

Hungary will exempt young people from personal income tax as of January 2022

ESPN Flash Report 2021/50

RÓBERT IVÁN GÁL – EUROPEAN SOCIAL POLICY NETWORK

JULY 2021



Description

Starting in January 2022, Hungary will exempt taxpayers aged 25 or younger from paying personal income tax. The government intends to contribute to their financial independence and expects to boost their employment. However, rather than enlarging the labour market, this could lead to a shift of the borderline between its formal and tax-evading segments. Instead of creating new jobs, the new measure could legalise previously informal labour arrangements.

On 28 April 2021, the Hungarian National Assembly decided to waive personal income tax (PIT) for people aged 25 or younger (Act 34/2021 amending Act 117/1995 on personal income tax and Act 150/2017 on the taxation rules). The exemption, effective from 1 January 2022, covers all sources of the consolidated tax base up to the amount of the average national gross wage in July of the previous year.

The PIT, a flat-rate tax, is set at 15% of gross income (excluding the employer's social contributions). It has become an increasing share, currently about 30%, of the total tax wedge, since the rate of the employers' contribution (called the social contribution tax, SCT) has been falling in recent years (it currently stands at 15.5% of gross wages, down from 27% in 2012, when the SCT replaced the previous taxes).

Estimations of the number of taxpayers affected vary a lot depending on the data source. According to tax statistics, which cover all forms of revenue, there will be 460 thousand beneficiaries (9% of PIT declarations; HVG 2021). However, labour statistics, which are based on a more restricted sample and apply stricter definitions of employment, suggest 280-300 thousand beneficiaries (about 5-6% of PIT declarations; *ibid*). The range given reflects the labour market position of young people, who often take up temporary, marginal jobs not fully covered in labour statistics. It also indicates that the measure may be limited in its effectiveness.

The same age group was the beneficiary of a similar measure in the past. Between 2013 and 2019, employers of young people aged 25 or below received a tax credit. Its estimated effect was a 2.6 percentage point increase in the employment rate of this age group (Svraka 2019). The programme was about 40% self-financing by the third year of its functioning, in terms of immediate increases in tax payment (*ibid*). However, in the booming labour market prior to the COVID-19 crisis, the government found the tax incentives unnecessary and abolished them.



Outlook and commentary

This exemption fits the pattern of Hungarian social policy reforms in recent years, in two aspects.

Firstly, the government is using the tax system to boost formal employment, and is waiving some of its potential revenues instead of collecting and redistributing them as cash transfers. A tax exemption implies formal employment, making it inaccessible for those having no job or working under tax-evading informal arrangements. It is in line with the declared aim of the government of building a "work-based society," one that offers "jobs instead of social assistance". As a result, a two-tier system is taking shape that provides conditional cash transfers to those who do not pay PIT (that is, the poorest) and tax exemptions to those who do -

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leaving more to the richer and less to the poorer.

Secondly, the new rule is linked to demographic instead of income-related criteria. Its target is an age group, not a group defined by income or social status. Similar measures from recent years include the family tax allowance (since 2011), which has become an essential family policy tool, with a corresponding reduction in the use of fixed-amount cash transfers; the temporary tax-reduction for newlyweds (since 2015 and only applicable to the first marriage); and the PIT exemption granted to mothers, not fathers, raising four or more children (since 2020; see Albert 2020).

The declared aim of the new exemption is to help young people become financially independent through higher wages and, as a secondary effect, to ease credit constraints. The government also expects an increase in employment of the target group through growing labour supply (since people make choices on the basis of the net wage on offer). Experts point out that the impact on employment could include, rather than an enlargement of the labour market, a shift of the borderline between its formal and tax-evading segments. Instead of creating new jobs, the new measure could legalise previously informal labour arrangements. This consideration also highlights related tax incidence issues. Since employers and employees frequently agree informally (and illegally) on net instead of gross

wages at the fringes of the labour market, some of the taxes waived could be pocketed by employers (Zara 2021).

Experts also offer an alternative, political reading of the new legislation (Princz 2021, Zara 2021). For two decades after the restoration of democracy in 1990, public spending followed a clear cyclical pattern, based on the length of time until the next general elections. This applied to public investments (Kálmán 2012), as well as to social policy and especially pensions (Gál and Tarcali 2008). Social policy reforms repeatedly became hostage to electoral competition. An unexpected effect of the collapse and subsequent fragmentation of the political left-of-centre and the cementing of right-of-centre parties in 2010 was that elections became one-sided. The ruling parties were not tempted to increase cash programmes at a high cost in order to shift the balance. Competing promises of new lucrative benefits would not have changed the outcome. All this changed when, after almost a decade, the opposition parties agreed on a joint list for next year's elections. As an immediate response, the 13th-month pension, an extra month of benefit that was partially or wholly paid between 2003 and 2009, was reinstated in 2021. Several commentators (Princz 2021, Zara 2021) interpret the new tax exemption as a further measure to influence the outcome of the elections.

Further reading

Albert, Fruzsina (2020), "Hungary: Tax exemption for mothers of four or more children", ESPN Flash Report 2020/17, European Social Policy Network (ESPN), Brussels: European Commission.

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HVG (2021), [Közel félmillió 25 év alattit érinthet a jövőre tervezett szja-mentesség](#) [Nearly half a million under-25s could be affected by the PIT-exemption planned for next year]. HVG, Budapest.

Kálmán, Judit (2012), "Political economy of multi-level government financing in Hungary: Analysis of political budget cycles and partisanship in municipal investment activities and central grant distribution". Lambert Academic Publishing, Saarbrücken.

Princz, Dániel (2021), [Fiatalok adómentessége: választási ígéret vagy gazdasági eszköz?](#) [Tax exemption for young people: Election carrot or economic tool?]. Mfor, Budapest.

Svraka, András (2019), [A munkaerőköltség csökkentésének hatása a sérülékeny csoportba tartozók foglalkoztatására: A magyar Munkahelyvédelmi Akció értékelése](#) [The effect of labour cost reduction on the employment of vulnerable groups: Evaluation of the Hungarian Job-protection Programme]. Pénzügyi Szemle [Financial Review], 64(1): 70-93.

Zara, László (2021), [Miért rossz, ha jó is lehetne a 25 év alattiak szja-mentessége?](#) [Why is the PIT-exemption for the under-25s bad, if it could be good?]. Portfolio, Budapest.

Author

[Róbert Iván Gál](#) (Hungarian Demographic Research Institute, Corvinus Institute for Advanced Study, Corvinus University, Budapest and TARKI Social Research Institute)

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Quoting this report: Gál, R.I. (2021). *Hungary will exempt young people from personal income tax as of January 2022*, ESPN Flash Report 2021/50, European Social Policy Network (ESPN), Brussels: European Commission.