

# Taxation Possibilities and Choices for Micro and Small Enterprises in Hungary

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## Abstract

In the last decades, the dominance and, consequently, the economic roles of micro-enterprises have been continuously increasing. These small businesses have great but often unexploited potential over large businesses in terms of market adaptation and flexibility. However, realizing this potential, especially in the case of large-scale changes, requires huge capital investments, which cause financial difficulties for small businesses. This situation is further hindered by the complex taxation system of Hungary. This paper deals with the financial situation of the Hungarian micro-enterprises and their connection to the current taxation system. The aim of the study is to examine the structure of this system and understand the experiences of domestic businesses with the public burdens and forms of taxation. In the literature review, micro-enterprises are introduced with their related financial background. Then the corporate taxation system of Hungary and its elements are examined. Considering the primary research, we distributed questionnaires to the domestic micro-enterprises and received 97 responses. The main conclusions of this research are that these businesses are having difficulties not only in choosing the appropriate form of taxation but also in the various conditions of the ones they choose. In order to facilitate the competitiveness of micro-enterprises in the long run, a stable and transparent financial background and taxation system are needed. Consequently, we provide suggestions that can be applied to ameliorate the situation.

**Key Words:** *Micro-enterprises; Tax system; Corporate tax; Competitiveness; Legal form*

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## 1. Introduction

This paper examines the financial situation of Hungarian microenterprises and their relationship with the tax system. Our goal is to provide a comprehensive and nuanced understanding of the challenges and opportunities facing these businesses.

Our secondary research focuses on both Hungarian and international literature, providing a broad overview of the competitive landscape for these entrepreneurs. In addition, in the framework of primary research, we examine the direct opinion on and assessment of the current situation by the concerned Hungarian micro-enterprises using an empirical methodological background.

We believe that a thorough examination, analysis, and review of the related financial situation and the modern corporate tax environment can actively support the day-to-day operation of these businesses. Overall, this research is not only intended to promote the development of the Hungarian micro-enterprises but also to support the increase of their competitiveness in the global market in the long term.

Despite the significant role that micro-enterprises play in the Hungarian economy, there is a notable lack of focused research on their financial situations and interactions with the taxation system. While micro-enterprises constitute approximately 95% of domestic SMEs and employ 54% of all SME workers, existing literature often overlooks their unique challenges and opportunities [1]. The current body of research tends to focus more broadly on SMEs, without distinguishing the specific needs and conditions of micro-enterprises. This generalization fails to address the distinct financial pressures and adaptive capabilities of micro-enterprises, which differ significantly from larger SMEs and multinational corporations.

Moreover, these businesses have great – but often unexploited – potential over large businesses in terms of market adaptation. Unlike large enterprises and multinational companies, these businesses do not have long chains of command – that would make the decision-making process more time-consuming and complex – and can rapidly answer to everyday changes [2]. However, adapting to the large-scale changes of the modern market economy – mainly caused by technological development and globalization – is causing them serious financial complications.

Hungary's complex tax system exacerbates these financial difficulties. Since it is a constitutional duty of all businesses to pay taxes and contributions, the leaders of the micro-enterprises should be aware of the current laws and regulations. However, the process of acquiring this information is extremely time-consuming, especially because of the continuously changing system. Many micro-enterprises cannot afford this 'loss of time', so they may miss out on some opportunities enabled, for example, by changing the form of taxation [3]. In conclusion, several factors underscore the importance and timeliness of this research. These include the lack of knowledge among business leaders about the tax system, the scarcity of academic literature on the risks and opportunities for microenterprises, and the growing importance of these businesses [4].

Furthermore, at the time of writing, the government is planning to tighten the system. The purpose of this study was to provide a snapshot of the current situation and a basis for further research.

## 2. Literature Review

### 2.1. Legal background

In Hungary, the Parliament ratified the criteria for the classification of small and medium-sized enterprises. This is the act XXXIV of 2004 on small and medium enterprises, and their support for development which entered into force on January 1, 2005. According to this, micro-enterprises are those SMEs that have less than 10 employees and a maximum of 2 million Euros (€2,000,000) annual net turnover or balance sheet total [5].

Based on the SME summary publication of KSH [1], the total number of registered domestic micro-enterprises is 709,159, excluding the financial and administrative sectors of the national economy. Moreover, it can be noted that the number and the share of these businesses are continuously increasing at approximately 4 percent per year. This process also contributes to the fact that the ratio of employees working in micro-enterprises to all enterprises is outstanding at its 35 percent.

Regarding the field of activity, the majority of these businesses are engaged in the service sector. One of the primary factors contributing to this inclination is the relative ease with which one can establish a business in the service sector, which typically requires less initial capital than the production sector. The service sector encompasses a multitude of activities, with commerce, motor vehicle repair, and professional services representing the most prevalent.

With regard to the propensity to invest, micro-enterprises exhibit the lowest levels of investment activity, as evidenced by the observation that approximately 8% of all investments by enterprises can be attributed to these micro-enterprises. Although there is a decline in this ratio in the past few years, the total amount of investments in micro-enterprises is rapidly growing. The cause of this apparent contradiction is that enterprises with foreign interests are raising their investments at a higher rate than micro-enterprises [1].

Despite these tendencies, micro-enterprises face serious difficulties and risks during their operation, and in particular cases, their survival is at stake. Examining the information from the Hungarian Central Statistical Office, we can state that approximately 99.12 percent of all liquidation processes in 2017 could be linked to micro-enterprises. This ratio is growing at a slow and fluctuating pace over the past 20 years [1].

