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Article

Tax-book conformity: Evidence from Hungary

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Abstract: Accounting can be regulated using either a principle-based or rule-based approach; however, profit determined for taxes purposes is invariably subject to rigorous regulation, permitting minimal flexibility. Entities are strongly motivated to utilize same or highly similar tax figures for financial accounting and tax purposes, as it reduces costs and effort. Nevertheless, this form of tax-book conformity frequently results in decreased financial reporting quality, as proven by prior studies. In numerous jurisdictions, governments are developing simplified accounting systems that utilize figures established by accounting regulations, as this facilitates accurate tax calculations and enables entities to optimize efforts and expenses in preparing financial statements. However, these systems result in lower-quality financial statements, which consequently reduce transparency and makes decision-making. more complicated and less accurate. This study examines a specific example from Hungary where a simplified accounting system was introduced in conformity with tax regulations; nonetheless, the principle of true and fair view was replaced by standardization and uniformity. The research investigates if this tradeoff is acceptable as organizations utilizing this legislation (qualifying entities) are those whose scale suggests that such simplification will not significantly compromise public interest. The study reveals that in Hungary, smaller entities typically do not make significant changes to determine their taxable earnings. The introduction of this system is justifiable given the regulations available for smaller organizations.

Keywords: tax-book conformity; financial accounting; regulation; taxation; small and middle-sized entities

1. Introduction

Tax-book conformity refers to the alignment or degree of consistency between a company's financial accounting (book) income and taxable income as reported to tax authorities. This concept reflects the extent to which financial accounting rules and tax regulations overlap or diverge in determining income, expenses, and other financial measures (Hanlon and Shevlin, 2005; Hanlon et al., 2005, 2008).

Tax-book conformity is critical in discussions about tax policy, corporate governance, and financial transparency, as it influences how companies report profits to shareholders and calculate tax liabilities. High conformity reduces discrepancies, potentially simplifying compliance but limiting the flexibility of financial reporting for management purposes. Conversely, low conformity allows companies to use different methods for financial reporting and tax reporting, offering more flexibility but increasing complexity and the potential for manipulation (Shackelford et al., 2007).

This paper examines tax-book conformity in relation to the Hungarian entities. We looked for evidence of the phenomena using an extensive dataset and looking for correlation between the size and conformity.

Our result is important for the regulator to enhance the creation of relevant regulation and also to other shareholders of the financial statements to understand to which extent financial statements produced by entities emphasis true and fair view over reduced cost and simplicity among the Hungarian entities.

2. Previous relevant literature, evaluation of the area of application

2.1. Role and regulation of financial statements

The primary product of the accounting process is unequivocally the financial statements. It provides information to stakeholders and is enforced by an authorized entity—the regulator. This compulsion comprises two components: firstly, this body establishes the regulations to be adhered to (regarding the preparation of financial statements), and secondly, it imposes penalties on those who either fail to provide the data or provide it inaccurately, with such inaccuracies resulting from gross negligence or intentional misconduct. The financial statements comprise five components: the statement of financial position (balance sheet), the statement of comprehensive income, the statement of changes in equity, the statement of cash flows, and the accompanying notes elucidating these figures. Financial statements must possess two fundamental characteristics. Initially, they must possess suitable quality. This satisfactory quality is articulated in many manners globally, with continental European rules stipulating the necessity for an accurate and fair picture (Alexander, 1993). Another fundamental requirement is that financial statements must be useful, meaning they should provide stakeholders with the necessary information while allowing for an appropriate allocation of resources (Lakatos, 2010).

