor és ma*, (2011) (1) *Alkotmánybíráskodási Szemle*, (72–82) 73.

⁵³ Constitutional Court decision 1558/B/1991.

⁵⁴ Pokol B., *Jogelmélet* (Századvég, Budapest, 2005) 87–90.

Since 2010, the power of the Constitutional Court has been restricted in the area of fiscal legislation;⁵⁵ the essential purpose of these rules is to delimit the potential intervention of the Court in budget framing and public debt reduction. While public ('general government') debt exceeds 50% of the GDP, the Constitutional Court has powers to review laws on the central budget, the implementation of the central budget, central taxes and other fiscal levies, and on the legislation of conditions for local taxes for conformity with the Fundamental Law solely as pertaining to fundamental rights defined in the Fundamental Law or infringing the procedural rules of legislation laid down by the Fundamental Law.⁵⁶

3. Tax competences in the European Union

Neil Walker clearly articulated the historic importance of European cooperation when he wrote that European integration had provided Europe with important public goods after World War II: peace and prosperity.⁵⁷ The European Union is a special legal construct in which sovereignty problems have been solved by legalisation. This means that legislative powers have been shared between the Union and the Member States, and the Court of Justice of the European Union has been given special powers.⁵⁸ Article E(2) of the Fundamental Law provides for Hungary's relationship with the European Union as follows:

"(2) With a view to participating in the European Union as a Member State and on the basis of an international treaty, Hungary may, to the extent necessary to exercise the rights and fulfil the obligations deriving from the Founding Treaties, exercise some of its competences arising from the Fundamental Law jointly with other Member States, through the institutions of the European Union. Exercise of competences under this paragraph shall comply with the fundamental rights and freedoms provided for in the Fundamental Law and shall not limit the inalienable right of Hungary to determine its territorial unity, population, form of government and state structure."

The EU treaties divide legislative power between the Member States and the EU institutions.⁵⁹ In the area of fiscal legislation, customs law is an exclusive competence of the Union. Taxes are a shared competence, with control being in the hands of the

⁵⁵ 1. § of Act CXIX of 2010 on the Modification of the Constitution modified the 32/A. § of the Constitution with the effect of 17 November 2010.

⁵⁶ Art. 37(4) of the Fundamental Law.

⁵⁷ N. Walker, The Place of European Law, in G. de Búrca and J. H. H. Weiler (eds), *The Worlds of European Constitutionalism* (Cambridge University Press, Cambridge, 2011) 57–105.

⁵⁸ R. W. Stone, *Controlling Institutions* (Cambridge, 2011) 104.

⁵⁹ Article 5(2) TEU, Art. 2-6 TFEU.

Member States under the special legislative procedure rules, since unanimity in the Council is required to adopt tax legislation.⁶⁰

The law-making role of the European Court of Justice's rulings is beyond dispute. As has been argued in the tax law literature, the Court of Justice's rulings have clearly defined themselves as the depositories of the strengthening of integration; the Court sees the ultimate aim and spirit of European law as the achievement of ever closer integration.⁶¹ The judgments of the European Court of Justice have contributed to the incorporation of provisions in the tax laws of individual Member States that contain similar solutions in specific areas. This is why the Court's activities are seen as an indirect catalyst for tax harmonisation, a kind of negative harmonisation – or in other words, back-door harmonisation.⁶² By interpreting the Treaties, the Court of Justice has created a new constitutional legal order enforceable against the Member States.⁶³ As has already been mentioned in relation to the Hungarian Constitutional Court, the judicial forum with the competence of a constitutional court plays a decisive role in the political system by annulling the normative decisions of the supreme legislative forum and making interpretative decisions. According to a marked opinion in the literature, it takes supremacy over the democratically established political institutional system resulting from elections. In essence, political decisions are made in a legal language, not by a majority of the electorate, but by a majority within a given judicial forum.⁶⁴ Over the past decades, there have been several conflicts between national constitutional courts and the European Court of Justice, which have essentially been jurisdictional disputes over the boundaries between national law and EU law. Neil MacCormick, in a study published after the Maastricht decision of the German Constitutional Court, proposes a pluralistic approach to resolving disputes over the hierarchy of sources and powers. In essence, he argues that it is inappropriate to interpret the problem in the Kelsen model and to argue about whether national or European law is at the top of the hierarchy of sources of law, because this is not the way to solve the problem within the conceptual framework of law. It is more appropriate to understand them as interconnected, communicating legal systems, the scope of which is defined by the Treaties. However,

⁶⁰ Art. 113, 114(2), 115, 289(2) TFEU.

⁶¹ E.g. M. G. H. Schaper, Chapter 2: Introduction to Part II, in *The Structure and Organization of EU Law in the Field of Direct Taxes* (IBFD, 2013) (Online Books IBFD) 2.3.1.3; A. S. Sweet, *The European Court of Justice and the Judicialization of EU Governance*, (2010) 5 (2) *Living Reviews in European Governance*, DOI: <https://dx.doi.org/10.2139/ssrn.1583345>

⁶² M. Helminen, *EU Tax Law – Direct Taxation* (IBFD, Amsterdam, 2011) 10.