The risk of liquidation is more serious in the case of the so-called forced enterprises. The cause behind the foundation of these businesses is need: the owners need a new workplace to make a living after they lose their previous ones and are unemployed for some time [6].

The survival of micro-enterprises is further hampered by increasing competition. Globalization has expanded the system of economic relations, accelerated the international capital flow, and enabled foreign actors to gain ground. Trans- and multinational enterprises are founded, developed, and aimed to compete in the domestic markets of all countries.

Moreover, the founding of the European Union (EU) further enhanced the process of internationalization and the strength of competition in the domestic market. This is why Hungarian micro-enterprises need to compete not only with each other but also with foreign businesses. Also, these businesses alone cannot exploit the opportunities of the European Single Market. Furthermore, a harmonized tax system within the EU could also increase the

competition beyond borders, but it could also increase the economic efficiency for SMEs as well [7]. Considering the latest five-year data of KSH [8] between 2014 and 2018, the total export sales revenue generated by micro-enterprises shows a slowly increasing tendency. Despite this growth, the proportion of its contribution to the overall export performance of all enterprises is declining.

The domestic micro-enterprises are rather selling their products and providing their services at local markets than at international ones. Kallay and Lengyel [9], economists, found that there is a correlation between the size and geographic location of the target market. They stated that if large and multinational enterprises increased their export performance, it would positively influence the growth rate and the competitiveness of the supplier micro-enterprises [9].

Investigating the position and various indicators of the domestic micro-enterprises compared to the EU average, we can detect differences. In the case of the number of enterprises and employees, the share of the Hungarian micro-enterprises is above, while in the case of the gross value-added, the share of these businesses is under the EU average. Based on these performances, we can state that in terms of value-added per employee or productivity, the domestic micro-enterprises lag behind the EU-28 averages [10]. Moreover, profitability and employment satisfaction could be increased by developing entrepreneurial competencies [11].

By the 20th century, the European Union had recognized the key importance of smaller enterprises – including micro-enterprises – and therefore adopted the Small Business Act in 2008 [12]. The knowledge-based economy requires dynamic and innovative enterprises. Moreover, the European Commission has created a central strategy for assisting SMEs. The long-term goal of this strategy is to make the European market the most attractive one for SMEs to start, operate, and evolve. The system is constantly monitored and continuously developed in order to effectively and efficiently support small- and medium-sized enterprises [13].

Since 2008, Hungary implemented policies and measures connected to 8 areas of the Small Business Act with the financial support of European Structural and Investment Funds. The two areas that have not yet been considered are the second chance and the single market [10]. The focus of this research requires that the area of responsive administration be highlighted. Most of the indicators of this area are in line with the EU average. In terms of paid-in minimum capital, the time needed for tax payments, and the competency of government employees to support developing enterprises, Hungary shows a huge lag. On the other hand, the county has outstanding results in the areas of ‘time to start an enterprise’ and ‘cost of enforcing contracts.

In the area of ‘access to finance, we can also experience salient differences. The indicators that are above the EU average are the strength of the legal right index, the unfavorable debt loss, the willingness of commercial banks to provide loans, and the total time needed to get paid. However, in the case of the costs of small versus large loans, the access to financial support, the business angels, and unaccepted loan applications, Hungary has a negative standard deviation compared to the EU average [7].

In terms of the ‘only one’ principle, we can state that it is not fully addressed within the current system in Hungary. The current systems of the various public administrations are not integrated. Thus, enterprises need to provide data and information separately and in more rounds to these public organs [10].

## 2.2. Challenges faced by micro-enterprises

As a result of globalization and the ever-growing market competition, the above-mentioned continuous growth and the increase in competitiveness are inevitable for micro-enterprises to succeed. To properly develop, these businesses need to invest not only in innovation but also in related human expertise and structural changes. In almost all cases, this process requires capital investment which micro-enterprises need to acquire and allocate.

According to Holicza [14], the main difficulties of these businesses are as follows:

- Lack of proper financing.
- Huge losses in case of failure.
- The complex administration system.
- The complex system for transferring the management of the business.
- Lack of education about entrepreneurship.

Hagen et al. [15] also confirm that a major cause of the problems of micro-enterprises is the lack of financial resources and opportunities. However, their study highlights the importance of different problematic areas such as foreign language knowledge, innovation, and cooperation between businesses. Moreover, administrative barriers could also increase the operation of these businesses, and, therefore, decrease employment [16].

This is why feasible and well-thought-out financial decisions are crucial for micro-enterprises for long-term stable and successful operation. These decisions are about choosing the most appropriate source of finance – that is available for the business – for the given purpose. An entrepreneur needs to make a financial decision based on the capabilities of the company and its willingness to take risks. Moreover, the various opportunities of the market should be taken into consideration [17]. That requires not only time and careful attention but also proper at least basic financial knowledge.

The financial decisions can be classified along two main criteria: these are the time effect and the affected area. The time effect indicates whether the decision has an impact on the short- or long-term assets or liabilities of the company or both. The affected area can be the assets or the liabilities of the particular business. Short-term decisions are referred to as working capital management and are tied to a maximum of one year, while long-term decisions consider more strategic aspects on longer time scales [18].

Moreover, we can distinguish between internal and external revenues. Internal sources are generated internally through the basic operation of the business. It is important to mention that these sources also have expenses and target expectations that should always be taken into consideration. The cause of this is that the owners seek as much return as in the case of investments available in the market [19].

