

András Horváth: The state of combating tax fraud networks in Hungary and its neighboring countries

Introduction

The importance of combating off-shore tax-havens, countering certain tax evasion forms of multinational companies and the revision of the operation of certain bank-systems aiding the illicit capital flight of sums resulting from tax frauds is highlighted at EU-level more frequently nowadays. The methods by which tax authorities try to combating tax-fraud networks in Hungary and its neighboring countries are to expand the inverse VAT-paying method for more and more areas and drafting plans for VAT-decrease (respectively by their realization). All these international and Hungarian initiatives are on the agenda for “whitening” the black economy and taxing the incomes generated there, as well as reaching a higher level of governmental revenues.

What exactly is that area where this “whitening” should occur? What paved the way for the countries of the European Union (and with special regard to Hungary and its new neighboring countries) to feel the obligation for taking the above referenced steps, and what could be the real solution? I try to cover all these questions in my essay based on my work as a government employee at the Hungarian Tax Authority, as well as my cross-cutting analysis regarding the **grain and food industry**. Taking into consideration that the Hungarian tax fraud networks are not independent from similar entities in the neighboring countries, and that they are cooperating to achieve higher effectiveness, my analysis will discuss the taxation anomalies in the East-European region (regarded in a wider sense), and I also try to point out that these situations resulting from a longer process need a treatment at the Union level, and much more attention should be paid to these issues by the European Union.

In my essay I will present those elements of the Hungarian Tax Authority (and the harmful processes that can be observed there) which have expressly aided the proliferation of black economy, and without the modification of which there is no chance for long-term and effective countering measures against the fraud series damaging the state budget and infecting full sectors. I also will present the macroeconomical impacts that are resulting from the above mentioned processes – and which seem to be avoided in the communication by the governments involved – and which nevertheless have a destructive effect both on social and economical level.

A few highly important figures from the above mentioned two areas

The tax fraud networks that are operating across the borders are based on the so called “missing traders” that are carrying out no economical activities and which are operated by organized criminal groups expressly for the fulfillment of fraudulent transactions. In the field of food industry these companies – **140 limited liability companies** based on the data *processed until now* – have **effactuated procurements** from January 2011 until June 2013 in a sum of **213 billion HUF** (in 2011 75 billion HUF, in 2012 120 billion HUF) from **Slovakian, Rumanian, Czech and in a lesser part Slovenian companies** strictly with and intent of tax fraud. These type of invoicing “stars” most frequently granulated sugar, cooking oil (mostly sunflower-oil), various meat industry products and live pigs, coffee, milk and other dairy products, as well as energy drinks. Before we move forward it is important to see the **areas** where missing traders are utilized.

One area is the classical aim of tax fraud in which case certain companies with different backgrounds and roles on the market claim **illegitimate VAT-refunds** with the utilization of cross-border transactions (carousel transactions), and the commodities are often missing. In these cases the company giving in the refund claim can be regarded as the “top of the fictitious invoice chain”, and the missing trader as a buyer is the “taxpayer” of another country. A **new chain can start**

there, resulting in tax-refund claim in the recipient country as well, or recycling the products to another merchant towards the sender country.

The other area of utilization occurs regarding those taxpayers who receive fictitious invoices with the **aim of cost-decrease**, or when they sell the products that are bought on behalf of the missing trader **without invoices in the inland** (within the country). In this case it is **necessary to derecognize the false invoice contents or the products sold on the black market in another country**, that is, the bogus sales in an alien country. This is the point where the phantom enterprise from a neighboring country enters the process and hinders, or delays at least, the investigational work of the authorities of one or more countries regarding these unlawful transactions.

Naturally the missing trader can be found at the end of the chain in each described variation.

My observations were concentrating on 27 Hungarian and 4 foreign companies (the 4 latter ones have a Hungarian VAT-number, they are so called VAT-registered companies) that have marketed food products in vast amounts in the regional countries (most of it was marketed in Slovakia, whose market size is half of Hungary's market size) **with the background mentioned above**, and the **products have characteristically returned to Hungary in a short period**. The products arrived to **those phantom companies** that – as I mentioned above – have effectuated procurements in a sum of 213 billion HUF from January 2011 until June 2013. The above mentioned 31 companies have delivered food products into the neighboring countries in a worth of **133 billion HUF** during the period of January 2011 to June 2013. The annual average sum of the deliveries between 2010-2012 was 55 billion HUF. This last piece of data is interesting, because in this period of time the **result of sales** towards suspicious foreign companies for the above mentioned company group was **threefold compared the result of 2009**. It indicates that we are facing an explosion-like change, which is even more apparent, when we know that the majority of these companies had no or just insignificant commercial relationships with a Slovakian partner. **The run-up (we could also say the recruiting) phase occurred between 2010-2011**. Although real transactions may have mixed with fraudulent transactions, having regard to the known circumstances we can assume that behind the majority of sales there are significant budgetary wrongdoings. In this taxpayer circle the invoiced total sum reached 208 billion HUF starting from 2008 until the first half of 2013.

The companies involved in these invoicings can be regarded as middle size taxpayers (with the exception of one), **their annual revenue is between 2-10 billion HUF**. It is an important circumstance, **that almost every one of them is considered a large taxpayer** in the county where they are registered according to the jurisdictional regulation. A few of them operate discount-shop networks and retails, there are some that are known country-wide, and the same can be said about the commercial partners operating on the Slovakian side. But – as I previously mentioned – these recycle the majority of the products into a phantom company network operated in Hungary. An identical phantom company network operates in Slovakia, Rumania and the Czech Republic as well. The executive managers and owners of the Czech companies are in general Slovakian, occasionally Rumanian private persons, and **Hungarian private persons are in significant cases in charge of the Slovakian companies**. It is common to have Serbian or Ukrainian citizens as frontmen at Hungarian missing traders, and there are quite a few Rumanian citizens involved.

One could observe a specific co-operational method that had the following mechanism: the decreased VAT-refund amounts claimed in the year 2012 as well as the food product sales towards suspicious Slovakian companies were substituted with sales that had an identical background and direction of Slovakian and Rumanian resident companies who also had a Hungarian tax number (they are the so called VAT-registered companies). On the basis of the Hungarian regulations the VAT-registered taxpayers' activities and operation in Hungary is completely impenetrable for the majority of tax controllers, because there are specific competence regulations regarding these taxpayers.

If we now ask the question: where is the performance of the missing traders utilized, **we reached to the next** – and from the point of view of the state budget, the most damaging – role, namely serving the **demands of the multinational merchant/trading companies**. In this case, the missing trader

(or more precisely: the merchant staying in the background) establishes the price deep below the procurement price (the 27% VAT gives a large room for it) thus avoiding the tax-paying obligation in the inland; he adds a virtual VAT upon this sum, which will be deducted unlawfully by the multinational wholesale company or retail chain with the help of a few tax fraud companies. The beneficial company is able to obtain the products at a much cheaper price compared to buying it from the real seller (producer, distributor). And this area is exactly the one where the Tax Authority has the least effective performance – which I will explicate in the following chapters.

At this point we have to note the fact that in many cases the trucks drive to the site of the multinational wholesale chain **directly** and the goods (such as cooking oil) are brought into the warehouse, as if there were no other companies before this step in the chain. (These companies are nonetheless involved in the documentation!)

It would be difficult to establish the exact tax-obligation of the above mentioned fraudulent invoice-processes, namely if we pick the Hungarian point of view, the distributed products have various tax-rates, some have 27% (previously 25%) and some have 18%. The above mentioned company group that is constituted of 31 members has damaged the Hungarian budget at an estimated annual 10-15 billion HUF, nevertheless, the sum embezzled by multinational retail-chains is even a multiple sum of this. Furthermore, the **phantom Hungarian procurements may cover for Slovakian, Rumanian and Czech VAT-refund transactions**, which are often reported by the partner countries' authorities, and it even occurs that in the same carousel-transaction sequence the taxpayers of multiple countries attempt to claim tax-refunds (on the same products).

I could manifest procurements made by Hungarian missing traders in a sum of **60 billion HUF** for the year 2011 and **40 billion HUF** for the first half of 2012 in the area of oilseed-trade. (These data refer to the current state of processed information.) **The procurement sources are almost exclusively Rumanian and Slovakian taxpayers** (I registered the data of 59 such companies), and some of them have had a turnover of 10-12 billion HUF resulting from the transactions with Hungarian partners. It was characteristic for quite a few of them (similarly to the food product traders) that they issued invoices in the direction of Hungary to the same extent that they have made procurements from Hungary. Among the Hungarian exporters making business with these type of companies there were also large taxpayers.