⁶³ J. Gillingham, *European Integration 1950–2003 – Superstate or New Market Economy?* (Cambridge University Press, Cambridge, 2003) 74.

⁶⁴ Pokol B., *Európai jurisztokrácia – az Európai Unió jurisztokratikus szerkezetének kérdései* (Dialog Campus, Budapest, 2019).

it must also be seen, he writes, that not all disputes can be decided at the legal level, and there are some issues that require a political decision.⁶⁵

4. Global decisions on tax issues – soft law

The traditional order of international tax law has been changing over the past two decades. The BEPS project under the OECD, followed by BEPS 2.0 and the new, expanded regime for information exchange – including FATCA agreements – has been emerging as a new element of tax regulation, meaning that global soft law has become hard law in the EU legal system and in the legal systems of nation states. The Inclusive Framework aims to broaden the scope of BEPS cooperation; not only can OECD member states participate, but any state can join. Today, the Inclusive Framework has more than 140 member countries. Whereas previously, starting with the report prepared by the four experts in the framework of the League of Nations, through the first OECD Model Convention adopted and published in 1977, to the subsequent amendments, the basic concept was a kind of harmonisation of the conceptual set and the structure of bilateral conventions, the BEPS project is different. The Multilateral Instrument contains globally agreed normative texts that states make part of their bilateral treaties, subject to mutual agreement. This solution not only restricts the room for manoeuvre for the conclusion of treaties, especially for smaller, so-called follower states, but also poses a constitutional problem since a solution for the ratification of treaties has to be found. Hungary has chosen to enact the MLI itself. It promulgated the text of the MLI as an annex to the act and set out the reservations to each of the points of the MLI. The reservations already adopted by the time of the adoption of the act, which concern bilateral treaties, have been specified in the act itself for certain articles of the MLI.⁶⁶ However, it should be noted that, as the Act in question also shows, the actual substantive impact of the MLI is limited due to the different interests of each country.⁶⁷

⁶⁵ N. MacCormick, *The Maastricht-Urteil: Sovereignty Now*, (1995) (3) *European Law Journal*, 259–266.

⁶⁶ Act III of 2021 on the Proclamation of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ('MLI Act').

⁶⁷ R. S. Avi-Yonah and E. Lempert, *The Historical Origins and Current Prospects of the Multilateral Tax Convention*, (2023) 15 (3) *World Tax Journal*, 379–411.

III. THE CONSTITUTIONAL PRINCIPLES OF SHARING THE FISCAL BURDEN

1. The issue

A fundamental problem for any society is how to share the benefits and burdens of community life with the scarce resources that are available. Taxation is at the centre of this issue. We must be clear that the conceptual set of our tax principles is rooted in the philosophical foundations of the bourgeois societies that followed feudalism. At their heart is individual freedom, which has previously been marginalised. If one reflects on how our predecessors (and ourselves today) thought (think) about the justification for taxation, and later on the sharing of the tax burden,⁶⁸ this always involves the relationship between the individual and the community. The main issue of burden sharing during the emergence of capitalist systems was the universality and equality of taxation, which essentially meant that the tax exemption of the nobility was abolished, and taxes were paid by all. The invention was sharing the burden in a proportional way, which meant that the proportions of primary income distribution via the market were not modified. This way, inequalities in the material positions of taxpayers were formulated into equality in taxation. The next watershed occurred around the turn of the 19th and 20th centuries, when the theoretical basis and the justification for personal income taxation were worked out during the so-called progressive era; the ability-to-pay principle gained momentum at that time.

2. The basic question and the short conclusion of the study

A specific feature of the Hungarian Fundamental Law is that it contains in the above-quoted clause the principles of tax burden sharing, with the ability-to-pay principle at its centre. The ability-to-pay principle is extended with the constitutional right of the child-rearing parents to tax benefits. The third principle is participation in the economy. This latter is an invention of the constituent *Országgyűlés*, the purpose of which has been to involve new criteria for taxation that have no direct connection to the ability to pay of the taxpayer; green taxes serve as an example.

The *central question* of the habilitation theses is what the ability-to-pay principle defined in the Fundamental Law means. It is important to note here that the cardinal

⁶⁸ E.g. Földes G., *Adójog* (Osiris, Budapest, 2004) 22–27; G. Bizioli and E. Reimer, Equality, ability to pay, and neutrality, in C. H. J. I. Panayi, W. Hansleaner and E. Traversa (eds), *Research Handbook on European Taxation Law* (Edward Elgar, Cheltenham, 2020) (51–74) 63–64; K. Vogel, The Justification for Taxation: A Forgotten Question, (1988) 33 (1) *American Journal of Jurisprudence*, (19–59) 22–25.

Stability Act contains four rules that partly give meaning to the principle and at the same time limit the decision-making power of the *Országgyűlés*, which decides by simple majority. As regards labour income, these rules are the mandatory flat tax, the 50% cap on the tax wedge and the family allowance rule. The latter states that an increasing amount per child has to be provided, depending on the number of children. As regards the taxation of business income, the Stability Act contains a flat tax rule.⁶⁹

The short preliminary response to the central question above and the *conclusion* is that the overall tax burden borne by each taxpayer, whether as a taxpayer or as a non-taxpayer (e.g. a consumer in the VAT system), must comply with the ability-to-pay principle, which is a special tax principle of equality – meaning that the same taxpayer must be handled in the same way, and different taxpayers must be handled in a different way.