External sources are obtained from outside entities. We can define two main areas of these sources: debt and equity. In equity, the fund is gained from investors in exchange for a particular proportion of ownership without repayment obligations. Debts consist of loans and borrowings from private individuals or financial institutions. In these cases, the other party has a financial claim against the organization but receives no ownership right. The combination of these sources equity and debt is referred to as the capital structure of the business. To maximize the return and avoid a huge and unexpected increase in the overall level of risks, a careful design of this mixture is essential [17,20].

Besides the already mentioned opportunities, micro-enterprises can also acquire finance through a special channel known as subsidies (supports). Subsidies are external financial sources that provide funds either by onerous contracts or without any future claims. These subsidies can be classified into state-founded subsidies and European Union-founded subsidies.

Micro-enterprises can apply to state support through direct applications and tenders. The direct application process is characterized as targeted support without any competition. This is because once the conditions are met, the obtainment of the subsidy is guaranteed. Tenders, on the other hand, have a predefined budget; thus, the obtainment is not guaranteed. Even if the applicants meet the required conditions of the tender, they need to compete with each other for the subsidy [21].

The subsidies provided by the European Union can mainly be obtained through tenders. These financial sources, in many cases, complement the budget allocated by the state for the given purpose and are collectively distributed through a given tender opportunity. Nowadays, these tenders are becoming widespread and gaining popularity among micro-enterprises. However, it is a constraint of the tenders that the scope is predefined; so, it is not always possible to finance the actual objectives and projects of these businesses.

However, there are many external financing opportunities, all of which micro-enterprises do not have access to, thus getting into a disadvantageous market situation. This is due to the high risks caused by the uncertain operation and insufficient funds of these businesses [17]. This high risk could increase the failure of small enterprises [22].

Even though domestic businesses especially micro-enterprises – rather use internal financial sources, in particular cases, the involvement of external sources is unavoidable. The higher the proportion of use of these external sources, the greater the risk to the enterprise [23,24]. On the other hand, in a situation of a prosperous economy, this strategy can multiply the return [25]

Gyurcsik et al. [17] confirm this tendency but also emphasize the influence of the cost and availability of the sources. The internal sources are flexible, directly available, and strengthen the financial security of the micro-enterprise. The external financial sources, on the other hand, are less costly; however, they carry more risks, and the access process is more complicated.

One of the most serious and dangerous risks of bank loans is the debt spiral or circular debt. This occurs when a business needs to borrow money in order to finance its previous financial obligations. In the case of micro-enterprises, this spiral can greatly endanger their survival by causing huge liquidity problems. Also, this situation destroys the confidence of the entrepreneur and can cause bad morale among the employees [26].

### **2.3. State support of small businesses**

To widen the range of the external finance opportunities available for micro-enterprises and reduce the connected risks, many programs and projects have been founded and operated, as it was revealed that the growth of small enterprises is obstructed by institutional and financial barriers [27]. Among these, the first attempt to provide micro-enterprises with preferential loans was the Microcredit Program in 1992. The program was based on the idea of Mohammad Yunus and provided both financial and expert help to the micro-enterprises.



The next program was the Szechenyi Vallalkozasfejlesztési Program (Szechenyi Enterprise Development Program) started in 2002. This tendering system was supported by the European Union and aimed to strengthen competitiveness, thus facilitating the participation of the micro-enterprises in the European Single Market. This program focused more on the human aspects of the businesses and provided professional mentoring for the participants.

To decrease the risks of the banks and thus facilitate the lending to smaller enterprises, the Magyar Nemzeti Bank [MNB] (Hungarian National Bank) started its own program called the Novekedési Hitelprogram [NHP] (Funding for Growth Scheme program). The main objective of this project was to improve the conditions offered for micro-, small- and medium-sized enterprises through favorable financing from the central bank.

The project had three phases between 2013 and 2016. During the whole duration, approximately 40, 000 SMEs obtained loans above 2, 800 billion Hungarian forints through this favorable opportunity [28,29].

According to Szira [26], despite the objectives of this program, the interest rates of 2013 were still extremely high. This resulted in micro-enterprises with debt needing to use up most of their profit to properly pay back their loans.

Still in 2018, to support the transition of both banks and SMEs to market-based lending, the MNB launched the Market-based Lending Scheme. Through this program, the MNB provided risk and liquidity management tools for commercial banks to reduce their risks. As the expected result fell short, the program was terminated at the end of 2018.

This is the reason the NHP program was relaunched at the beginning of 2019. The 'new' program was called Novekedési Hitelprogram Fix (Funding for Growth Scheme Fix) and only supports investment purposes of smaller businesses. The total planned budget of the program was 1,000 billion Hungarian forints and was provided and allocated by the MNB [28]. The latest data of June 2020 show that 17,269 SMEs received fixed rates on loan products through this program, and the total amount exceeds 564 billion Hungarian forints. More than half, approximately 52 percent, of it was distributed to micro-enterprises [30].

In April 2020, as a response to the effects of the COVID-19 pandemic, another phase of this program was launched, the so-called Novekedési Hitelprogram Hajra! (Funding for Growth Scheme Go!). The main objective of this project was to mitigate the negative effects of the pandemic and the associated quarantine period on the domestic market economy and the SMEs operating in it. Examining the share of micro-enterprises, we can state that despite their numerical dominance, they received only approximately 36 percent of the total amount of loans [31].

However, the above-mentioned programs and projects have greatly contributed to the development of many domestic micro-enterprises; yet just a proportion of the whole segment has been involved. In order to, at least, provide the opportunity to all Hungarian micro-enterprises, a large-scale and comprehensive system would be needed.

This system should not only focus on loans and other external financial sources but also on mentoring and professional support which have not yet got enough importance.