The majority of grains produced in Hungary was exported to Western-Europe by multinational companies owned by foreigners and – to a smaller extent – by Hungarian companies. The grain and oilseed sales by Hungarian small and semi-size companies towards Rumania and Slovakia can be considered fictitious in the majority of the cases. These products arrived back in Hungary through missing traders, and with the virtual ('on paper') assistance of a few invoice issuer (tax fraud) companies arrived **directly at the warehouses of the exporters**. It is important to highlight, that the VAT-amounts previously deducted and claimed as refundable, were **not** paid at previous stages of the chain, and the price advantage was utilized by the real beneficiaries of the sector. These procurement chains could be tracked back to the missing traders in almost each case, these traders were involved during the mentioned 1,5 years in fraudulent transactions of a sum of 100 billion HUF.

Upon observation of the VAT-refund and allocation data of 21 grain-traders (among them the largest multinational exporters) it is striking that something unordinary did happen between 2011-2012 in this area as well.

The value of **VAT-refund claims** has **doubled** in the period of July 2011 to June 2012 compared to the period of July 2010 to June 2011, and the sum of tax allocation (effectuated by the authority) has multiplied by 1.5 in the period of January 2011 to June 2012, compared to the previous two years (2009-2010). (This growth was 42 billion HUF.) At the data procession level of 80% it can be ascertained that if we isolate the 10 biggest from the above mentioned company group, we can establish that the amount that they deducted and claimed refundable and **is** displayed on invoices regarding procurements from companies that are operating expressly or largely with the aim of tax

fraud exceeded 29 billion HUF in 2011. Behind this are those fictitious invoice chains that reach to the Slovakian and Rumanian taxpayers.

The surge in the number of tax refunds can be tracked back to two modifications of legislation. From July 2011 the **inverse taxation** was introduced on the distribution of grain and oilseed-products in **Rumania**, and the same taxation method was introduced in **Hungary exactly a year after this for the same products**. It was this year where the number of VAT-refund claims has risen to a never before witnessed level – and (sadly) so has the extent of VAT-allocations on behalf of the government. This implies that the **VAT-profits lost in Rumania were complemented in Hungary by organized criminal groups**. As we can conclude from the figures described above, the Slovakian-Hungarian-Rumanian tax fraud/phantom companies were quite active in this critical period. This activation (and the upcoming date, the 1st of July, 2012) eventuated that companies infected with tax fraud supplier networks could effectuate a threefold growth in the amount of their VAT-refund claims in the 1st semester of 2012, compared to the previous years' 1st semester data.

In the light of the above we may ask the question: how did the Tax Authority react upon this?

The attitude of the Tax Authority

There are tax inspections in process at 27 food traders (except for two). Unfortunately these controlling processes are **not full scale**: there are companies at which the Authority did not have sufficient resources to execute an inspection for the previous years, and there are companies at which the Authority does not examine the tax declaration, filed in later periods, even though the basic conditions for the order to start controlling processes have not ceased to exist. This can be explained only partially with the lack of capacity originating from the structural problems of the Tax Authority.

The situation cannot be declared ideal either if we consider the ratio of tax allocation in this very group: in the period of January 2008 to the first semester of 2013 **85% of the claimed total sum of 26 billion HUF was allocated**. This has happened despite the fact that these claims were the “products” of an organized tax fraud network with foreign relations – as we can conclude from the above described processes. (A determinative part of the allocations occurred in the years 2010-2012.) Among the reasons – as a commonly cited reason on behalf of leaders of the Tax Authority – we can find the threat by the interest payment obligation in the case where the Tax Authority is not able to justify the legality of the deduction of the VAT-amount in question. Partially because of this – the practice of **transferring the money first and examining afterwards** – has established itself as a common practice. The drawback of it is that the Authority has to “chase the money” once it turns out that tax-refund claim was unlawful. One practice is indefensible, namely that in the process of investigating a certain time period, the Tax Authority is able to see the tendencies, and (in addition) receives indications and reports on fraud – for instance from the Slovakian authorities – but still continues to effect new payments to a virtually failed taxpayer. This can be considered a severe operational mistake at least.

The next problem has surfaced because of the lag in the reaction of the Tax Authority – in several cases more than 2 years – regarding the sudden change in a given company's behavior on a market, and in this time period significant budgetary damages have occurred. The Tax Authority should have recognized the following facts sooner:

- on the buyers' side unusual trading directions had emerged, respectively the number of suspicious partners had increased (mostly Slovakian);
- what was the ground for the sudden increase in the turnover on the suppliers' site (the investigation on tax-minimizing chains);
- among the newly introduced products such products have emerged that are inherently highly risky from the point of view of tax fraud (mostly granulated sugar, cooking oil, coffee);

- and not at all independently from the above factors, the exporters involved had started claiming VAT-refunds in great amounts, or they decreased their tax-paying obligations in a significant extent.

All this is highly interesting, because the products traded by the companies involved were among the prioritized ones in the so called "control directions" of the Tax Authority, and even independently of this the competent leaders should have known about the frequent frauds regarding these type of food products.

On the other hand there were **203 tax-investigations** started at the 140 missing traders (!) who had a total invoiced net amount of 213 billion HUF. Several among them had already finished with the assessment of tax-deficit on the scale of 10 or 100 million HUF. Having regard to the fact that the activities of these 140 "traders" generating chains needs the contribution of even more hundreds of intermediary companies, we can conclude that on the basis of the current practice of the Authority **it may imply further investigations resulting the control of more hundred companies**. The risk management departments of the Tax Authority issue proposals on controls in a vast number. **(But for what reason?) The Tax Authority can "sell itself" this way, and display performance and even its continuous increase**. There is hardly any other benefit resulting from these tax inspections, because:

- a) the tax-paying obligations arising from these inspections are not encashable – in almost 100% of the cases. (According to my knowledge, the determined sum of tax deficit regarding these type of companies was 350-400 billion HUF in 2012.)
- b) The companies involved in inspections are in most cases phantom companies that are operated with "stooge" directors, without any proper business activities, and their documentation is not accessible. The beneficiaries are not these companies, so their inspection could be performed with a simple check of their books and records as well as the invoices (receipts), or the examination of the validity of certain business transactions – as this method has been introduced lately. However, in this case it would not be possible to determine a tax deficit.
- c) The tax-inspections often halted at the level of the investigated company (without moving to other levels), and the full exploration of the underlying organizing circles or the real influence of the company is omitted. There are reasons for this both of objective (nobody can be reached) and of subjective nature, and the managerial expectations are often limited to the aim of determining taxation deficit as high as possible.

Taking the fact into consideration that the majority of these companies have a registered seat at registered office service providers in the region of Budapest and Pest county (not just in the previously mentioned two sectors but others as well), the directorates responsible for these regions at the Central-Hungarian Regional Taxation Directorate-General are facing an insolvable task regarding the management of these companies' cases. The inspection of these phantom companies make up for the only job role of complete tax-inspectorial departments, even though these resources could be used in the Authority for more complex and more important tasks of different nature. I am referring to the organized and full scale inspections regarding the beneficiaries – regarding which there would be a chance to collect the assessed (and unpaid) taxes.

On the other hand, the inspection of the missing traders and the intermediaries are often delegated to organizational units that have a completely different profile. All this is not sufficient: the taxpayers of this type are investigated by authorities in other counties as well – with a presidential permission. The cases are often delegated to them in many cases with the obvious aim of elevating the determined tax-deficit amounts to a level that is expected by the higher management. The direct consequence of the dispersion of issues is that the investigation of these companies operating in most cases in networks lacks the complex approach, they are isolated from the **occasional** investigation of the real beneficiaries of these networks. (Here I am not referring to the investigations ordered by the counties on the catenary investigation of their own taxpayers.) This

operational method results in situations in which the investigation of a given company's tax declaration period takes place in 3-4 countries. We could also ask: where is the efficiency?