To make this short conclusion and the argumentation in this study clear, it is necessary to clarify some basic elements of the terminology as they are understood in this study. First, the principles of ability-to-pay, faculty, and capability are synonyms.⁷⁰ Second, the ability-to-pay principle applies to both natural persons and legal entities.⁷¹ Third, the ability-to-pay principle is a yardstick for direct and indirect taxes. Therefore, fourth, the ability-to-pay principle is the benchmark for the sum of all taxes paid by natural persons and legal entities as tax subjects or simply as the bearers of the tax burden. In other words, the ability-to-pay principle is a yardstick for the complete income and wealth of natural and legal persons. The terminology is not merely based on the normative ideas of the author, but on the explanatory memoranda of two Constitutions referred to below and the decisions of the Constitutional Court.

At this point, we arrive at difficult terrain because differentiation is inevitable. This concerns whether – as examples of differentiation – the family policy preferences which occupy a prominent place in Hungarian tax policy, and the contested sectoral taxes on banking, retail trade, energy and other sectors are compatible with the principle of ability to pay as thus conceptualised.

3. Ability to pay as a condition of social justice in the constitutional texts

The purpose of the ability-to-pay principle under Hungarian law is to ensure burden sharing according to the principle of social justice, as can be read in the legislative explanatory memorandum of the Fundamental Law. The previous Constitution, as

⁶⁹ 36–38. § of Stability Act.

⁷⁰ E.g. R. Musgrave, *The Theory of Public Finance: A Study in Public Economy* (McGraw-Hill, New York, 1959) 94; S. G. Utz, Ability to pay, (2002) 23 (4) *Whittier Law Review*, (867–950) 867–869; E. Seligman, *The Income Tax* (MacMillan, New York, 1914) 3–22.

⁷¹ Constitutional Court decision 8/2007. (II. 28.), C-75/18. *Vodafone Hungary v NAV*.

amended in 1989, created the constitutional basis for taxation similarly on the basis of the principle of ability to pay ('according to income and wealth'), and its explanatory memoranda also defined the legislative purpose of the ability-to-pay principle, as equity in taxation. That means that taxation under the Hungarian constitutional system will meet the condition of the ability-to-pay principle if it meets the condition of social justice or equity in the previous wording. Therefore, one must first clarify *the concept of (social) justice* as far as the context requires it.

4. Aristotle's concept of justice

The literature on distributive justice frequently commences the discussion of this topic by referring to Aristotle. He says that *justice seems somehow to be equality*.⁷² Aristotle's interest in justice and equality came from his presupposition that harm to this rule is one of the causative factors of social upheavals, revolutions and changes in the form of government.⁷³ He distinguished between arithmetic and geometric equality. The first is based on equality in numbers, the latter on value, and therefore, proportionality is required as the means of expressing equality and, at the same time, difference.⁷⁴ For Aristotle, inequality means injustice. He made a distinction between universal and partial justice (equality), and within the latter, he also defined two categories, namely commutative and distributive justice. The concept of distributive justice for Aristotle applies to the justification of the distribution of advantages, such as offices or newly acquired land, among the members of the political community. Aristotle analysed 158 constitutions⁷⁵ and derived the conclusion that the criterion of distribution in different states was merit. However, depending on the form of government, different meanings of merit were utilised in the constitutions. In a democracy, the status of a free citizen qualified as merit; in an oligarchic state, noble status or wealth; while in an aristocratic political system, virtue was the decisive form of merit.⁷⁶ *One can derive the conclusion that the actual political balance of power created the basis of qualification (merit) and, in this way, the basis of distributive justice.* Aristotle offers a solution to the problem of citizens' equality, or rather inequality;

⁷² Arisztotelész, *Eudémoszti etika*, VII. book 9, 1, <https://mek.oszk.hu/05700/05709/05709.htm#5> (last accessed: 31.12.2024.).

⁷³ Takács P., Az ókori politikai bölcselet vázlata, in Egresi K. et al., *Államelmélet* (Széchenyi Egyetem, Győr, 2016) 12., 17.

⁷⁴ Arisztoteles, *Politika*, V. book, 1, <https://mek.oszk.hu/04900/04966/04966.htm> (last accessed: 31.12.2024.).

⁷⁵ Sarkady J., Bevezetés, in Arisztotelész, *Az Athéni állam – Pseudo-Xenophón: Az athéni állam* (Akadémia, Budapest, 1954) 7–17.

⁷⁶ Aristotle, *The Nicomachean Ethics*, (5th ed., Kegan Paul, Trench, Trubner & Co., London, 1893) 145–146.

however, the criterion (i.e., merit) for qualification is abstract and flexible and depends on the form of dominance (form of government) and the value judgements and interests it is imbued with; ultimately, it is power that decides.