## 2.4. Taxation system

The taxation system has always been a key pillar for maintaining and developing the well-being of society by covering the expenses and expenditures of the different governmental organizations of the countries. Taxes are based on statutory provision and are gathered exceptionally or regularly in nature; for example, in earlier times, they were collected in the form of crops or cash, for which the taxpayers did not receive direct consideration. Either the tax authority or the local municipalities collect these taxes. During the taxation process, a predefined amount of the income of the citizens becomes subject to (local) government control.

The different taxes have three important economic functions. Among these, the most important is the redistribution of the citizens' income and wealth. The second is the already mentioned function to cover the expenditures of both the government and local municipalities, thereby ensuring their proper operation. Finally, taxes and allowances have an influential power over the market trends and the behavior of the market players. The increase in taxes can hinder emerging markets, while tax allowances have a supporting function [32]. Moreover, Mutascu [33] founded that in the ex-communist EU countries the ageing society has a positive effect on the tax income of the state.

The general taxation process consists of seven basic steps that all businesses need to follow. The first is the notification of the state and the filing of the declaration about the chosen form of taxation. The next step is the issuance of the different documents and the invoice. The following part concerns the continuous record keeping and bookkeeping of the enterprise. The fourth step includes the tax base and tax assessment executed by the business (mainly by the internal or external accountants) and tax declaration. After that, the tax advance and the payment of the tax is the fifth and sixth steps, respectively. Finally, the businesses need to fulfil other reporting obligations that possibly arise after the payment of the different taxes.

Considering the possibilities of micro-enterprises, there are two commonly applied simplified forms of taxation in 2021. These are the *kisvállalati adó* [KIVA] (Small business tax) and the *kisadózó vállalkozások teteles adója* [KATA] (Fixed-Rate Tax of Low Tax-Bracket Enterprises). The applicable law currently in force that regulates these two simplified forms of taxation is the latest version of the Act CXLVII of 2012 on the Fixed-Rate Tax of Low Tax-Bracket Enterprises and Small Business Tax [34]. Based on the data of *Nemzeti Adó- és Vámhivatal* [NAV], both simplified forms of taxation are gaining popularity among the smaller businesses [35].

The following businesses can apply for KATA: sole proprietors, private entrepreneurship, limited partnerships with only private members, general partnerships with only private members and law firms. In this form of taxation, micro-enterprises need to pay 50,000 Hungarian forints after each full-time small taxpayer and 25,000 Hungarian forints after each not full-time small taxpayer. However, if the income of these businesses exceeds 12 million Hungarian forints, the businesses need to pay 40 percent of the excess amount as taxes. In general, the businesses are exempt from the following taxes [34]:

- Entrepreneurial personal income tax and entrepreneurial dividend fund.
- Corporate income tax.
- Personal income tax and other personal contributions.
- Social contribution tax and training levy.



Moreover, these taxpayers are entitled to various cash and in-kind social security benefits in order to mitigate the loss of their earnings. In the case of cash benefits, these entrepreneurs have the opportunity to pay higher taxes after each full-time employee, in order to reach higher benefits in case of need.

It is a great advantage of KATA that the whole system, with all its processes and the connected declaration, is simple. Commonly, micro-enterprises do not necessarily need to hire an accountant to prepare this declaration as they can do it by themselves.

Additionally, for micro-enterprises to be able to choose the KIVA form of taxation, all the following criteria must be complied with [34]:

- The average statistical number of employees should not exceed 50 in the previous tax year.
- The total income to be accounted for should not exceed 3 billion Hungarian forints in the previous tax year.
- The tax number has not been permanently cancelled in the previous two calendar years,
- The end of the financial year is 31 December.
- The balance sheet total does not exceed 3 billion Hungarian forints in the previous tax year.
- The taxpayer does not own, manage and operate any controlled foreign company in the previous tax year.
- The financing costs cannot exceed the taxable interest income and the economically equivalent taxable income with more than 939,810,000 Hungarian forints in the previous tax year.

Micro-enterprises that opt for this simplified form of taxation are exempt from corporate income tax, social contribution tax and levy. The rate of this small business tax is currently 11 percent of the calculated tax base of the particular business [34]. The assessment of these forms of taxation is executed at the end of each tax year and the connected declaration and payment are done till 31st May in the following tax year. The tax base and the tax advance base are calculated along the same methodology. These amounts are based on the result of the dividends, the capital transactions and the additional adjustment items increased by the personal payments but consider the sum of these personal payments. The additional adjustment items in this calculation are intended not only to ensure the avoidance of the so-called double taxation, but also to secure the tax bases of the businesses [36]. These simplified forms of taxation do not influence the value-added tax liabilities and obligations of the concerned businesses. Due to the fundamentally different nature of some products and services, Act CXXVII of 2007 on Value-Added Tax differentiates four groups of goods and services and associates those with unique predefined tax rates. Among these groups, the first one collects all free tax and is mainly related with public goods and services.

The four groups, according to their rates and the included goods and services, are listed below [37]:

- 0 percent: public interest-related activities, predefined financial services, predefined import and export activities.
- 5 percent: medications and other medical products, products for disabled people, printed (press) products, animals and related products, district heating, performance services, catering services, internet services and accommodation services.

- 18 percent: milk and dairy products, products made with cereals, flour, starch or milk, event entry services.
- 27 percent: goods and services that are not included in any of the formerly mentioned groups.

Furthermore, micro-enterprises applying the KIVA form of taxation are not exempt from the various liabilities related to the wages. In the case of all employee salaries, the businesses need to pay both 15 percent of personal income tax advance and 18.5 percent of social security tax. Therefore, this 33.5 percent overall rate of tax highly influences the possibilities of micro-enterprises in hiring and employing more personnel.