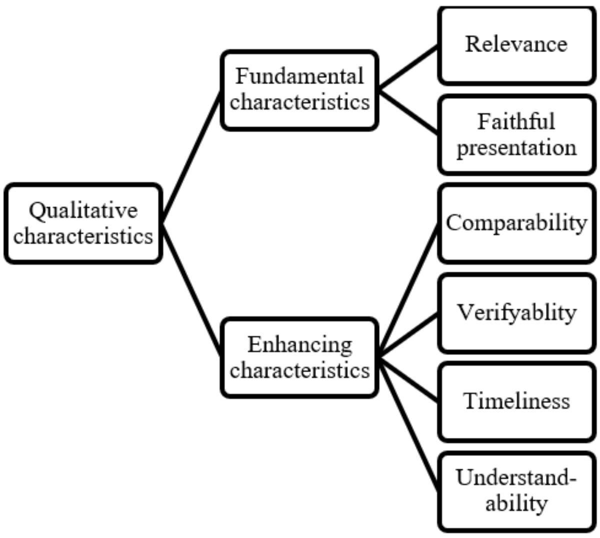

Figure 1. Quality Characteristics in IFRS as a Conceptual Framework (developed by the authors).

The system of rules can be developed in two approaches. The principle-based approach involves providing the reporter with options, anticipating that these options will effectively facilitate the preparer in fulfilling stakeholder information requirements. This does not imply that the law grants the preparer absolute autonomy;

rather, it establishes constraints that are not rules but principles or qualitative characteristics. IFRS is presently the most extensively utilized transnational framework globally, employing a global principles-based methodology (**Figure 1**). The system delineates the subsequent fundamental concepts, the hierarchy of quality attributes:

Alongside the principles, there exist specific regulations that are exclusively drawn from them, and the system encompasses various alternatives. When the processes are well chosen, the outcome is a statement of superior quality with substantial informational value. (Sundvik, 2019) Nevertheless, this inherently adaptable approach entails considerable responsibility and expense: identifying the most suitable solutions for an accurate and dependable overall representation is both costly and time-intensive due to the need for expertise.

Conversely, rules-based systems, exemplified by US GAAP and those prevalent in economies that have extensive state control, primarily function through explicit regulations, hence minimizing the discretion allowed to entrepreneurs in accounting decisions. In this context, while the preparer's discretion is limited, the resources needed to compile the financial statements are reduced, the decision-making responsibility declines, and data is accessible quicker. Nonetheless, this incurs a cost: Sundvik's aforementioned research indicates that such reports are less useful.

The regulator can so select between two alternatives. The pertinent question is how the regulator can determine the appropriate course of action. Nobes and Parker have established a crucial principle on this matter: "Accounting is a methodology practiced in various political, economic, and social contexts" (Parker, 2016). Consequently, the regulator must consider the operational environment and tailor regulations accordingly. In their research, they discover several issues that need consideration (**Figure 2**).

Examples include:

- judicial framework,
- the company's financing structure,
- cultural integration,
- the magnitude of public demand for information.

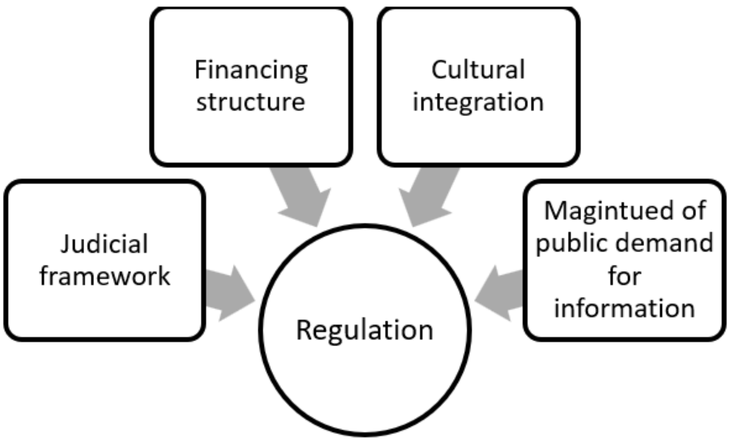

Figure 2. Factors influencing the accounting regulation (developed by the authors).

In addition to the aforementioned aspects, our prior study indicates that the expectations of stakeholders and report compilers must also be considered in the regulation design (Lakatos, 2010, 2014).

2.2. The difference between profit and tax base and tax-book confirmity

In examining stakeholder needs, the tax-book conformity issue serves as a valuable indicator of the degree to which stakeholders require principle-based data in addition to the information generated through regulated processes. This can be evaluated by assessing the disparity between the outcome and the tax base.