5. The evolution of the concept of fair taxation

With respect to taxation, a usual starting point in the discussion of fair taxation is Adam Smith's maxim of proportionality.⁷⁷ Having presented this principle, based on geometric equality, Smith devised an answer to the question of how inequalities – such as those in the post-feudal context – could be handled to ensure equality in taxation. According to his concept, market-based income structure need not be modified. There are two ways of understanding his maxim; one of them is the so-called benefit approach, and the other is the ability-to-pay approach. They do not correspond directly to the individualistic and communitarian theories in terms of redistribution.⁷⁸ They differ from each other on the basis of the relationship between the individual and the state and in the relationship between tax payment on the one hand and services provided by the state on the other, or, more plainly, the two sides of the budget.⁷⁹ Some authors – e.g. De Viti de Marco – have argued in favour of a progressive tax rate on the basis of the benefit principle.⁸⁰

John Stuart Mill solved the issue of excluding the exchange concept included in contractarian benefit theories by applying a concept of state in which the functions of the state, the existence of the state itself, create the justification for taxation. He also offered an answer to the equality-inequality question via his equal sacrifice theory, which creates the basis for linear taxation that does not modify primary income distribution.⁸¹ This equal sacrifice model was transformed into the equal marginal

⁷⁷ A. Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Book V, Chapter II, Part II, https://www.econlib.org/library/Smith/smWN.html?chapter_num=36#book-reader (last accessed: 31.12.2024.).

⁷⁸ R. Nozick, *Anarchy, State and Utopia* (Blackwell, Oxford, 1999, reprinted); A. Wagner, Three Extracts on Public Finance, in R. A. Musgrave and A. T. Peacock (eds), *Classics in the Theory of Public Finance* (Palgrave Macmillan, New York, 1967, 1896) 1–15; J. Rawls, *The Theory of Justice* (Harvard University Press, Boston, 1971); M. J. Sandel, *Justice: What's the Right Thing to Do?* (Straus and Giroux, Farrar, 2009); A. Macintyre, *Az erény nyomában – Erkölcselméleti tanulmány*, (Osiris, Budapest, 1999) 327–341.

⁷⁹ Musgrave, *The Theory of Public Finance: A Study in Public Economy*, 62.

⁸⁰ Musgrave, *The Theory of Public Finance: A Study in Public Economy*, 72–73; A. Petretto, The Modern Theory of Regulation as an Inheritance of De Viti de Marco's Cooperative State, (2014) 9 (21) *Working Papers – Economics (Università degli Studi di Firenze)*, 1–23.

⁸¹ Musgrave, *The Theory of Public Finance: A Study in Public Economy*, 90; R. Musgrave, A Brief History of Fiscal Doctrine, in A. J. Auerbach and M. Feldstein (eds), *Handbook of Public Economics* (North-Holland, 1985) Vol. 1, 18.

sacrifice version, which emerged as the ‘correct’ solution, as it has an immediate fairness appeal, according to Musgrave.⁸²

Richard Musgrave formulated the ability-to-pay principle by applying its two components, horizontal and vertical equity.⁸³ It is important to note that he applied the terms ‘equality’ and ‘equity’ as synonyms, which sometimes causes confusion.⁸⁴ Musgrave’s formula embraces the solution to the question of how equality as horizontal equity and inequality as vertical equity can be considered. The concept was born in the Second World War era when the welfare state was invented. To summarise the burden-sharing principles, the authors intended to develop the defining principle of equal and therefore fair taxation – in the modern era – within a framework of equality of rights and inequality of income and wealth. The basic question in defining the principle is whether the primary – market – distribution of income should be modified.

It is important to emphasise in this context that income is a relevant but not the sole index of ability to pay, and income tax is a strongly relevant element of the tax system, but not the sole tax type and is not the only tax burden borne by taxpayers.

6. Contemporary concepts involving the ability-to-pay principle

Reading the contemporary Hungarian and foreign literature, it can be recognised that different authors attribute different meanings to this principle. Some examples are worth mentioning to illustrate the problems of concept formulation.

In the Hungarian literature, Gábor Földes’s view is that the ability-to-pay principle is a conceptual element of proportionality and implies a progressive tax rate. However, the principle applies only to the tax system as a whole, not to each individual tax.⁸⁵ Dániel Deák distinguishes between the concepts of proportionality and ability to pay, and the latter implies the application of a progressive tax rate. However, this is only applicable to natural persons.⁸⁶

As for the foreign literature, Ekkehart Reimer and Gianluigi Bizioli write that the principle of equality applies to the field of taxation – treating the same as the same, treating different as different – employing the concepts of horizontal and vertical equity. However, the principle of equality is described as merely providing a structural – relative – guarantee, whereas the principle of ability to pay does more than that. It limits the

⁸² R. Musgrave, Horizontal Equity, Once More, (1990) 43 (2) *National Tax Journal*, (113–122) 115–116.

⁸³ Musgrave, *The Theory of Public Finance: A Study in Public Economy*, 160.

⁸⁴ Musgrave, A Brief History of Fiscal Doctrine, 16; Musgrave, Horizontal Equity, Once More, 114–115.

⁸⁵ Földes, *Adójog*, 107.