On the other hand, the Hungarian taxation system is still highly complicated. Currently, it not only contains the four main taxes personal income tax, corporate income tax, budget excises and value-added tax but also has approximately 45 other tax liabilities [38]. In her publication, Gosi [39] draws the same conclusion based on the still more than 40 taxes. In 2020, the overall number of taxes even increased and nowadays we can count 54 tax liabilities besides the main taxes.

Another issue is that the Hungarian taxation system is characterized by a high level of uncertainty and unpredictability as the different taxes are changing even within a year. This is why it is extremely difficult, especially for micro-enterprises having no responsible accountants, to follow and pay attention to the particular changes in the taxation system [26]. Hoss [40] also highlights this situation from the point of view of competitiveness. In her paper, she concludes that the simplicity and transparency of the domestic regulations and taxation systems significantly influence the operations of the micro-enterprises. Also, she contends that these businesses are commonly not able to hire specialists for each different area. However, neither the current taxation system nor the legislation supports these businesses in this regard.

Hagen et al. [15] came to a similar conclusion in their work. They state that in the case of micro-enterprises, the owner manages the everyday operations of the business mainly alone. This is why these entrepreneurs face a lack of time in processing all the invoices and performing the connected accounting processes; so, they prefer to delegate these tasks to the accounting offices. However, the outsourcing of these accounting activities involves monthly additional costs for the micro-enterprises, which will affect their financial situation. Moreover, these businesses still need to collect and provide the issued invoices for these accounting offices, so the process still requires some of their time.

To conclude, the main aims of the Hungarian taxation system are the economic bleaching and the development of the competitiveness of the domestic businesses. Due to the importance of micro-enterprises, these processes are mainly targeted at this sector. Both the simplified forms of taxation, KATA and KIVA, were introduced as a part of this project. However, even if these forms are gaining popularity, the micro-enterprises still face serious difficulties due to the complexity and administrative requirements of the system.

In order to facilitate the job creation and investments of the Hungarian micro-enterprises, a well-designed, structured and operated taxation system is essential. This well-functioning system would greatly support the accelerating rate of development of the domestic market economy. Moreover, with a stable economic background and an ensured (long-term) survival, the innovations of the micro-enterprises would also shoot up.

### 3. Materials and Methods

The applied research approach in our work is deductive as we formulated and based the hypotheses to be tested on the existing theories from secondary data sources. Considering the classification of the design of this research, our work can be characterized as conclusive and descriptive research. For our research, we formulated the following hypotheses:

- H1: The chosen simplified form of taxation is defined by and is in connection with the legal form of the micro-enterprises.
- H2: The micro-enterprises find it rather difficult to choose the most appropriate form of taxation for themselves.

In order to properly test these hypotheses, we chose a quantitative research procedure. Within the frameworks of this quantitative research, we collected data from the people working in Hungarian micro-enterprises. To gather the above-mentioned quantitative data, we applied a questionnaire-based data collection technique. Within this group, we chose to conduct an electronic survey.

In the next table (Table 1), the structure, steps and the related timetable of our primary research can be seen:

**Table 1:** *Timetable of our primary research.*

Main steps	Jan-21	Feb-21	Mar-21	Apr-21	May 2021
Compilation of the questionnaire					
Pre-test of the questionnaire					
Promotion of the questionnaire					
Data processing and evaluation					
Examining data correlations					
Drawing conclusions					

Participation in the questionnaire was voluntary, and the personal privacy of the respondents was ensured. The data was collected anonymously and has been handled and analyzed confidentially throughout the whole process. Moreover, the responses obtained were used exclusively in this research and will not be shared with third parties. In conclusion, all the main ethical considerations were considered during the full duration of the research project, which included the following [41]:

- Informed consent.
- No harm.
- No deception and full transparency.
- Objectivity.
- Privacy and anonymity.
- Confidentiality.
- Voluntary participation and.
- Trust.

### 3.1. Questionnaire

In our survey, the following question types were applied:

1. Close-ended question:
  - Multiple choice.
  - Likert scales.
2. Open-ended question.

In the case of the Likert scale, we applied 4 levels in order to compare some of our results with the results from our former primary research. The survey consisted of 10 questions and an option for the representatives of the micro-enterprises to provide any additional thoughts they wished to share. All 10 questions were mandatory to fill, thereby ensuring the completeness of our database. All in all, it took around 7-10 minutes for the participants to complete all of them.

Our questions focused on the following main topics:

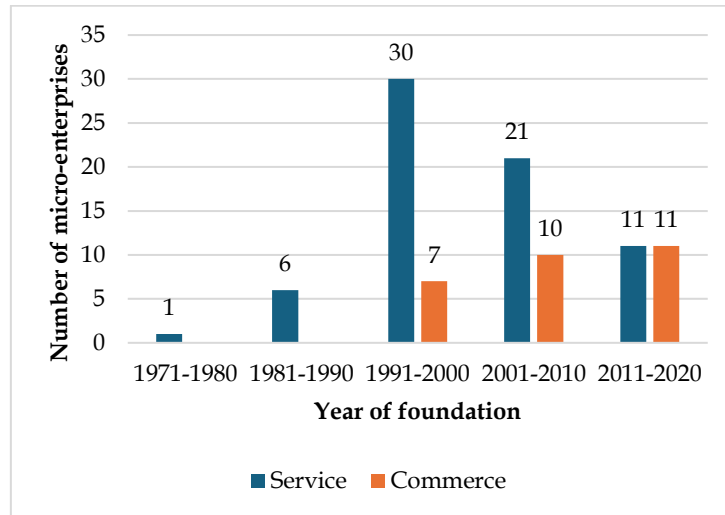
- General characteristics of micro-enterprises
- Taxation system and process
- Taxes and public burdens