The income statement is an essential component of the financial statements, measuring the performance (profit or loss) of a fiscal year by assessing the profitability or losses incurred during that period. The performance delivers critical insights for all stakeholders: it informs management of the value generated by its activities, enables shareholders to anticipate dividends from profits, and conveys a compelling message to creditors, who are more likely to repay previously granted loans.

Among the stakeholders is the government, which possesses a direct interest through taxation. The two primary components of this function are the computation and collection of taxes. Taxes can be categorized in several manners, although one of the most fundamental and initial classifications is the income tax vs. other taxes (Samuelson and Nordhaus, 2009). Income taxes are a form of taxation imposed on a specific category of profit, usually the pre-tax earnings of a business. The corporate income tax is usually a universally imposed tax. Given that income tax is based on profit, a logical alternative would be to use the profit before taxes presented in the financial statements as the tax base. This evidently apparent approach is not implemented in practice.

The government (one of the stakeholders) retains the authority to modify the accounting profit through various items (tax base adjustments) to achieve a tax base that is acceptable to them. There are three primary forms of tax base adjustment: firstly, the State incentivizes specific activities (e.g., investments) by modifying the tax base, resulting in lower tax liabilities for participants; conversely, it 'penalizes' certain expenditures (e.g., fines incurred) by implementing adjustments that result in comparatively higher taxes. The third unique category of modifications is timing. A company may encounter several scenarios where it must make accounting decisions regarding specific expenses, determining whether to allocate an expense to one period or another, potentially affecting multiple periods significantly. This option is available to accountants to generate good-quality financial statements, specifically to fulfill the criterion of a true and fair picture. Establishing principles is more effective, as formulating a rigid set of rules that accurately covers all scenarios is futile. Nonetheless, it is undeniable that this alternative allows the entrepreneur to 'manage' the tax base, allocating the outcome suitably within a structured framework. This allowed decision, without a corresponding tax base adjustment, directly affects the tax base, which is unacceptable to the government (and thus to the general public), as it may result in unstable and unpredictable revenue from taxes. Consequently, the legislator frequently selects a solution that permits discretion within accounting regulations, thereby ensuring adherence to a dependable and equitable overall representation while simultaneously stipulating the timeframe for tax considerations, ensuring that accounting choices do not influence the tax base. An illustrative example of the aforementioned item is depreciation. Non-current assets must be systematically written down against profit or loss during their useful lives (depreciation). Regarding the useful life and depreciation rate, regulations usually grant organizations significant autonomy in determining the duration an asset contributes to operations and the method of recognizing depreciation, whether evenly over this period, on an accelerated basis, or based on its specific utilization (one example is Hungary, but this is a general phenomenon). Nevertheless, the tax regulations do not permit this flexibility: with few exceptions, they specify the timeframe during which the value of each asset must be allocated to profit or loss and do not accommodate any variation in the timing of the allocation. This is where the issue of tax-book conformity arises. The significant implication is that a substantial amount of additional effort is required to ascertain both the values: the book value that adhere to accounting standards, ensuring a reliable and appropriate overall representation, and the tax values that conform to tax regulations. This explains the global response to the convergence of these two values, even at the cost of an accurate and impartial representation, so affecting the application of values derived from taxation in financial statements.

Significant in this context are the investigations by Hanlon et al. (2005) that emphasize the information loss during this response. Their 2005 study validated a significant conjecture by analyzing data from publicly traded companies, demonstrating that the convergence of earnings and tax base led to lower-quality and less relevant financial statements, hence worsening the circumstances of nearly all stakeholders. Hanlon's research notably emphasized the process within the framework of major, publicly listed corporations. A 2008 study corroborated this finding by demonstrating that a specific rule change resulted in a transition towards tax-book conformity, which caused a loss of knowledge and thus lowered the overall quality of the trustworthy and equitable representation (Hanlon et al., 2008; Hsu and Liu, 2023) and supporting data, including instances from continental Europe (Medeiros et al., 2023).