⁸⁶ Deák D., A közteherviselés alkotmányos tartalmának változásai Magyarországon, (2015) 19 (1) *Fundamentum*, (37–54) 45.

taxing power in its choice of possible tax objects and contains an absolute ceiling and exemptions concerning the minimum subsistence level.⁸⁷ Joachim English and Hanno Kube explain the concept of the ability to pay, which was worked out by the German Constitutional Court. Traditionally, the Court judged the constitutionality of income taxes based on the principle of ability to pay but recently extended the application of the principle to other direct taxes, in particular inheritance and gift taxes. If the constitutionality of a tax is to be judged based on the ability-to-pay principle, it must comply with the two standards of justice, horizontal and vertical equality.⁸⁸ According to Joachim Lang, the ability-to-pay principle justifies only a linear burden. To justify a progressive tax rate, it is necessary to apply the welfare state principle in addition to the ability-to-pay principle, because the ability-to-pay principle does not serve social policy purposes. He considers that this principle only applies to personal income tax.⁸⁹ The problem with the ability-to-pay principle, says Wolfgang Gassner, is that everyone understands exactly what it means, but no one can explain it. In his view, the principle of ability to pay does not exist as a universal principle of law but can only be interpreted in a particular legal system. He says that German and Austrian law have many common features, thanks to their historical roots, but the ability-to-pay principle must be interpreted in both countries within their own constitutional frameworks, which are different.⁹⁰ Peter Essers and Arie Rijkers have reason to doubt that there will ever be an interpretation of the principle that is universal.⁹¹

Continuing the above line of thought, the ability-to-pay principle is a historically evolved legal principle, which has developed under different conditions in different countries.

⁸⁷ Bizioli and Reimer, Equality, ability to pay, and neutrality, 63–64.

⁸⁸ J. English and H. Kube, Constitutional Requirements for Substantive Tax Law in the Federal Republic of Germany, (2023) 2 (3) *Review of International and European Economic Law (RIEEL)*, (123–141) 128–129.

⁸⁹ J. Lang, The Influence of Tax Principles on the Taxation of Income from Capital, in P. Essers and A. Rijkers (eds), *The Notion of Income from Capital*, (IBFD, Amsterdam, 2005) (EATLP International Tax Series vol 1.) 3–31.

⁹⁰ W. Gassner, The Influence of Tax Principles on the Notion of Income, in P. Essers and A. Rijkers (eds), *The Notion of Income from Capital*, (IBFD, Amsterdam, 2005) (EATLP International Tax Series vol 1.) (33–52) 42., 44.

⁹¹ P. Essers and A. Rijkers, General Report, in P. Essers and A. Rijkers (eds), *The Notion of Income from Capital*, (IBFD, Amsterdam, 2005) (EATLP International Tax Series vol 1.) (281–337) 291.

7. The ability-to-pay principle as developed by the Constitutional Court⁹²

Given that the Constitutional Court's fiscal jurisdiction has been limited over the past decade and a half, the analysis is based on the decisions of the old Constitution, given that the tax clauses of the two constitutions are essentially identical. When discussing the concept of the ability-to-pay principle, one cannot avoid pointing out that the concept of tax in Hungarian law – according to the legislative practice and the jurisprudence of the Constitutional Court⁹³ – embraces all the three goals of taxation:⁹⁴ financing the state, redistribution, and regulation.

Although the ability-to-pay principle was included in the text of the Constitution in 1989, the Constitutional Court discovered it relatively late, in 2009, and it applied this principle to a negligible extent not only before but also after 2009; its decisions were based on the general equality principle. This was presumably because the conceptual framework of the constitutional law dogmatics developed by the Constitutional Court was largely influenced by the practice of foreign constitutional courts, especially the German one. The German Basic Law does not contain the principle of ability to pay; it was derived from the general principle of equality by the German Constitutional Court.

The Constitutional Court first ruled in 2009 that the principle of ability to pay is a special equality principle governing taxation.⁹⁵ It based its decisions on this constitutional principle in cases where the disproportionality of a tax type was explicitly at issue.⁹⁶ In other cases, where issues of horizontal⁹⁷ and vertical⁹⁸ equity arose, petitions and the decisions were based on the non-discrimination clause contained in 70/A §.

The Constitutional Court has ruled on the two extremes of the ability-to-pay principle, that is, the exemption of the minimum subsistence level and the prohibition of confiscation. The Court rejected the petition concerning the exemption from taxation of the minimum subsistence level.⁹⁹ The Constitutional Court also ruled on excessively disproportionate and confiscatory taxes.¹⁰⁰

⁹² See: I. Simon, Restricting the Legislative Power to Tax – National Report: Hungary. In *Restricting the Legislative Power to Tax*, IACL 17th Congress (General reporter: Henry Ordower), (2007) 15 (2) *Michigan State Journal of International Law*, 341–369.

⁹³ For example, Constitutional Court decisions: 31/1998. (VI. 25.) V.; 440/D//2001. (V. 12.) III.1.; 657/B/2005. III. 2.1.

⁹⁴ R. S. Avi-Yonah, The Three Goals of Taxation, (2006) 60 (1) *Tax L. Rev.*, 1–28.

⁹⁵ Constitutional Court decision 127/2009. (XII. 17.) IV. 2.