After the formulation of our questionnaire, we conducted a pilot data collection with a group of three respondents in order to ensure an understandable survey with easy and smooth manageability for the real respondents. The popularization period of our questionnaire lasted almost three weeks in March. During this period, we were able to collect almost 100 responses from micro-enterprises. However, it is to be noted that due to the extensive number of Hungarian micro-enterprises, the results derived from the 97 responses taken into account cannot be considered as representative. Furthermore, the Hungarian Central Statistical Office lacks precise data regarding the sector from a tax perspective. Consequently, without a comprehensive understanding of the composition, it is not possible to draw a representative sample. As for data storage, handling and analysis, we used Microsoft Excel of Office 365 Education package and the SPSS Statistics program of IBM. During the data analysis, we applied the various statistical methods and introduced as well as explained the results of them below.

## 4. Results

### 4.1. Characteristics of respondents

Firstly, we examined the respondents' year of foundation of the micro-enterprises and the chosen scope of activity. In the case of the years, we grouped the data by equal intervals, that is by decades, and defined the following 5 groups.

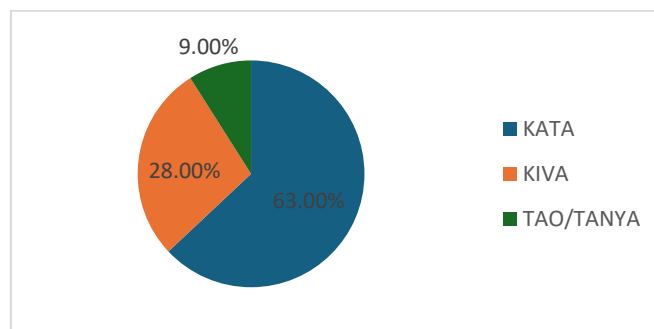


**Figure 1:** *The classification of micro-enterprises (year of foundation, scope of activity).*

From Figure 1, we can see that from the 1990s, entrepreneurs have started to capture the market share in the field of commerce. Moreover, we can also see a peak in the case of the number of micro-enterprises founded in service sector during the same period.

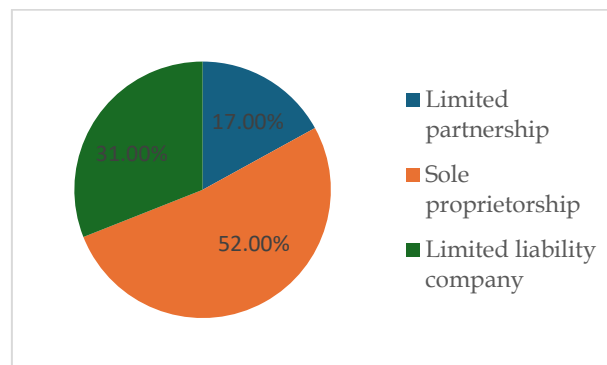
One of the reasons for this tendency—the sudden increase in the number of micro-enterprises—can be the effect of the regime change that facilitated the foundation of private companies.

We analyzed the ratios of the respondents' micro-enterprises using different forms of taxation. According to Figure 2, we can say that the majority, or exactly 63% of the respondents, were applying KATA simplified form of taxation. Moreover, we can see that the rest of the answers were provided by KIVA and TAO taxpayers with the distribution of 28% and 9%, respectively.



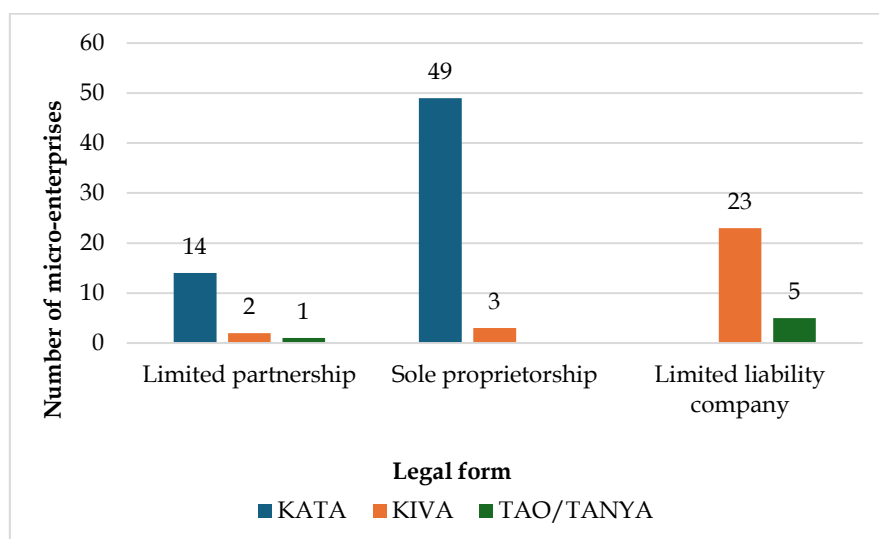
**Figure 2:** *The classification of micro-enterprises (taxation form).*

After this classification, we created a similar pie chart in terms of the legal form of the respondents' domestic micro-enterprises. The most common group was that of sole proprietorships with 52%, which was followed by limited liability companies with 31%; and only 17% of the respondents worked in limited partnerships (Figure 3).