Several studies suggested very similar outcome that were focusing on one specific country/region (Artsberg, 1996; Chan et al., 2010; Febrina and Rachmawati, 2023; Frydlender and Pham, 1996; Gallego, 2004; Guenther et al., 1997; Hung, 2000; Istrate, 2024; Lamb, 1996; Lawrence, n.d.; Pais and Dias, 2022; Schutte and Zwan, 2024; Sun et al., 2023; Whitaker, 2005) or a specific issue like tax avoidance, earnings management, relationship with size, with reporting framework, ease of decision making, CSR (Alsaadi, 2020; Atwood et al., 2010; Blouin and Born, 2024; Chan et al., 2013, 2023; Chen et al., 2023; Hapsoro et al., 2024; Hsu and Liu, 2023; Hung, 2000; Kerr, 2019; Kuo and Lee, 2016; M Guimarães and Macedo, 2024; Prochazka and Molin, 2016).

A key aspect of tax-book conformity is earnings management, which was the subject of pioneering and extensive research conducted by Floropoulos et al. (2024). Floropoulos conducted a literature review on 60 studies examining the impact of book-tax conformity on earnings management and similar issues. They analyzed this association in publicly traded corporations and subsequently compared it with private firms. They also analyze external factors that may affect this relationship, such changes in accounting standards, the implementation of International Financial Reporting Standards (IFRS), revisions in tax legislation, tax enforcement, and external audits. Ultimately, they analyzed the information about book-tax conformity and wage characteristics. The results are inconclusive about whether high book-tax conformity increases or decreases earnings management. Their findings suggest that private firms undertake more comprehensive earnings and tax management than public corporations when book-tax conformity is solid and that the mere adoption of IFRS does not adequately reduce earnings management or improve tax compliance. Companies utilize negative discretionary accruals before tax rate reductions to achieve their tax planning strategies. Ultimately, tax authority enforcement improves the quality of financial reporting and reduces tax avoidance, whereas increased book-tax conformity impairs the informational usefulness and transparency of accounting earnings, which was a significant finding for our research.

The accounting regulation will directly impact taxation and tax-book conformity. Researchers have indicated that the magnitude of this phenomena is significantly influenced by the regulatory framework of the tax system in the country being examined (Nobes and Parker, 2008). Continental European regulators typically require that the tax base must be generated from accounting profit, whereas Anglo-Saxon reasoning consistently asserts that these two computations should be performed independently (Lakatos, 2010). Nonetheless, the phenomena is also temporal, considering the perpetually evolving tax landscape. Classifying a regulation as either rule-based or principle-based is essential for evaluating tax-book conformity and drawing conclusions.

2.3. Evaluation of Hungarian regulation: Principle-based versus rule-based

The primary inquiry pertains to the provisions of Hungarian legislation: does it require entities to use a principle-based or rules-based system? The modern accounting system of the country was established by the shift to a market economy. Despite the accounting profession's prior generation produced high-quality financial statements, these documents were evidently utilized to oversee government initiatives and were characterized by excessively detailed regulations. The Accounting Act of 1991, effective from 1992, addresses this issue by transitioning from rule-based regulation to a principles-based approach. The fundamentals of the Hungarian regulatory system are depicted in the subsequent diagram (**Figure 3**).