Coming back to the investigations of the "27", the fact that these cases are uncoordinated, the important information and evidences produced at other organizational units (such as the units carrying out investigations) will not reach the level of tax auditors, and the fact that managerial support is often missing indicates a further severe dysfunction in the operation of the Tax Authority. I spoke with auditors carrying out these inspections, and they confirmed the previously stated facts: they perform their tasks abandoned, being isolated from important information, without the knowledge about highly important correlations – which is manifested in the efficiency (or more precisely the lack of it) of the inspections – at the latest in the stage of legal remedy of the cases. The circumstance that these kinds of inspections are characterized by the lack of cooperation is seemingly strange, especially in the light of the fact that the Authority has got organizational units for coordination and to support inspections. Those are able to provide "results" when it is necessary, but nevertheless the overall picture is quite sad.

I will not go into details about the investigational circumstances of grain-merchants, because the same applies to them regarding their management by the Authority which I explained in the above part. Nevertheless, I would highlight the fact that (in relation to the largest ones) the tax inspections are concentrating on just a few time periods, even when it is obvious that the company did not only take part in fraudulent transactions in the examined period, but there are antecedents to it, and the company kept on maintaining the relations with the suspicious business partners in a later period as well. Even though the grain sector's infection level is not a new phenomenon, it was present even before the introduction of the inverse VAT, it is quite a telling piece of data that according to the VAT-refund claims in the period of January 2010 until the end of the first semester of 2012 the Hungarian Tax Authority (NAV) allocated 177 billion HUF to the 21 taxpayers mentioned previously – without carrying out necessary examinations. Considering the fact that 30 or even 50 percent of the claimed (and allocated) tax refund amounts were transferred to companies that are constitutive parts of tax fraud invoicing-marketing networks, there should have been more care taken about the immediate inspection of these mammoth companies – apart from the inspections in process at the moment. I will introduce the circumstances that pose as obstacles regarding this necessity.

The causes of operational problems

The inspectorial activities of the Tax Authority lie in ruins to put it bluntly (especially regarding VAT and contributions). This is indicated by the analysis of the tax consultant company Ernst & Young that was published in various media channels on 24th September 2013, which ascertains that the number of such verdicts of the 2nd degree Tax Authority that are in favor of taxpayers who filed in an appeal has significantly risen in the past few years, and additionally the courts make decisions for the benefit of taxpayers more and more often.

The reason behind all these facts is the decrease of the level of inspectorial activities which can be tracked back to the following reasons:

- a) The current level of human-resource management does not ensure the optimal distribution of public servants working at the NAV who have satisfactory knowledge and experience to the critical inspectorial areas, which results in the significant **overload** of the given organizational units and the employees working there, and which is also the first reason for delays in deadlines and inspections.
- b) The underlying reasons for the **internal transfers of workforce** (which have reached a critical level) and the **increased fluctuation** that could be witnessed under the previous government as well are the facts described in the above. It is easy to see that those who stay at the NAV (or return to it) are orienting themselves towards such organizational units or areas where the workload is less and where the work circumstances are favorable in more

aspects. Because the abandoned inspectorial department is not able to make up for the lost workforce in most cases, the managers are neglecting the requests on transfers coming from the employees, but this method is only useful for a shorter period.

- c) The majority of the organizational problems can be tracked back to the **'selection of the unfittest'** among the **managerial staff** that is unable to make decisions in professional questions as well as to fulfill their managerial job roles, and which are incapable of retaining the employees because of their incompetence. (This process is not new, in fact, it started in 2007-2008.) The central element of their attitude is to comply with the orders coming from higher levels and the expectations that degrade public interest without questioning them, even when these orders lead to the operational paralyzation of the organizational units led by them.
- d) The increase of administrative burdens – the extent of which hinder the work in merit significantly, that is the actual inspectorial activities – is a severe problem as well. We have to mention at this point the **proliferation of the reporting system** (which basically is only a waste of energy and time) and the current orderliness of the **jurisdictional regulations**, which can be regarded as a step backwards compared to the previous governmental cycle. The **anomalies of deadline management** also constitute a severe problem. (The vast majority of the connected inspections are ordered not for obtaining information in merit, but to make it possible for the inspector to gain extra time for his/her major inspection or for other inspections. The taxpayers and accountants suffer from this as well.) One reason for the lack of capacity is the approach which can be seen in the **obsolete, much criticized quantitative approach** that is apparent in the performance requirements set out by the high level leaders of the Tax Authority. The basis of bonus given to a certain government officer is based on the fulfillment of a precisely prescribed number of inspection types. It is no need to mention how pointless and counterproductive these regulations are regarding the government officers and organizational units that are combating the organized criminal networks.
- e) **The acknowledgement (professional, personal and monetary)** of public servants who are experienced, creative, self-sufficing and who are able to manage their professional tasks **is generally at a low level**, which can be deducted to the consciously organized processes aiding the survival of the unfittest, namely that the officers who may lack experience and professional knowledge, but in turn are adaptable to the organizational culture – which is centered around hindering the effectiveness ('effet utile') of public interest – are promoted by the authority.

The above factors strengthen each other, the organization slides down the slope ever further, which means that the above circumstances need to be halted, respectively that the current problems would need to be solved instead of hiding them and withholding them. On the other hand it is indisputable that the above described operational anomalies that are hindering the effective and successful combating the tax fraud networks do establish favorable circumstances for the other parties, namely those who benefit from the chaotic circumstances.

The effective combating of the networks mentioned above and of their organizers is **fundamentally hindered by the long-time present method of managing the large taxpayers**, which also can be considered as the plague spot of the operation of the Tax Authority.

In this system the large taxpayers (companies who are registered at the Directorate for Large Taxpayers or at general departments for large taxpayers at the counties) remain uninspected. By this I mean that the auditors do not examine transactions fulfilled by these companies including their substantial elements, instead of this they only perform formal inspections of the accounting and the books and records. The personnel of the competent organizational units are trained to match this practice – they have to comply with demands and expectations coming from higher levels according to a **special philosophy**, namely: “the large taxpayers are law abiding companies, they need special

treatment, they are not accountable for receiving products that are transferred to them by tax fraud networks, their willfulness cannot be proven”.

These organizational units are only willing to perform substantial inspections if there is a strong stimulation to do so in cases that are suspicious of fraud – which cases would normally entail an automatic inspection in the case of taxpayers of a different type and size. This way of administration of large taxpayers could be regarded as unequivocally discriminative and it may trigger a legitimate outrage within the NAV and outside of it.

Regarding the taxpayers who apply for tax refund frequently, the above mentioned mean in practical terms that the auditors perform one or two inspections on the bookkeeping and receipt accounting at certain companies on the basis of designation, which are usually finished after a few days. It is not possible to determine a tax difference at these type of inspections, to do so it would be necessary to convert to taxation scheme control (that is, VAT-control before transferring the money), which is quite rare in the case of large taxpayers. The so called cross-cutting inspections (regarding periods years before) are involving substantial questions rarely, and although it may occur that the auditors determine a lack of paid taxes and contributions, those are insignificant compared to the revenue of these companies, and when we compare it to the complete circle of large taxpayers they are negligible in their total amount as well. This is the ground why in the case of many large taxpayers there are no substantial inspections (inspections in merit) to be found going back to 5-10 years, and this phenomenon is the cause of the tax frauds indicated in the previous chapters.

The facts that I enumerated previously are applying even to a greater extent on grain merchants (and I even met this kind of operational mode of the authority in the case of other sectors), and if someone in the possession of a proper delegation would observe the inspections of multinational retail chains he would experience the same. The undifferentiated inspection of these conglomerates **possessing a great capability to enforce their own interests** is considered a taboo topic at the Hungarian Tax Authority, and these inspections are protected by a **well established system** inside NAV. I mentioned a few elements of this previously.

The fact that there had been an order to start inspections at 25 food wholesaler merchants can be considered as a positive turn of events, although we may have concerns about their results – they may be very limited, which is rooted in the old-established operational problems (and the lack of possibility to solve them) of the Tax Authority. We have to note that the **merchants in question who are involved in inspections are middle-size enterprises owned by Hungarian owners (with the except of one)**, which means that there is plenty room for improvement, because in regard of the actual amounts the extent of tax fraud is the greatest by the multinational companies. The Authority will have hard time when they want to reach successes with those taxpayers in whose regard the proceeding organizational units are key audit departments, because the long-established philosophy and procedural system are hindering it. All these cause a lot of conflicts and weaken the potential for cooperation by those inspectorial projects where auditors (and leaders) from departments for large taxpayers have to cooperate with auditors working at departments that are managing “classical issues”. These problems appear even more intensified at the inspections of the companies dealing with grain.