⁹⁶ E.g.: Constitutional Court decision 1531/B/1991.

⁹⁷ E.g.: Constitutional Court decisions 54/1993. (X. 13.), 34/1997. (VI. 11.) V.2., 137/B/1991., 191/B/1992., 12/1994. (III. 2.), 3/1995. (II. 17.), 1872/B/1991.

⁹⁸ E.g.: Constitutional Court decisions 1558/B/1991.; 140/B/1995., 61/1992. (XI. 20.).

⁹⁹ Constitutional Court decision 85/B/1996., 1253/B/1996.

¹⁰⁰ Constitutional Court decisions 1531/B/1991., 184/2010. (X. 28.), 37/2011. (V. 10.), 37/2011. (V. 10.), 6/2014. (II. 26.); Chronowski N., Az Alkotmánybíróság második határozata a 98 százalékos

8. The issue of the overall tax burden in the context of the ability-to-pay principle and a potential solution for resolving the issue

In its decision, the Constitutional Court stated that the tax system as a whole must comply with Article 70/I/I of the Constitution, which is in line with the principle of ability to pay.¹⁰¹ Despite the fact that the Constitutional Court has ruled on this, the result of its decisions shows that another picture has emerged. As a former justice of the Court explained in a study, the Constitutional Court does not observe the tax system as a whole on the basis of the ability to pay since it has no mandate for that. The Court has the mandate to observe the constitutionality of single tax statutes in the form of abstract and concrete norm control only, and not the overall tax burden-bearing capacity that must be observed in the context of the ability to pay.¹⁰² *The problem with this concept is that if each tax meets the condition, it does not mean that the tax system as a whole does. This is the key problem of the Hungarian tax system, analysing it from a constitutional perspective.*

Measuring the total tax burden on taxpayers using economic statistics methodology and information technology is likely to be almost as accurate as measuring inflation. As changes in the consumer price index do not reflect either the personal inflation of people or the inflation relevant to individual business organisations, the overall tax burden can only be determined for statistically identifiable groups in each tax system, taking into consideration the effects of each tax type. Then the tax burden can be considered and limited. Obviously, the first objective is to equalise the burden via eliminating the regressive effect of indirect taxes on individuals. With the current state of information technology, the system can be refined to apply qualitative parameters in addition to quantitative indicators.

IV. THE INTERPRETATION OF THE POST-2010 TAX REFORM

1. The merit of the issue: some data on households' ability to pay

a) An example of middle-class incomes: in 2009, the net income of a four-member family with two kids was HUF 240,000, provided the parents, in their early forties, were secondary school teachers. This was equivalent to 114% of the subsistence minimum (HUF 208,000) for a household of four with two active members and two children, according to the figures of the Central Statistical Office.

különadó ügyében, (2012) 3 (3) *Jogesetek Magyarázata*, 3–11; Kecső G., A pénzügyi tárgyú törvények alkotmányossági felülvizsgálatának korlátai, (2020) (10) *Jogtudományi Közlöny*, 471–479.

¹⁰¹ Constitutional Court decision 127/2009. (XII. 17.) V. 2.

¹⁰² Tertyánszkiné Vasadi É., A magyar Alkotmánybíróság pénzügyi tárgyú döntései, in Hajas B. and Schanda B. (szerk.), *Formatori iuris publici* (Szent István Társulat, Budapest, 2006) 483.

b) Hungarian real wages did not increase between 1990 and 2009.¹⁰³ The socialist system was – conceptually – based on redistribution, thus all welfare (e.g. healthcare, schooling) services were provided by the state free of charge. Now, only a fragment of those services is covered by public finances.

c) Although the proportion of those individuals who would not be able to cover an unexpected bill for cc 200 euros because of their lack of savings decreased from 75% to 35% between 2013 and 2019,¹⁰⁴ the economic effects of the pandemic and the war in Ukraine increased this figure again.

d) A closer look at the wage structure at the national level may also add important information. The national average net wage (5th decile in the gross wage statistics) was one and a half times more than the subsistence minima (HUF 75,024 in 2009 and 78,736 in 2010) in 2010; this figure was two and a half times more in the seventh decile, in the eighth decile the net wage was three times more than the subsistence level and in the ninth decile four times more. There was a very narrow scope for the progressive taxation of labour income, and this is true of the present situation as well, in spite of the fact that the last couple of years have brought an increase in wage levels.¹⁰⁵ In 2010, the highest (10th) level decile was composed of cc 46,000 taxpayers whose monthly gross income was 1.5 million Hungarian forints, or 780 thousand net, after (progressive) tax and social security contributions.

e) The effective personal income tax rate was 16.34% on the global tax base (basically wages) in 2010.¹⁰⁶

f) According to estimates, 20-33% of the tax base remained untaxed between 1990 and 2009.¹⁰⁷

¹⁰³ Kovács I., A jövedelemeloszlás és jövedelemegyenlőtlenség a személyi jövedelemadó-bevallási adatok tükrében, (2011) 89 (3) *Statisztikai Szemle*, (294–312) 306–307.