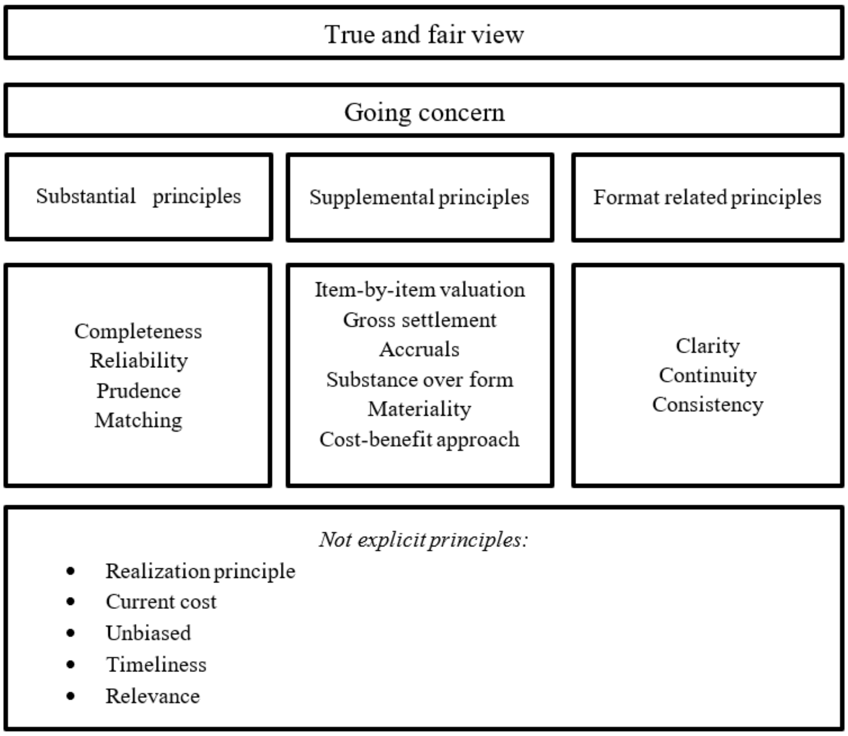

Figure 3. Principles of the Hungarian regulation (Róth et al., 2024).

The inaugural modern accounting statute was recodified in 2000. This legislation, currently in effect, remains anchored in its foundational principles; however, due to the escalating complexity of the economic landscape, several specific regulations have been implemented, undermining the principle-based approach. In the early 2000s, Hungary increasingly recognized the necessity of reducing administrative burdens, necessitating a rationalization of processes, even at the expense of reducing the information content of reports. Current accounting standards standardized the reporting framework from the beginning, facilitating a streamlined and concise presentation of the accounts; nonetheless, the system still mandated that the organization undertake virtually all decisions critical for delivering an accurate and fair representation.

In 2012, in response to increasing demand, the regulation transitioned from a principle-based framework to a reporting style that emphasizes regularity, so substituting principle-based regulation with rule-based regulation. This category of accounting pertains to the simplified annual reports of micro-entities. This category of accounts significantly streamlines financial reporting obligations. Only two primary statements must be published: a highly condensed profit and loss account reflecting the annual performance and a simplified balance sheet. Simultaneously, it offers minimal options to entrepreneurs, as is customary in standard reporting: it typically mandates compliance in a prescribed manner, usually dictated by tax regulations, irrespective of whether this aligns with the necessity for an accurate and fair presentation. This reporting format is available to entities that do not exceed two of the following three thresholds for two consecutive financial years: a balance sheet total not exceeding HUF 100 million (cca. 250 kEUR), and revenue not exceeding HUF 200 million (cca. 500 kEUR), and an average annual headcount not exceeding 10. The

2021 tax filings indicate a substantial number of entrepreneurs in the scope. Data from tax returns indicate that cca. 83% of entrepreneurs were allowed to prepare this form of reporting, specifically for the 2021 financial year (the preliminary data for 2022 suggest the same portion; see **Tables 1** and **2** below).

Table 1. Distribution of entity size statistics by percentage (relative distribution); Grey area: Qualifying entities.

		Revenue brackets (million HUF)									
		Not reported	**0–10**	**10–50**	**50–100**	**100–200**	**200–500**	**500–2500**	**2500–12,500**	**Above 12,500**	**Total**
Asset total brackets (million HUF)	0–10	18.4%	24.6%	6.7%	0.3%	0.0%	0.0%	0.0%	0.0%	0.0%	50.0%
	10–50	2.7%	7.1%	13.0%	3.2%	0.5%	0.9%	0.0%	0.0%	0.0%	27.4%
	50–100	0.7%	1.0%	2.0%	1.7%	0.5%	1.6%	0.1%	0.0%	0.0%	7.7%
	100–250	0.6%	0.7%	1.3%	0.9%	0.4%	2.5%	0.4%	0.0%	0.0%	6.8%
	250–500	0.3%	0.2%	0.4%	0.3%	0.1%	1.2%	0.7%	0.0%	0.0%	3.2%
	500–2500	0.4%	0.2%	0.2%	0.2%	0.1%	0.7%	1.5%	0.3%	0.0%	3.7%
	2500–12,500	0.1%	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%	0.4%	0.1%	1.0%
	Above 12,500	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.3%
	Total	23.2%	33.9%	23.7%	6.6%	1.6%	7.1%	3.0%	0.8%	0.2%	100.0%

Table 2. Distribution of entity size statistics (absolute distribution); Grey area: Qualifying entities.