At this stage we arrived at a node of problems about which there is a lot of informal talk within the Authority, which is known by many, and in which are also many involved (I can name persons like that), but of which nobody dared to speak openly because of existential or other fears. I am talking about those **external acts of influence**, that **impact** the government officers carrying out the tax inspections through the intermediary acts of managers (often in high positions), and behind which strong business and political interest groups – business potentates or oligarchs if you like – are standing, respectively their intermediaries channeling their will. These acts of influence are aimed mostly at the closure or hindering of certain inspections, the decrease of the possibly payable sum arising of the ascertainment of lack of paid tax by the auditor, and setting the uncorruptible government officers aside. The success of these attempts of influence could be unequivocally

proven by a general revision of the records of the Tax Authority carried out on the basis of special principles.

We may ask the question, **whose interest it is to** maintain a legislative context and the overload of tax inspectors – both of which I already mentioned – resulting in the prolongation of favorable circumstances for entities benefiting from fraudulent transactions regardless of the size of the given taxpayer.

Why do the high level managers of the Tax Authority nothing to solve the operational problems that can be a breeding ground for corruption in certain cases? Why do they sweep those problems under the rug?

Who approved and **who did not prevent due to their position the setting aside of auditors and leaders on various levels**, their transfer into different job roles or even their dismissal, when they performed their work with honor, true to their oath as a governmental public servant, according their best knowledge, protecting the public interest, and their only “sin” was that they had got in a conflict with “higher interests”. (We are not just a few people.) This process has been going on for a long time, and its victims are the state budget and indirectly the overwhelming majority of Hungarian citizens.

Why is the person considered as incompatible, who tries to do something for the solution of operational problems, or merely wants to perform his job well, based on his professional experience and knowledge, devoid of manipulative acts of a negative nature?

The solution of tax issues via informal relationships has become systematic but in most cases there is no need to utilize these relationships because the established way of operation is a kind of guarantee in itself to protect the companies that have the greatest tax performance from tax inspections. The majority of leaders ‘know their place and their role’, and know that they should exercise utmost care in the administration of tax subjects who have a certain company size and company background (or ownership with perceived or real political connections). Witnesses for this are the failed inspections, the **tax inspections** ending with insignificant or even without any assessment of missing payable tax (regarding the large taxpayers and their key suppliers) and the officers who have been set aside. Beside all these, the inspectoral unit also can be called as witness with their shattered, dysfunctional way operation which results in easily debatable products.

Anyone who has read the above with attention can see which areas and departments of the operation of the Tax Authority are those where the referenced cases suspicious of corruption may occur. It is not difficult to guess – and it should be actually seen on behalf of the leading organizations – which leadership levels and concrete managerial positions which (who) are responsible for the established situations. It is also a necessity to examine who transferred these managers into their positions.

There is no chance for enhancing the level of inspections (as well as their efficiency and effectiveness) without terminating these deteriorative relationships between certain taxpayers and the Tax Authority. All that is left is the success-propaganda that is often invalid or even full with misleading statements – which was present in an unprecedented extent in the communication of the Authority towards the press in 2013. (This would deserve a study on its own, and I also explained some elements of it in one of my other works.)

Powerless Authority?

The Hungarian daily economic newspaper Napi Gazdaság published a compilation on May 09, 2013 about the situation of tax frauds in the region and which also gives an overview about the operational problems of the the Tax Authority indirectly. The title of the compilation is: ***VAT-scandal: the shops are flooded with black market products in a value of thousand billions Forints.***

According to the report of the newspaper, the excise officials patrolled on the roads close to the Slovakian-Hungarian border for three months. The NAV registered the entry of trucks into Hungary

from Slovakia, and it turned out that after the start of the inspections the number of trucks was 1600 less than the daily average of the reference day which was registered prior to the action. According to the calculations from the newspaper, the value of cargo from the ‘missing’ 1600 trucks could be estimated equivalent to 8 billion HUF (or even twice this amount). (I can confirm this: if we consider sugar, which is among the cheaper products, and also a “bestseller” among products involved in tax fraud one could transfer 38 400 tons – which estimated value is around 8 billion HUF.) According to the estimation of the newspaper, under these circumstances, at this section of the border the inherent VAT-amount of the cargo passing over may reach the value of more hundred billion HUF annually. By projecting the values obtained at the Slovakian-Hungarian border to other sections of the border (Rumanian-Hungarian in the first place) the article gave an estimated yearly turnover of 4-6000 billion HUF of products “shipped without fair intent”, which means a VAT-content of 1000 billion HUF. (The estimates described may be close to the truth – sadly –, we will explain this further on.) The journalist also noted that *according to the experience, these supplies reach their destination in the warehouses of large chains in most of the cases*. We can agree with the following statement of the article: *the Tax Authority is able to catch these types of frauds only at a later moment, because of the inertia of the system*.

These circumstances are really scandalous, so the question may arise: **shouldn’t the responsible persons be found? Why did the Hungarian Tax Authority let things evolve in a way like this? Why doesn’t the Government take steps?**

The statements of this article were not denied, according to my knowledge there was no interpellation at the Hungarian Parliament about this topic, and there were no consequences of it in the Tax Authority either. Have we become so ignorant about the scale of black economy? Does Hungary not need the whitening of black economy and the additional revenue in a scale of thousand billion Forints?

The employees of the NAV have become out of joint about the presentation of the ruling by the Court of Justice of the European Union on the 21st of June 2012 in a case about the proceedings of a Hungarian company versus a regional General Directorate of NAV in which the Court ruled in the benefit of the taxpayer company. The point of this ruling in a nutshell: according to the concerning sections of the **Council Directive 2006/112/EC of 28 November 2006** on the common system of value added tax, the Tax Authority cannot refuse the right of the [taxpayer] to deduct if the taxable person was not in possession of any material justifying the suspicion that irregularities or fraud have been committed within that invoice issuer’s sphere of activity, and as a result of this he could be having no information about taking part in successive tax fraud.

The high level leaders of the Tax Authority shouted from the rooftops (with a certain goal in mind that is obvious) that the exploration of these successive transactions has become significantly more difficult because of the above cited Court ruling, and quite many managers have become puzzled at this, not to mention many auditors, whom they wanted to perplex.

This is a mere misinterpretation and conscious distortion of the Court ruling, because it did not have any novelty or unknown element, and many rulings were passed with identical content since our EU accession. **This misrepresentation is disseminated from the Directorate for Large taxpayers**, me and quite a few of my colleagues have heard from government employees working there this misleading interpretation with the following explanation: “now you see that there is nothing to do” – namely in the case of large taxpayers involved in successive transactions. In reality nothing like this can be deducted from the Court ruling, the fact is rather that **the Tax Authority was not able to present any convincing evidence about the circumstances**, namely that the taxpayer in question was cooperating in the successive sales transactions knowing that he contributed to fraud. Providing evidence is not at all impossible, and I mention more factors in this analysis in connection with multinational retailers that hint at the fact that they must be aware of the fraudulent nature of the background of the business.

The increase of the number of similar passed decisions made by the Tax Authority is a clear consequence of the operational problems that I enumerated in the previous chapter.

There may be two reasons behind the dissemination of misleading information.

The first is that at the end of 2011 the Directorate for Large Taxpayers started multiple inspections at multinational wholesale chains (not by their own free will), for it came to light that these chains have accepted invoices from quite a few companies that are involved in successive transactions of tax fraud. After a while it has become evident that these inspections cannot be closed without tax assessment even **for those employees of the Authority that are the major defenders** of the operational scheme which disregards the substantial inspection of taxpayers – that I had already drew up. The overstatement of certain parts of the rulings of the mentioned type and the communication of misconclusions may contribute to the loss of impact that the tax assessments (which are of a much smaller scale compared to the scale of the fraudulent transactions – this being a sad practice) can eventuate regarding the cases in proceeding.

Furthermore, keeping the misconclusions from these type of rulings on the agenda may halt many employees from examining the substantial authenticity of transactions made by large taxpayers (the major beneficiaries in the catenary transactions) in the future, or even to initiate these kind of inspections.

The other reason is obvious too.

Shortly before the beginning of the misleading action the announcement of the Bonafarm group was published (which I will refer to later on) which pointed out in a taboo-breaking way that the **multinational retail chains are stuffed with products of untaxed origin, and of which fact the chains had to have knowledge**. These taxpayers are in the protected circles, and this way we can understand the specific reaction described above on behalf of the Authority.