**Figure 3:** *The classification of micro-enterprises (legal form).*

As a first element of our deeper analyses, we investigated the relationship between the legal form and the taxation form of the respondents' micro-enterprises. The next Figure 4 shows the dominance of sole proprietorships and that the respondents usually applied for KATA simplified form of taxation. Regarding the limited partnerships, KATA was the most popular as well. Finally, limited liability companies mainly applied KIVA simplified form of taxation. Overall, we can clearly see the dominance of the simplified forms of taxation (KATA and KIVA) over Tarsasagi ado [TAO] (Corporate Tax). One of the main reasons of this dominance is the basic nature of these taxation forms and because they were initially created for smaller businesses. This is why they are aimed at simplifying the taxation process and in lightening the tax burdens of these businesses to facilitate their development and survival.



**Figure 4:** *The classification of micro-enterprises (legal form, taxation form).*

With the help of the Mann-Whitney significance test, we examined the relationship between the legal form and the simplified form of taxation of the respondents' micro-enterprises and we found a significant ( $p=0.00$ ) relation between the two characteristics. The following 2. Table shows that while the majority of the limited liability companies apply KIVA, sole proprietorships and limited partnerships tend to choose the KATA form of taxation. Also,



more than 80% of micro-enterprises applying KIVA belong to the limited liability companies and almost 80% of the KATA taxpayers to the sole proprietors. This result suggests that the size of a company's workforce is a determining factor in its tax form. In other words, companies with fewer employees are more likely to choose the KATA tax form than those with larger workforces.

**Table 2:** Crosstabulation (legal form, taxation form).

			What is the form of taxation of the micro-enterprise?		
			KATA	KIVA	Total
What is the legal form of the micro-enterprise?	Limited liability company	% within legal form	0,00%	100,00%	100,00%
		% within taxation form	0,00%	82,10%	25,30%
	Sole proprietorship	% within legal form	94,20%	5,80%	100,00%
		% within taxation form	77,80%	10,70%	57,10%
	Limited partnership	% within legal form	87,50%	12,50%	100,00%
		% within taxation form	22,20%	7,10%	17,60%
	Total	% within legal form	69,20%	30,80%	100,00%
		% within taxation form	100,00%	100,00%	100,00%

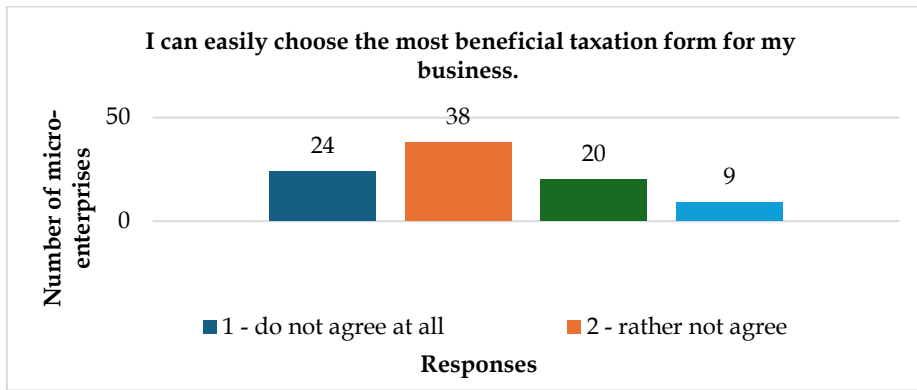
## 4.2. Taxation system and process

The next part of our analysis concentrates on the experiences of the micro-enterprises in terms of the choice of their taxation form. The initial statement in our questionnaire was this: "I can easily choose the most beneficial taxation form for my business". The respondents had 4 options in this Likert scale question to choose from, which were:

- 1 - do not agree at all.
- 2 - rather not agree.
- 3 - rather agree.
- 4 - fully agree.

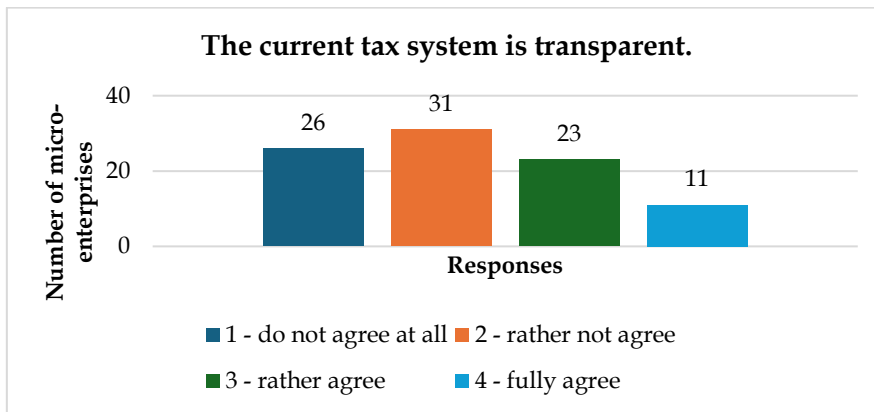
We can see in Figure 5 that the micro-enterprises tended to disagree with this statement. Most of the respondents (approximately 40%) have chosen the Likert scale value of 2, meaning that they would rather not agree with it. Moreover, less than 10% of the micro-enterprises found it easy to properly choose their taxation form.

Connected to this statement, we also investigated the opinion of the respondents regarding the transparency of the taxation system and the available taxation opportunities for micro-enterprises.