		Revenue brackets (million HUF)									
		Not reported	**0–10**	**10–50**	**50–100**	**100–200**	**200–500**	**500–2500**	**2500–12500**	**Above 12500**	**Total**
Asset total brackets (million HUF)	0–10	58,993	78,743	21,347	842	79	159	21	1	0	160,185
	10–50	8516	22,780	41,660	10,223	1600	2865	72	2	0	87,718
	50–100	2124	3305	6550	5488	1530	5280	248	8	0	24,533
	100–250	1930	2107	4172	2931	1184	8062	1266	14	0	21,666
	250–500	993	733	1261	844	306	3768	2311	40	0	10,256
	500–2500	1140	592	797	636	263	2330	4880	1101	12	11,751
	2500–12,500	350	136	137	57	27	326	655	1207	284	3179
	Above 12,500	181	34	29	10	5	44	109	139	372	923
	Total	74,227	108,430	75,953	21,031	4994	22,834	9562	2512	668	320,211

Currently, there is no public data regarding the precise number of micro-entrepreneurs who used the option to prepare simplified annual accounts. However, it is evident from the available information that a substantial percentage of those eligible have not took advantage themselves of this option, thereby assuming additional administrative responsibilities. Filyó's 2017 study indicates that around 30% of the entities actually used this type of reporting (**Figure 4**). (Filyó, 2017)

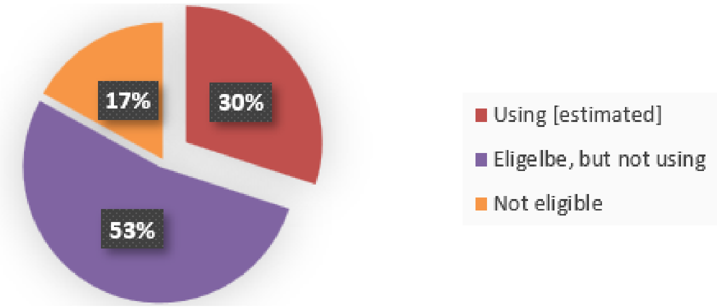

Figure 4. Distribution of entities—Use of the simplified reporting.

3. Study results

3.1. Problem

While the newly introduced reporting option for micro-entities may be advantageous and attractive to many, its implementation lacked analysis to ascertain whether the potential decline in reporting quality will surpass the cost savings associated with compiling full financial statements. An intuitive argument suggested that companies with less tax adjustments are likely to adopt this method; however, no evidence was shown indicating that smaller companies are implementing very minor tax adjustments. This paper examines this relationship.

3.2. Hypothesis development

In consideration of the aforementioned results, we analyzed the Hungarian economic environment with two objectives in focus. Initially, we sought evidence for the existence of the tax-book conformity phenomenon. We analyzed which organizations are inclined to align their accounting and tax records, potentially compromising a reliable and fair overall representation. It is evident that linking accounting and tax records offers substantial benefits: a modified system can significantly reduce the administrative burden (eliminating the necessity to concurrently record and oversee multiple datasets), and a reduced dataset also reduces the likelihood of errors, an inherent aspect of the accounting process (Lakatos and Tarpataki, 2024). Initial research indicates that smaller enterprises are more prone to adhering to the fixed parameters of tax regulations while having the option for alternative accounting methods, in order to ensure a consistent and fair overall representation. Despite conflicting findings observed in large enterprises in different contexts (such as stock market behavior) (Hanlon and Shevlin, 2005; Hanlon et al., 2005), it remains pertinent to investigate if a correlation between size and tax-book conformity exists within the Hungarian economy.

Our study also focuses on the analysis of Hungarian legislation. We examine whether the Hungarian accounting regulatory framework employs a principles-based or rules-based approach.

3.2.1. The correlation between size and the distance of the tax base

We hypothesize a linear relationship between size and the distance from the result to the tax base. To validate our theory, we established the subsequent hypothesis:

H1: Larger corporations are more inclined to make decisions that create a disparity between the company's pre-tax accounting profit and its tax base.