The **background check of the units responsible for Large taxpayers** would be of great importance, because the above described facts indicate that there are some departments and leaders at the Tax Authority that or who are interested in the sustainment of the positive discrimination of multinational or strong Hungarian companies – due to pressure coming from business and/or political interest groups – instead of representing the public interest. This phenomenon deprives the state budget from tax revenues of a magnitude of thousand billion Forints yearly.

The daily newspaper Napi Gazdaság published two articles (January 2nd 2013 and May 9th 2013, respectively) about the fact that the auditors' position has become more difficult because of the judgments, how puzzled they are, and that there is need for the introduction of new methods for the old ones are not working anymore. (But for what reason?)

There are in fact two inspectorial techniques that are utilized more frequently in the recent period than they were before, and these are introduced as “new methods”. One method is the full border control, that displayed the deviation of the mentioned 1600 trucks. I do not intend to explain the other one, but I would like to highlight that neither of them is a “secret weapon”. There is a limit for the effectiveness of both techniques, namely that there should be following, in-depth tax inspections on the basis of the acquired data, and the success of this is not at all granted taken into consideration the current organizational, operational, personal facilities, respectively the existing problems in connection with them. And by this we returned to the deficiencies of the inspectoral units.

As for the question in the title: we are not powerless, we just pretend to be.

Macroeconomical impacts

I will now cite a few relevant recent publications from the press, which draw the attention to the gravity and unsustainability of the current situation.

Tamás Éder, the social chair of the Hungarian Association of Meat Industry Professionals (*Magyar Húsiparosok Szövetsége*) shed light on the intolerable situation regarding the sector on more occasions during the past year. According to the declarations of the news portal origo.hu (March 13th 2013) and the daily newspaper Magyar Nemzet (March 26th 2013):

“Tamás Éder highlighted, that there is no successful strategy for pig farming strategy without a successful meat industry. According to him, in order to achieve a more successful meat industry, the weight of the black economy should be decreased and the industrial players taking part in frauds and misuse should be named and punished strictly. Furthermore the VAT rate of basic food products such as meats and meat products should be decreased as soon as possible to the value that is considered to be an average in the Union, namely below 10 percent.”

“The criminals are endangering the existence of the companies that produce quality products and who are operating lawfully. The latter are losing ground on the market, because it is impossible to remain in competition with the tax evading companies.”

I can confirm the standpoint of the representative of this professional organization: I could name many companies that were infected just from those two sectors whose data concerning tax evasion (fraud) I already described. Among them there are agricultural producers, producers of food industrial products and enterprises that operate retail chains. The majority of them have a long past, and during their operation they tried to keep themselves away from companies that were involved in fraudulent transactions. Sadly, many of them surrendered around 2010-2011, in this period organized criminal groups managed to encompass companies that had been operating more or less in a clear manner – mostly due to the dysfunctionality and intentional crippling of the Tax Authority and the total distortion of the market environment. In their supplier networks suddenly those companies have appeared that have a well known type, that are registered mostly at registered office service providers and whose owners are also well known, and who managed to minimize the tax obligations for other market players with their well established methods.

Because of the distorted market circumstances many “newcomers” had to choose between two options: they either accept the opportunity and become members of the network, or their sales opportunities decrease to an extent that they will go bankrupt, risking the future of their employees as well. It is doubtless, which path they chose. It may have contributed to their decision, that in Hungary there is a good chance of getting away with the expectable penal consequences and taxation fines – even more so if it is “done at a large scale” or if they have certain connections in addition. Due to the change (entering tax fraud networks) some could bring to book an increase of 30-50% in their turnover, and they started sales activities in previously rarely utilized directions (for example Slovakia). These factors are the ones that a properly operating tax authority should have perceived, and upon this should have taken preemptive measures to stop further damages by stopping these processes. I might add: there were one or two tax directorates, that did this in time, and others had their opportunity to do so as well, but did not act.

We probably do not miscalculate if we assume that the bankruptcies of the recent period were partly induced by the decrease of legal inland sales because of the proliferating impacts of the black market. The remediation has costs of many billion HUF for the state, respectively for the local governments.

But these impacts do not only deteriorate these two sectors, but they contaminate the whole Hungarian economy: **these days witness a newly formed market culture that accepts, tolerates and assimilates black market, that is elements that ensure an advantage or survival by the evasion of regulations.** Can the government expect to unleash creative and innovative energies in the entrepreneurial sector by expanding credit opportunities and other kind of subsidies, when the state can be tapped with established illegal techniques and thus the entrepreneurs manage to gain vast profits? **And if someone does not want to utilize fraudulent methods, is it reasonable at all to enter the Hungarian market?** And if he is already here, will he also stay on this market?

And now I cite the article of the daily newspaper Magyar Nemzet published on 23rd of August 2013:

*“According to the Research Institute for Agricultural Economy in 2013 **the number of slaughtered porks was 6,4 percent less than in the same period previous year, that is the period of January-May. According to the report of the Hungarian Central Statistical Office in the same period the export of pork livestock exceeded by 41 percent the amount for the same period of the previous***

year. Meanwhile – how interesting – the import of pork livestock was 15 percent less than in the previous year. The biggest importers are the Netherlands, Poland and Slovakia, and the biggest receiver countries are Slovakia and Rumania. In the same article Antal Németh, the president of the Meat Product Council of Hungary (Hústerméktanács) declared that it is sad that “in the case of fresh pork meat we cannot obtain a clear picture about the status of the market because of the black market which has a ratio of 35-40 percent”. We may also add: neither can we obtain a clear picture from other sectors.

An article of the daily newspaper Napi Gazdaság (November 12th 2012) calls attention to the anomalies of the coffee market, where we could witness a significant increase in export first from 2008 to 2009 and then from 2010 to 2011:

*According to the estimates of the daily newspaper Napi Gazdaság – which tried to take into consideration the increase in the prices as well – the market has displayed an annual 5-10 percent decrease regarding the quantity. This is significant but it does not come close to the extent which is outlined on the basis of the import-export ratio. According to an informant who works in the coffee industry such a **boost in the quantities could only be witnessed if there were two more factories built** – the surplus quantity is by and large equivalent to this. But this certainly is not the case, and the Hungarians haven't given up on the consumption of coffee to this extent.*

*It is much more probable that certain players on the market have been committing tax fraud, that is, they manifest a significant part of the imported coffee as export, but the products do not leave the country. Export is a VAT free transaction, and therefore if the product stays in the inland and returns back into trade in an illegal way, the trader is able to reach a 27 percent margin. He can offer an unrealistically low price and reach a higher profit at the same time. These kinds of products can be placed in various catering industry units, where it is impossible to track down the actual utilized amounts precisely, but – according to our source – **these ‘black’ coffee shipments can also find their ways to the shelves of wholesale chains.**”*

I could add just one more thing: out of the already mentioned 27 food merchants many have sold significant amounts of coffee to **Slovakia** in 2011-2012, and the majority of these amounts returned to Hungary.

According to the report of the news portal *agrarszektor.hu* (September 16th 2013) a new mystery thrills the members of the sector which is in connection with the topic explained above, namely that suddenly 1,5-2 million kilograms of fodder corn appeared from nowhere, whose origins are unknown even for the administration. “*The consumption in the last season was far greater than what could be satisfied according to official data on yields and the existing stocks. The commodity should have become exhausted, but still, the market shows no signs of lack even today.*” The calculations made by professionals show that there could have been a deviation of one million tons between the registered data and the actual product quantities in 2011-2012, which may be to the detriment of export statistics.

There is a chance that the 2011/2012 issues of record-breaking VAT-refunds and the suddenly mysteriously appeared fodder corn may be connected this way. The statisticians, who announced a stable increase in exports regarding certain sectors in the past few years are in a difficult situation, **because the half-year data from the first semester of 2012 established an unsurpassable basis** for example in the case of grain-trade, **all this because of the fictitious grain transactions of 2011-2012.** The reason indicated above is also highlighted by the fact that the amount of corn export in the first semester of 2013 is only a third of the amount registered in the first semester of 2012. (It is useful to go back to that chapter in which I explained the taxation data and circumstances of the related period.) The question arises: wouldn't it be necessary to bring the transactions under investigations that were made by companies involved in fraudulent transactions in those tax declaration periods that have been neglected by the Tax Authority until this time? Isn't it an obligation to find the major responsible persons for VAT-refund claims based on fraudulent transactions – and the subsequent allocations – as well as for the large scale contamination of specific sectors?