¹⁰⁴ Central Statistical Office, *Standard of Living of Households 2020*, <https://www.ksh.hu/docs/hun/xftp/idoszaki/hazteletszinv/2020/index.html> (last accessed: 31.12.2024.).

¹⁰⁵ STATADAT: 2.1.35. *Az alkalmazásban állók havi bruttó átlagkeresete a nemzetgazdaságban (Employees' monthly gross wage) (2000–)*, http://www.ksh.hu/docs/hun/xstadat/xstadat_eves/i_qli012b.html (last accessed: 31.12.2024.).

¹⁰⁶ National Tax and Customs Authority, *Personal income tax statistics 2004–2010*, <https://nav.gov.hu/nav/archiv/szolgaltatasok/adostatisztikak> (last accessed: 31.12.2024.).

¹⁰⁷ E.g.: Krekó J. and P. Kiss G., *Adóelkerülés és a magyar adórendszer*, (MNB, Budapest, 2007) (MNB Műhelytanulmányok 65) 4., 31.

g) 90% of members of the Hungarian population live in their own residential property.¹⁰⁸ This is the only reported saving for 80-90% of households.¹⁰⁹

2. The dual structure of the Hungarian economy

Andreas Nölke and Aljan Vliegenvhart proposed to name the economic systems of East-Central European countries, among them Hungary, dependent market economies. These economies differ from the two traditional models, i.e. the liberal model represented by the US and the coordinative model represented by Germany.¹¹⁰ The main feature of dependent market economies is the dominant role of foreign ownership. Taking the example of Hungary, foreign-owned companies accounted for 50% of both the gross income and gross added value of GDP between 2010 and 2015. In the energy industry, their gross income proportion was 71.3% in 2010 and 55% in 2015. As employers, these companies employed 25% of the labour force in Hungary.¹¹¹

Hungary was in a deep crisis before 2010.¹¹² After the election, Hungary chose a process of crisis management that was different from the then widely applied orthodox method; therefore, it was named 'unorthodox'. The root of the conflict between Hungary and certain power centres in the Western world – including the IMF, the EU, and some of its Member States – was fiscal, which was a consequence of the tax reform.

3. The unorthodox tax reform

The key concept of the tax reform was to decrease fiscal levies on labour and on business – as it was thought that this would increase the level of employment and support economic growth – and to maintain the high level of consumption taxes. Also, the linear income tax rate and family tax allowance were significantly increased to support wage-earning middle-class families with children.

The loss of revenue from personal income tax was covered by the state through special taxes introduced on certain sectors of the economy. These special taxes,

¹⁰⁸ EUROSTAT: *Owning or renting? What is the EU's housing situation?* December 2021, <https://ec.europa.eu/eurostat/de/web/products-eurostat-news/-/wdn-20211230-1> (last accessed: 31.12.2024.).

¹⁰⁹ Erdős T., Az adózás, a hatékonyság és a gazdasági növekedés kapcsolatának néhány elméleti problémája, (2014) 61 (különszám) *Közgazdasági Szemle*, (1–76) 34.

¹¹⁰ A. Nölke and A. Vliegenvhart, Enlarging the Varieties of Capitalism – The Emergence of Dependent Market Economies in East Central Europe, (2009) 61 (4) *World Politics*, 670–702.

¹¹¹ Central Statistical Office of Hungary, <http://www.ksh.hu/docs/hun/xftp/idoszaki/pdf/kulfleany15.pdf> (last accessed: 31.12.2024.).

¹¹² Kolosi T. and Tóth I. Gy. (szerk.), *Társadalmi riport 2010 (Social Report 2010)*, (TÁRKI, Budapest, 2010).

temporarily (2010–2012), reallocated the tax burden from labour to certain industries (retail trade, banking, telecommunication, energy). Some tax types remained in the tax system, and some of them were reintroduced to finance the Ukrainian-Russian wartime budget.

4. The constitutionality of the tax reform

The Constitutional Court's competence in fiscal matters was already limited at the time of the tax reform. The question is how to assess the constitutionality of the tax reform in light of its previous practice. In the scope of horizontal equity, the Court decided upon differentiation by tax type (e.g., different business tax regimes for sole entrepreneurs and companies)¹¹³ and within tax types (e.g., differentiation between employees' income and sole entrepreneurs' income on the basis of risk-taking).¹¹⁴ In a landmark decision, the Court decided that "it is the scope of authority of the legislator to decide to create different rules for different groups of entrepreneurs and their taxable activities. This power is limited by the Constitution to ensure that *the regulation shall not result in discrimination within the same selected group of entrepreneurs, within the same scope of activity.*"¹¹⁵ The interpretation of the 'same scope of activity' in this case was a very narrow standard, and the decision made a distinction between providing a loan and its functional equivalent, leasing. As a consequence of the concept of this judgment, sectoral taxes and extraordinary sectoral taxes are in accordance with the Fundamental Law.

The question that arises, regardless of the decisions of the Constitutional Court, is whether it is economically reasonable and morally fair to differentiate between businesses based on the line of business they operate in. Considering the above data, the burden on individual taxpayers did not comply with the principle of ability to pay as it is defined in the Constitution. My view is that the temporary reallocation of burdens to certain business sectors was justified and necessary. Unlike manufacturing companies, which provide local jobs and, to some extent, technology transfer and sell their products globally, the revenue of the industries burdened by additional taxes arises from domestic consumption, and the 'extra profit' realised in the previous decade stemmed more from location-specific than firm-specific rents.