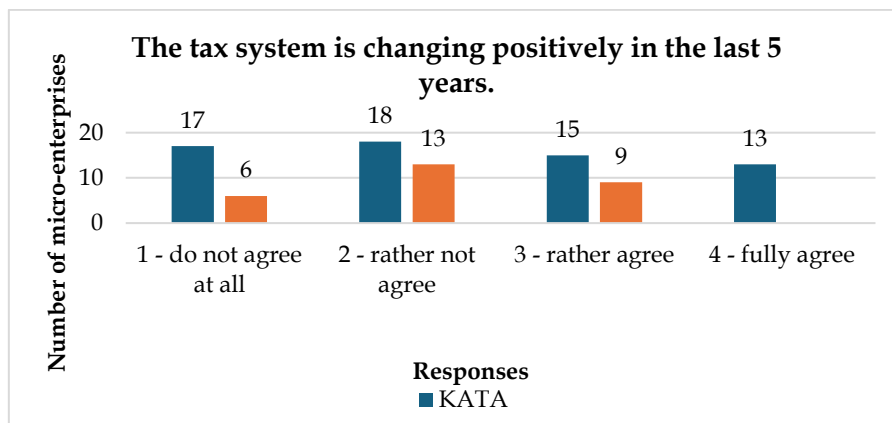
**Figure 5:** The classification of micro-enterprises (choice of taxation form).

Considering the first one, Figure 6 indicates that the respondents did not find the current tax system transparent. This can be due to many reasons, among which the lack of time and lack of sufficient resources are the most important ones. Nearly 70% of respondents said that they did not have the time or resources to keep up with the changes in the tax system.



**Figure 6:** The classification of micro-enterprises (tax system transparency).

The following part of our analysis focuses on the perceptions and experiences of the representatives of the domestic micro-enterprises regarding the changes in the taxation system over the last five years. As Figure 7 indicates, both KATA and KIVA taxpayers did not agree with this statement: “The tax system is changing positively in the last 5 years”.



**Figure 7:** The classification of micro-enterprises (taxation form, tax system changes).

In connection with the last 2 questions where we mentioned the difficulties caused by the current taxes and the changes in the various taxes that has occurred in the last 5 years, the challenges caused by COVID-19 are worth mentioning. For almost one and a half years now, there have been many governmental restrictions aimed at handling the situation and preventing the accelerated pace of the infections, which have caused difficulties for the micro-enterprises.

Due to the multiple temporary closures of the various business types, the average revenue of the Hungarian micro-enterprises has drastically dropped. Moreover, these businesses generally do not have the required reserves to survive even 1-2 months with a loss of income. This puts these businesses in the most vulnerable position nowadays.

All these are important in terms of the answers provided as the payment of the taxes can become difficult to manage in the absence of normal revenue. That is the reason why this COVID-19 situation can greatly influence the perceptions of the respondents.

## 5. Discussion

Although the simplified forms of taxation are aimed at easing the situation of the micro-enterprises, there are many elements and conditions that these businesses need to be aware of and should follow on an ongoing basis. The complex taxation system has both direct and indirect effects on the financial situation of these businesses. As a direct effect, we can mention the liquidity problems that are caused by value-added tax and tax advancement payments. An example for an indirect effect is that caused by the relatively fast changes in this system, which creates a need for micro-enterprises to hire accountants and pay them monthly thereby influencing their financial situation.

In association with these research questions, we defined four hypotheses. Among these, the first one is that “The chosen simplified form of taxation is defined by – in connection with – the legal form of the micro-enterprises.” (H1). As the performed significance test did not satisfy all criteria of the crosstabulation, the identified significant ( $p=0.00$ ) relation – also represented on Figure 4 and Table 2 – is only presumed to exist. This is why we can neither confirm nor reject our H1 hypothesis as it would require further research. Our third hypothesis focuses on the experiences of micro-enterprises regarding the choice of the most appropriate form of taxation for themselves and assumes that they find it rather difficult to choose that (H2). Based on Figure 5, we can state that most of the respondents, that is almost 70%, disagreed with the statement that it is easy for them to choose the most appropriate form of taxation for themselves. Thus, we accept our H2 hypothesis.

Based on the literature review and the analyses of the questionnaire, it is clearly demonstrated that the micro-enterprises experience difficulties caused by the complicated and relatively fast-changing domestic taxation system. As sole proprietors and limited partnerships favor the KATA as a form of taxation, and the legal framework provides them with it, the government has announced its intention to alter this status quo, a decision that has generated considerable tension within the sector. Therefore, it would be advisable to develop a decision support system for small enterprises to make them effective in the field of choosing the best possible taxation form as it is possible to forecast the tax arrears [42].

## 6. Conclusion

Due to the aforementioned characteristics of the taxation system, these businesses would need an up-to-date guideline. As every business and also their chosen form of taxation is registered centrally, NAV – the responsible National Tax and Customs Administration of Hungary – could collect and send them an itemized, comprehensible tax description about the public burdens they need to pay that year. Alternatively, the chambers of the micro-enterprises could also perform this task.

As our research indicated, these businesses have neither the time nor the required resources to follow the changes in the taxation system. Therefore, a widely available, up-to-date online tax calculator could also provide them with tremendous help. This way, the micro-enterprises would only need to provide their basic data like the average statistical number of employees and their income, and the system could suggest the most appropriate taxation form for them. This can even be utilized by future entrepreneurs so that they can check their opportunities based on their targeted results. In order to avoid causing extra work for the micro-enterprises, these two suggestions could be linked and handled together with the help of the online customer portal of NAV. During the last decades, the dominance and, consequently, the economic role of micro-enterprises have been continuously increasing. This process is facilitated by their dynamic growth and opportunities for flexibility. Despite all this, these businesses are facing serious financial and taxation difficulties, which could even jeopardize their long-term survival. That is why it is key to study their situation and provide suggestions to promote their development.

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