It is completely obvious from the above facts that the fictitious successive cross-border VAT-transactions **distort the macroeconomical statistics**, and they also verify the suspicion that was conceived by tax inspectors about previous occurrences and the explored circumstances.

It has become also confirmed that Rumania and Slovakia have a key role in the maintenance of the tax evasive and tax fraud networks – even though the latter one has a market that is significantly smaller than Hungary's market. **In relation to these three countries** the total value of products being transferred from and to different locations may account for a scale of **thousand billion HUF** regarding the invoicings of every tax evasive sector. The two areas examined by me (and not to their full extent) account for 217 billion HUF regarding suspicious invoicings in the period 2011-2012. By defining this data I took into consideration the “product hiding” sales activities (that is, closely linked to tax fraud) performed by missing traders, and the sales activities aimed at the indicated direction by multinational wholesalers and middle-size enterprises. Nevertheless the total sum of these invoicings can be much greater, taking the fact into consideration that the grain merchants could have sold “hideable goods” to their parent companies in Western Europe as well. The above referenced deviation of 1 million tons could hardly be explained otherwise.

The results of these large scale cross-invoicings is that professionals speak sometimes of a pork livestock of 4 million pigs, other times of 3 million pigs (it may be possible that in reality the number is even less), that we do not know the amount of coffee consumption, and the deviation between statistical and real data may be even larger in the case of other food products, and that suddenly unexplainable amounts of corn appear out of nowhere.

How is it possible to draw well grounded plans, to establish sectoral strategies, credit and subsidy programs? How is it possible to plan tax incomes in a well grounded way and to make forecasts on the impact of modification of the sectoral VAT-rates with such distorted consumption data?

It is quite a big question, to what extent we can regard the “Hungarian product trademark” as **authentic**, if it is difficult to determine, where and from which primary commodities were products produced that are involved in fraudulent invoicings due to the cross-invoicings and cross-shipments, as well as the re-packaging of certain products.

It is not difficult to guess why Hungarian shopping malls are filled with food products made in Slovakia and Rumania (which Hungary is also able to produce), and reversely, why the products in question are shipped to the mentioned neighboring countries from Hungary. Several multinational producers are present in all concerning countries, but still, there is a “need” to procure products from a different state. The sales companies are the ones who claim VAT-refunds, and the buyers from the neighboring countries are missing traders.

According to a study made on behalf of the European Commission, in 2011 Hungary lost VAT revenues in the sum of 3.7 billion Euro (1110 billion HUF) which accounts for 3.7 percent (!) of the Hungarian GDP because of non-compliance or non-collection. (In Hungary the news portal Napi Gazdaság, www.napi.hu published information about this study on 19th September 2013.).

The performance of complete tax fraud chains may be situated between the set out values: if we consider the data on paid VAT and the allocated amounts, calculating with a moderate tax evasion rate of 30%, we obtain a sum of 1650 billion HUF which is equal to **5.5 billion Euros** (calculated at an exchange rate of 300 Ft/1 Euro). The situation has not improved ever since.

The difference between the calculations of the Commission and mine arise exactly from the fact that I added the VAT-refund claims with a fraudulent background to the non-collected VAT amounts. Regarding the sum of 22 billion Euros (net value) – and taking into consideration that a part of the tax evasive conduct occurs in the sector of small enterprises, respectively in the service sector, and that a part of fraudulent transactions remain between the borders –, **multiple billions of Euros may go to export and import transactions with a fictitious invoicing background**. All these can distort and discredit the data published by governmental organizations on the balance of trade.

The responsibility of the government

The described data, facts and occurrences prove that there was an increase in the years 2010-2012 regarding the fraudulent VAT-transactions that has significantly exceeded the level of growth of the previous years, and all this happened after the change of government in 2010. We would be unjust if we would blame solely the Orbán-government for the erodation process which I described previously. It is a fact that **the incremental and ongoing erodation at the inspectorial units had begun with the organizational and personal changes made in 2007 at NAV**; it was at this point when the internal fluctuations had begun (this was a phenomenon never experienced earlier, and which could only partly be explained by the organizational reforms) and when the ‘selection of the unfittest’ process had started, which has its impact still to this day, and which causes severe operational problems. This was the exact reason of our astonishment when we noted that the new government and the new president of APEH (Tax and Financial Control Administration, the precursor of NAV) gave a vote of confidence for the same leaders again, despite the fact that they steered the Tax Authority onto the path of dysfunction. There were personal changes (principally due to the new organizational structure), but nevertheless **the power center exercising a great influence on the internal operation of the Authority** (we could also say a network of leaders) **remained intact in practice.**

The responsibility of the current government can be established in the phenomenon that the **personal and structural changes were omitted** that could have steered the special inspectorial tasks of the government to a more successful path. Neither did they rehabilitate those uncorruptible persons who were laid off by the previous management (occasionally under political pressure) or those who were transferred into different job roles – parallel to withdrawing their assignments as leaders (another manifestation of selection of the unfittest). The consequence of all this was that the organizational changes aimed at the derogation and elimination of the centralized inspectorial unit for large taxpayers that performed centralized inspections as well as the harmful personal changes continued further on from 2011 – which the previous government could not finish before the change of government (in May 2010).

Nevertheless the government was aware of the fact that something was not properly working at the NAV, hence the report of the daily newspaper Magyar Nemzet (September 3rd 2011):

*“The prime minister took offence at the fact that the entrepreneurial sphere did not reciprocate the decrease of taxes by the government by a strict tax paying attitude. **The extent of misuse, evasion and fraud regarding taxes is still great. The Tax Authority should bring a better performance in this area in the future – announced the prime minister.**”*

These expectations were not met – this can be deducted from the official figures and from the communications of the professional organizations, there were no personal consequences, and even the process of setting aside governmental officers who endangered the established but in reality ineffective organizational operational system of the Authority continued further. And the black economy has gained even more ground.

Instead of taking steps in merit, the government accepted the success propaganda that was run by the Tax Authority – and which even increased from the end of 2012 – which was utilized in a significant part to cover up for the operational and inspectorial problems. The real necessity should have been the background check of certain operational areas at the Tax Authority – due to the protrusion of the number of tax evasive actions, the derogation of the activity aimed at pre-allocational inspection and the waste of human resources.

It is important to note that the expected (but hardly summarizable in concrete figures) results of the installation of connecting cash registers into the online system (hailed as a magic weapon in the fight against black economy and being in the spotlight of communication on behalf of the Tax Authority and the responsible Ministry) do not impact in any way the previously described methods of tax fraud, nor the companies involved in them.

I already mentioned that a significant part of the inspectorial staff has nothing else to do but to chase phantom companies or to try to explore networks operated by them – with more or less success. Many of them have become weary of this work, because they see that – for example – a great extent of products traded at the food market end up on the shelves of retail chains (owned either by Hungarians or foreigners), but it is impossible to “touch” this level, so the work as a tax auditor becomes meaningless. I already mentioned that this phenomenon is visible from the neighboring countries, and there is a possibility to observe similar networks operating in foreign countries as well.

Another member of the previously mentioned Bonafarm group is a multinational company which is specialized in food production, and which is one of the key suppliers of retail chains operating in Hungary. Both companies can be regarded as competent in the previously discussed topic, and this is why I quote the resolution made by one representative from the organization “Forum for the decrease of VAT on basic food products” (*Fórum az Alapvető Élelmiszerek Áfájának Csökkentéséért*):

“Tamás Torba, the spokesperson of the Forum is convinced that the ratio of products of uncontrolled origin may vary from 30-70 percent depending on the given sector of the Hungarian food market. This means that the Hungarian state has to suffer losses on an order of magnitude of hundred billion HUF, while the tax swindlers gain profits akin to the “diesel oil fraudsters”¹ of the nineties (a mafia-like business with cross-border networks in Hungary).”

“According to the data of the organization there is an abundance of products without duly paid taxes on the shelves of virtually every commercial company – Hungarian and international – except for two store chains, and in the majority of the cases the stores are informed about the true origin of the products, namely that there was no VAT paid in connection with them. It is impossible that a procurement specialist of a large store chain would not find it conspicuous that the incoming product has a lower price – and not infrequently even than the retail price is lower – than the production cost.”