¹¹³ Constitutional Court decision 54/1993. (X. 13.).

¹¹⁴ Constitutional Court decision 191/B/1992; Constitutional Court decision 12/2023. (VII. 13.).

¹¹⁵ Constitutional Court decisions 57/1995 (IX. 15.); 66/2006. (XI. 29.) III. 2. Emphasis added.

V. CONCLUSIONS

1. Two conclusions can be drawn from Chapter II of this study, which are still worth considering today. The first is that throughout history, different balances of power – closely linked to economic strength, military power and technological development – have determined the modes of subordination (the social hierarchy) and the composition of the political actors that decide on taxes. Add to this the fact that those burdened by material services, including taxation, have in quite exceptional circumstances been involved in the decisions. A study of Hungarian history does not lead to the conclusion that there is no taxation without representation. Furthermore, when there is representation, it is mostly formal in terms of tax burden sharing. The other lesson is that although Hungary – apart from during a few short periods – has retained its constitutional autonomy and sovereignty for more than a thousand years, this sovereignty was limited after 1526 due to Turkish, Habsburg, German and Soviet occupation. This meant that Hungary was part of an internal European colonisation process that affected the distribution and use of economic resources and internal capital accumulation. Several attempts to break out were made but were mostly unsuccessful. As mentioned above, Hungary is currently involved in conflicts whose root is substantially fiscal. The most recent notable example is the termination of the bilateral tax treaty by the US because Hungary blocked the adoption of the Global Minimum Tax Directive in the European Council.

As for the most important finding on the distribution of the tax burden, my view is that although the ability-to-pay principle has been enshrined in the Hungarian constitutions since the political transformation in 1989–90, it has limited impact on the actual distribution of the tax burden. The Hungarian tax system is regressive, mainly due to the high weight of indirect taxes and the low income level, which fact may also be realised in comparison with the data of other European countries. In view of the income levels mentioned above, the partial reallocation of the tax burden – the introduction of the flat rate income tax and the sectoral taxes – was necessary. It has reduced the disproportionality of the tax system for the salaried middle class, especially for those with children, thus bringing the tax system closer to the ability to pay principle. Even though the Constitutional Court's powers are now limited, it did not apply the ability-to-pay principle in a meaningful way in the period before 2010, as it was described above. Its decisions are mostly based on the general principle of equality. It must be added that the Constitutional Court did not have the means to apply the ability-to-pay principle to the overall tax burden in a satisfactory manner. As has been mentioned, nowadays, information technology and economic statistics methodologies would allow the principle to be used in the form of a real measurement tool in tax legislation to ensure fair taxation. An especially important lesson to be learned about the concept of the ability-to-pay principle is that it has different concepts in different

legal systems. Reading the definitions in the literature and the constitutional court case law that is cited shows that the concept of the ability-to-pay principle evolved historically and differs from country to country.

A phenomenon worth considering in terms of historical development is that indirect taxes were traditionally a less important part of political debates in Hungary because they were regalia based on the sovereign right of the ruler, and later, some of them turned into state monopolies. Given that similar developments can be observed in some other countries, this may provide an indication as to why the principle is applied only to income tax, in particular personal income tax, in some constitutional systems today.

2. Last among the conclusions is the question of what lessons can be drawn from the investigations into the right to decide on taxation and the ability-to-pay principle from the perspective of Hungary as an EU Member State in the age of the global economy and information technology. If we take seriously the fact that the state has functions to implement that are not being taken over by anyone, then the only reasonable policy is to reinforce the conditions that facilitate the performance of state functions. Thinking in financial terms, maintaining and, as far as possible, widening fiscal and monetary room for manoeuvre and decision-making is a reasonable objective.

The European Union is a soft version of globalisation at a regional level, where the single internal market is accompanied by a common decision-making system and a mechanism to reduce disparities between Member States. However, these equalisation systems are far from sufficient to effectively redress North-South and East-West imbalances. The political and sometimes legal conflicts that have arisen between the EU institutions – and sometimes other Member States – and Hungary have their roots in this system of regional inequality in the European sphere and have been fiscal in their manifestation since 2010, when the recently ruling Hungarian political forces won the elections. The aim of the Hungarian government of the time can be interpreted as an attempt to break out of a serious economic, social and political crisis in the short run and to reduce economic backwardness in the long run. One of the key points of that policy was tax reform, as discussed above.

If Europe is large enough to be analysed from a geographical perspective in a globalized and digitalized world, one may conclude – on the basis of historical experiences – that a country in the landlocked East-Central European area with the size and properties (e.g., demography, natural resources, capital accumulation) of Hungary lacks alternatives in which it has longstanding experience to decrease its economic backwardness. It seems that those areas where the country has competence in an EU context – e.g., tax policy, monetary policy – create the possibility for workable solutions for economic development, although they are associated with difficulties. From a Hungarian perspective, strengthening federative EU structures and modifying competences seem problematic, as I see it.