3.2.2. Material and methods

The examination was carried out for the fiscal year 2021. We possessed anonymized data of corporate tax filings submitted by each taxpayer of Hungary for the year 2021. We utilized the 2021 data as that is the most recent version accessible to us in its finalized form. We have excluded entities reporting under non-Hungarian regulations (IFRSs) and non-profit organizations since their reporting framework is not comparable with the Hungarian system. The analysis encompasses around 350,000 observations, enabling us to formulate representative conclusions.

To examine the correlation between size and the difference between accounting profit and taxable profit (tax base), we developed a relative variable. Given the extreme distribution of our sample, we ranked both size and the relative difference and applied Spearman's rho statistic to reach our conclusion. The size and completeness of our sample enable us to generalize our findings for Hungarian firms using Hungarian GAAP as a reporting framework.

3.2.3. Our investigation, proof of the hypothesis

The initial stage in doing the research is to identify the characteristic data utilized to quantify the company's size. Consequently, the initial stage is to identify the relevant indicators that accurately represent size; these typically include, in accordance with global norms, the value of total asset (balance sheet total) [Tas], the revenue [Rev], indicating sales volume during the period, and the headcount [Hea]. These were utilized in this study. The Hungarian economy presents a very extreme distribution in this regard, as illustrated by the tables below. Consequently, the study is conducted via rank correlation, to address the issue of this extreme distribution, specifically rating the firms by size based on balance sheet total and revenue (**Tables 1** and **2**).

For both total revenue [Rev] and total assets [Tas] the entities were ranked independently. A ranking was also made for headcount [Hea].

Then we have developed an indicator that quantifies the degree of voluntary profit and tax base diversion, specifically the extent to which corporations utilize tax base adjustments, which are predominantly at the company's discretion (**Table 3**). Only voluntary diversions are under consideration, as mandatory diversions lack a decision-making context and hence cannot explain the diversion whether the behavior is legitimate. The modifications to the tax base encompassed the subsequent subject matter:

- depreciation (the degree to which the accounting value diverges from the tax law value);
- the use of a development reserve;
- changes relating to unrealized foreign currency rate differences;
- matters concerning declared shareholdings and intangible assets;
- items pertaining to specific impairments;
- modifications pertaining to the exchange of beneficiary shares.

The description of the variable used is the following:

Table 3. Variables in the model.

Variable	Variable name	Variable explanation
Dep	Depreciation difference between accounting and tax	The difference between the depreciation recognized according to the accounting rules and tax rules.
Dev	Recognition of development reserve	Tax regulations permit the deduction of a specified amount from taxable profit, which must then be spent for the acquisition of property, plant, and equipment. The depreciation of these assets will not be eligible for tax deduction; hence, the tax deduction is acknowledged in advance, prior to the asset's acquisition.
Fxu	Net adjustment for unrealized foreign exchange gains and losses	Tax law permits the neutralization of unrealized foreign exchange gains and losses, allowing the associated asset or liability to be carried forward at the historical rate; hence, only the ultimate realized gain or loss will be subject to taxation.
Dii	Tax adjustment for declared investments and intangible assets	Certain investments in other entities, as well as intangible assets, can be "declared" to the tax office. If these assets are later disposed of, impaired, or the impairment is reversed, the profit or loss on these items will not be taxable (irrespective of whether it was a profit or loss).
Imp	Certain impairments and their reversals	Specific impairments and their reversal may be disregarded for tax purposes in the year they are reported and will be considered when the underlying asset is ultimately derecognized (relevant for investments, intangible assets and certain financial assets).
Qus	Exchange of qualifying shares	Exchanging eligible shares, when reported to the tax authority and pertinent entities, will not impact subsequent gains or losses for tax purposes (this is relevant when shares in a company are exchanged with shares in an other company without material cash settlement).
Pro	Tax before profit for the year	Reported profit before taxes of the entity
Rev	Revenue of the year	Used as size indicator
Tas	Total asset at the end of the year	Used as size indicator
Hea	Headcount (average over the year)	Used as size indicator