According to their estimates **the sum of unpaid VAT** in the sectors of food-production and the related trade sector is an annual amount of **350-500 billion HUF** (which enriches the black economy).

If we consider the previously shown circumstances on the market and in the Authority, there is no commentary needed. **And all these facts did not strike as intriguing or a ground for outcry only at two places: at the high level leaders of the Tax Authority and in the government.** More specifically there were individuals who tried to influence the leaders (including the top leaders of Hungary) by promoting an operational direction in which the real beneficiaries of VAT fraud would have been subjects to inspections (without positive discrimination). They were set aside with a “thank you” for their efforts.

Now we have reached to a point where we can declare without any doubt, that **the thesis so often communicated by the government has a false backdrop. This thesis is basically stating that the government leads a freedom fight against multinational interest groups and market players** on the ground that their activities resulting in extra profits detrimental to the citizens. In the sectors described above and in many other areas **the reality is contrary: we simply add to their extra profits by (there is no better word) aiding their conduct which is centered around tax evasion, illegitimate decrease of tax paying obligation as well as VAT- and social contribution frauds.** If we consider these two tax types we are speaking of **many billion Euros.** This is an enormous line in the budget.

The austerity packages introduced in the past few years that afflicted the final users (the citizens) and which inhibited economic growth (and gravely affected the areas of education, health care,

¹ In the 1990’s there was a large consumption tax on diesel oil and no such tax on household heating oil although these were practically the same products. Organised crime benefitted from this situation for several years gaining hundreds of billions of HUF before this loophole was closed by the government. – Note of the translator.

culture by severe fiscal withdrawals as well as the levy of new tax categories, such as the transactional tax) could have been avoided if the fiscal government had tried to concentrate at least partially on the collection of tax revenues that – similarly to the fraudulent VAT transactions and unpaid social contributions (based on similar methods) – decreased the budget revenues.

It is worth noting that the introduction of the so called ‘special tax’ on store retail trade burdened the involved sector only insignificantly, because their profit made by the distribution of untaxed products has exceeded the revenues made by this new tax category multiple times. (The ‘special tax’ on retail trade was introduced in December 2010, and it was obligatory for companies with an annual revenue above 500 million HUF. The special tax was abolished from the 1st of January 2013.) The concerns should have rather been made about the increase of the inspectorial effectiveness of the Tax Authority.

Nevertheless a small step was taken: a few investigations were started regarding a few periods for declaration in the case of a small number of multinational wholesalers and the above mentioned middle-size enterprises operating in the food industry – as a result of the pressure made by professional organizations, leaders or other government officers in the Ministry of Rural Development embracing their standpoint, or as a result of the pressure exercised by the organization referenced above (that is, due to external pressure).

It is just one factor that the government has a different philosophy regarding the composition of the budgetary revenues, the most severe problem is that **the high tax rate together with the extensive scale of tax frauds – with the assistance of the Hungarian Tax Authority – disarranged the economy in effect. There is need for urgent governmental steps** in order to reverse these processes. In order to achieve this it is necessary to change the current philosophy of the Tax Authority, its operational system and its inspectorial activities, and to involve a significantly larger group of multinational companies and the largest Hungarian companies in the intensive and substantial inspections. The essential condition of this is to terminate those harmful administrative-business-political informal relationships, interpenetrations and opportunities for manipulation which (in turn) disarranged the operation of the the Tax Authority. Without these steps it may be considered to decrease VAT-rates significantly or to introduce the reverse charge mechanism in 10-15 sectors.

I would like to mention another area which has deficiencies that are hindering the solution of the problems of the mentioned sectors, and **where governmental intervention is necessary. This is the fight against organized crime**, which has a quite low level in Hungary. Let us remember those scandalous corruption crimes that had a political relevance and which had crime organizations in their background; they were featured as political window-dressing, for it was in the interest of the political powers in rule to close them successfully, nonetheless the existence of the crime organization could not be proved. On the basis of my previous experience I think that the type of attitude of the prosecution, the type of inspectorial supervision or the type of activities aimed at helping the prosecution to support the charges which could allow for the exploration of any kind of organized (for example tax fraud) network and result in established charges are missing from the work of prosecutions (on a historical scale). This is the way I see it, but it is not certain that I have a good overview on this as an outsider of this area.

The fact I know for sure, that the Tax Authority inspectorials and the investigating authorities of the NAV are lagging behind in terms of exploration of the organized tax fraud networks. (The former one has arrears most of all.) Nobody should be misled by the fact that the criminal investigation units of the NAV announced the location of relatively numerous tax fraud networks in the press. It is an honorable feat in itself, but compared to the total activities performed by organized criminal groups during these years these are just drops in the ocean.

What is also very important: it is not at all irrelevant how far the the Tax Authority can get in terms of exploration of organized tax fraud networks both vertically and horizontally, or how far it is able to get, how far it is let by the government. It is the existence of these barriers that hinders us in pointing out those persons and organizations that are the major organizers and operators of these

networks by the way of a full scale exploration of certain organized networks. **The unbuilding of these barriers is impossible without governmental support, and in connection with this important political actors should have self-restraint as well.** These are even more so important, because the borderlines are standing on the same place regarding both special units (tax inspection and criminal investigation).

I would even add that according to my knowledge the criminal field has similar personal and organizational problems as the Tax Authority, and the workload of some inspectors is so big that it renders the effective exploration of crimes impossible.

The role of the European Union in fighting tax evasion in the light of the situation in Central Europe

The facts enumerated about the Hungarian situation is backed up by the study referenced above made on behalf of the European Commission by Eurostat (published under no. IP-13-844), according to which **Hungary is among the member states where the extent of uncollected VAT is relatively high.** *“Hungary modified the tax rates in the period in question (2000-2011), still the impact of it on the efficiency of tax collection is not unequivocal, because neither the increase, nor the decrease of the tax rates did not have an impact on the extent of unpaid taxes.”* *“According to Bruxelles in order to achieve more efficient tax collection mechanisms the administrations had to simplify the VAT-systems, enlarge the number of taxpayers, and thirdly exclude as many exceptions as possible from the system.”* (Napi Gazdaság, www.napi.hu 19th September 2013)

The above phenomena indicate that the Hungarian Tax Authority could not make an impact in merit on the tax evasive processes, on the other hand the repeated call made by the Commission to the Member States to limit tax exemptions and reductions can be applauded, even more so if it is concerning the non-discrimination of large taxpayers.

Slovakia had to modify the revenue elements of its government budget because they could expect tax incomes of a lesser amount by several hundred million Euros – compared to the original plans. (I will talk about one possible reason for this.) Peter Mihók, the president of the Slovakian Chamber of Commerce and Industry (SOPK) told in connection with this: *“the ground for the decrease of the expected tax revenues is that the government has chosen the method of increasing tax burdens with its consolidation packages instead of concentrating tax evaders.”* We seem to ‘have a déjà vu’ situation here.

According to the piece of news from the news portal manna.ro, published on 24th April 2012, the new president of the Rumanian Tax Authority (ANAF) admitted that: *“the tax fraud groups exercise very strong influence at ‘the highest level’ ”.* *“The institution leader **pointed out that the business groups mentioned by him reach ANAF in various ways”.***

With reference to the Rumanian daily newspaper Gandul, the Hungarian News Agency (MTI) published (December 27th 2012) that the extent of tax fraud in Rumania is 1.5 times more than the average of the EU. **Rumania** is the second (Bulgaria is the first) regarding the extent of shadow economy in the European Union. In Rumania, 29.6 percent of the GDP does not serve as basis for any kind of revenue.

I wanted to present by the above described facts that these three countries in the region are hindered by similar reasons in the combating the tax fraud networks, and because of this the **repelling of black economy could be reached by a strong cooperation**, in favor of which there is need for improvement regarding the inspectorial, respectively the law enforcement activities in the mentioned three countries.

What is also worth noting is that a large group of Czech companies enters the network of successive sellers in the field of food product merchandise, thus the Czech Republic is the fourth country with a high ratio of tax fraud network. The fraudulent traders of the **Czech Republic** appear primarily in so called **intermediaries of triangular transactions**, and because of this there is no payable tax or tax refund implication of cross-invoicing transactions in the Czech Republic, however, by the

involvement of these companies the Rumanian, Hungarian or Slovakian partners have a leeway, and they can hinder or make the job more difficult for tax authorities or crime fighting organizations. In this case the data provided by the member states in the VAT Information Exchange System (VIIES) are not telling unequivocally, and a further inquiry is required to establish the country of origin of the product that was shipped to a third country. These triangular transactions represent actual tax evasive conducts in so many cases that the revision of the concerning regulations would be necessary.

The tax authorities of the European Union are entitled to the so called '**spontaneous exchange of information**', and the enquiries must be answered by the authorities of the recipient country on suspicious cases within 3 months. The importance of information exchange is frequently highlighted by organs of the European Union. The enquiries between the indicated countries' Tax Authorities (primarily regarding the two major trading areas I indicated above) have reached a level that **can be considered unmanageable, the delays and the repeated and cross-enquiries are frequent**, while the traders get away. It is not rare that in respect of certain companies there are 15-20 enquiries annually, but there are also companies in respect of which the number of recorded enquiries was 100. There may be several thousand open enquiries simultaneously in the system, saturated **with many parallelisms**, which overloads the tax auditors unnecessarily, and by doing so destroying the efficiency of the whole field. The exchange of information is a highly important institution, it is essential in the effective exploration of cross border successive transactions, but – **because of the interweaving networks** – it is a common occurrence that for example the Slovakian authority cannot reply to the Hungarian enquiry, because the managing director is a Hungarian citizen, and it also has occurred that the Slovakian recipient asked his Hungarian colleague to refer to the Rumanian authority, because the Slovakian phantom company had a Rumanian citizen as managing director. And time keeps going by.

The exchange of information could be made more efficient, and the tax fraud networks operating by the participation of several countries' traders could be terminated if an **immediate cooperation would come to life between these countries' tax authorities operating on a regular basis**, which also could include joint inspections. The cooperation of the tax authorities shouldn't focus on the investigation of just one network of isolated smaller networks' tax fraud activities, instead of this it would be necessary to take steps against the organizational centers of whole taxation sectors and the infrastructural setup of the networks. In these cases the wide collection of data and information on fraudulent companies, respectively transactions registered at the Tax Authorities would be **disseminated in a wider scope together with the data collected by the tax authorities arising in the same field**. By the collection of relevant data in properly regulated and coordinated frameworks and their joint management by member states' authorities it would be possible to **decrease the overuse of capacity**, which can be experienced due to the large number of enquiries about companies. The detection would become significantly faster, because **it would be able to filter out the factor that hinders the inspections**, namely, that the managing director or owner of a given company is a resident of a neighboring company. This type of cooperation between the involved member states is sporadic, unsystematic, focused on just restricted areas and diversely supported by various tax authorities. I could give an example to illustrate the above.

The companies operating with the aim of fraud, cooperating on the two sides of the Slovakian and Hungarian border have identical operational circumstances (such as the use of registered office service, the number of members, foreign citizens as managing directors), and they usually have a registered seat or premises at settlements near the border for saving on shipping (respectively 'traveling') costs. It is easy to see from the Hungarian side that Hungarian citizens who are registered members in Slovakian companies have been the 'stooge' managing directors or owners of companies that have committed illegitimate acts in Hungary, and the same can be witnessed reversely. Strictly speaking the network structures – in which the fraudulent acts are committed, often under the guise of parallel exercised, legitimate business activities (to deceive the tax authorities) – can be clearly seen. **Despite all this, the distribution centers** (repository bases) involved in the recycling of **tens and hundreds of tons of products annually** – which can be charged with fraudulent activities or the support of these, and of whose owners and names are

changed periodically, and among which a few central ones transact the overwhelming part of the total turnover of a given sector based on fictitious invoices – **can boast of a long past and keep on operating**. In the course of one-two years these centers may establish connections with 30-40 missing traders, and this is the ground for the enquiries on behalf of member states at a scale of hundreds.

The VAT frauds – which are committed either virtually ‘on paper’ or by transferring goods – are based on a primitive method, but still, through the well organized networks they manage to burden the budgets of member states with enormous amounts, and as we pan to the east, we witness an increasing efficiency of these frauds. The tax authorities of the involved countries are not able to combat these frauds effectively (they are facing similar operational problems). That is the reason why the mechanisms of direct interaction should be relied upon – **also preferred by the European Union** – and find the complex, orchestrated solution for the challenges generated by organized networks by establishing regulated and systematically utilized structures. To achieve this, the efficacious cooperation of competent EU bodies will be obviously needed, because the publication of Recommendations seem to be insufficient. A further challenge for this region is that after the succession of Croatia – due to the termination of border control – the number of the above mentioned cross-invoicings may increase regarding this direction as well.

Regarding this region we may also mention the role played by Austrian companies which have a quite significant (even though not comparable to the above mentioned) business activity in connection with Hungarian companies which were demonstrably involved in fraudulent transactions. The conscious or passive engagement of these Austrian companies has yet to be proven, and the same can be said about certain Polish companies as well. There are a few Western European countries that are involved in damaging Central Eastern European countries’ budgets through their beneficiary multinational companies, whose privileged status should be terminated in favor of breaking down black economy in the region.

There is still another field that the European Union has competence over, and whose unprecautious utilization causes vast damages – which happens to occur in the Hungarian-Slovakian-Rumanian relation. (Obviously these kind of cooperative forms flourish on other parts of Europe, and the hazard of damage is existent in those areas as well.) I am talking about the recent issue, when during the year following the introduction of reverse VAT payment mechanism in Rumania the **Hungarian grain market was invaded by fraudulent acts – which have ceased to occur in Rumania**. And when Hungary introduced the inverse VAT payment mechanism, **the next victim was Slovakia**. Namely, the number of suspicious shipments has increased from July 2012 from Hungary to Slovakia, and it manifested in the VIIES records that many Hungarian traders who were involved until this time only in fraudulent transactions in the inland as intermediaries all of a sudden started to export to Slovakia. (There is no need to wonder about the radical decrease of Slovakian tax revenues.) If the moratorium expires in a certain country (the traditional tax payment system is restored) the concatenation begins anew.

The recent decrease of the tax rate of flour in Rumania (from 24% to 9%) **will cause identical damages** in Hungary (the professional organizations also warned us about this fact). The crime organizations are very flexible and able to react quickly, because they are present in both countries and they are cooperating anyway.

By these type of radical steps, these “fraud regions” of complementary countries should make cross-checks, and it would be even necessary to **orchestrate the VAT-systems with each other in the case of products with exposure to risk or fraud**. It may be possible that by these type of modifications a certain country may achieve “pole position”, but in the case of other products the other country may take over, and the harmful conducts of taxpayers may increase in the loser country. Maybe it would be beneficial to contemplate about these things in the midst of the big VAT race.

The European Commission on the other hand should pay strict attention by its decisions allowing for the inverse VAT procedure that **the introduction or retirement of new or already existing tax**

payment methods should be taking place simultaneously regarding certain products in regions that are easily defined and burdened with well organized fraud networks. On the basis of the occurrences of the recent period, and regarding this issue the responsibility of the Member States has increased, for – pursuant to the so called Quick Reaction Mechanism (QRM) – the Member States are allowed to introduce the reverse-charge mechanism in the processing time of one month.

The hot topic of this year's EU-summits was tax evasion and the increase of the efforts in the fight against tax fraud. In the framework of this it was brought up that the system of automatic exchange of information should be extended to states (Luxembourg, Switzerland, Monaco etc.) whose banks are the largest recipients of revenues generated on the market of tax evasion. The issue of taking actions against tax havens in non-EU countries is also being discussed, as well as the drive back of aggressive tax planning. The European Union also intends to take action against the 'back and forth' transfer of profits achieved by companies between various countries.

All these initiatives are to be applauded, and their implementation is urgent – considering the circumstances – but it is also worth noting that these expected measures (burdened with remonstrance) are only able to mitigate the secondary impact of tax frauds. The central goal of this combat should be to **seize** the sums that emerge from fraud, the evasion of regulations and which should be paid as VAT, corporate tax and contributions –before they reach tax and bank havens. **The competent authorities of the Member States should significantly increase the ratio which indicates the ratio of expected tax revenues and uncollected tax (constituted of sums generated by tax fraud and tax evasion). This analysis has been made to aid reaching this goal.**

The expectations of the European Union should be enforced, namely that the Member States should enhance the efficiency of their tax administration and of tax collection.

Budapest, October 2013