Given that the direction of the change (i.e., whether it is increasing or decreasing) is irrelevant, we computed the absolute value of the deviation and subsequently aggregated the deviations. So the following variable was created for each of the entities:

$$Var_i = |Dep_i| + |Dev_i| + |Fxu_i| + |Dii_i| + |Imp_i| + |Qus_i| \tag{1}$$

To eliminate the influence of absolute size—where larger enterprises exhibit more deviations in absolute terms—we examined the ratio of the total to the result. This provided us with a metric to quantify the size of the change. Therefore the following indicator was calculated:

$$RVar_i = \frac{Var_i}{Pro_i} \tag{2}$$

The resultant indicator was ranked to compute a metric illustrating the association. Spearman's rho was used to assess the correlation strength due to the absence of information about the population distribution.

The research utilized Spearman's rho correlation to assess the monotonic association between company size and voluntary tax adjustments. This non-parametric strategy was selected because of the significant variation in company sizes within the Hungarian economy. Variables such as revenue, total assets, and personnel were ranked independently, and the extent of voluntary changes was standardized in relation to pre-tax profits to ensure comparison among companies.

The outcome of the correlation analysis between the rank of voluntary diversion and the rank of each size indicator was as follows (**Table 4**):

Table 4. Result of the Spearman rho statistic.

	For rank of revenue (Rev)	For rank of total assets (Tas)	For rank of headcount (Hea)
Spearman rho	0.431	0.443	0.338
Sig. (2-tailed)	< 0.001	< 0.001	< 0.001
N	301731	301539	274379

The calculation results suggest a fairly strong positive and monotonic relationship between the magnitude of the tax adjustments and the size of the entity (for headcount the relationship is weaker), allowing us to accept our hypothesis.

4. Discussion

Our findings suggest that Hungarian entities exhibit a notable degree of tax-book conformity, with larger firms more likely to deviate from tax law stipulations to achieve their desired financial reporting outcomes. This positive and relatively strong correlation between voluntary adjustments (e.g., depreciation differences, development reserves, and foreign exchange adjustments) and firm size aligns with prior studies indicating that bigger companies often possess more resources to maneuver between financial reporting and tax regulations (Hanlon et al., 2005, 2008; Kerr, 2019). Such behavior is consistent with the argument that reduced conformity provides greater flexibility but, in turn, increases complexity and can diminish the informational value of financial statements (Hsu and Liu, 2023; Medeiros et al., 2023; Shackelford et al., 2007). In Hungary's environment—where regulators formally uphold a principle-based approach but simultaneously offer simplified, rules-based options—our data underscore how many micro-entities choose not to adopt simplified statements, suggesting they still perceive benefits from exercising accounting discretion. This raises policy considerations: while a simplified, tax-aligned regime can lower administrative burdens, an overemphasis on tax-book conformity could compromise the "true and fair" principle that underpins accounting quality (Alexander, 1993; Lakatos, 2010). Future research can build on these insights by assessing longitudinal datasets and comparing Hungarian outcomes with those in other jurisdictions that also wrestle with balancing financial statement usefulness against regulatory simplicity. Such comparative perspectives may provide broader evidence on whether stronger tax-book conformity unequivocally undermines or merely reshapes financial reporting quality.

The results of this study correspond with previous studies on tax-book conformity in nations exhibiting similar regulatory and financial characteristics to Hungary. Research conducted in Poland and the Czech Republic underscores analogous trends in regulatory transitions between principle-based and rule-based frameworks. In these nations, smaller companies exhibit more tax-book conformity due to constrained resources for managing dual reporting systems.

A notable analogy may be seen with Slovakia, where regulatory revisions aimed at simplifying reporting resulted in considerable administrative cost reductions, however also heightened concerns around financial transparency. These instances highlight the trade-offs that policymakers encounter worldwide in their attempt of balancing cost efficiency with reporting truthfulness.

Future study may further examine these mechanisms in transitional economies, where simplified frameworks are frequently employed to rectify systemic inefficiencies but may unintentionally undermine stakeholder trust.

5. Conclusion, further implications for the regulator

5.1. Our conclusion

Our study provides evidence that, similar to several economies worldwide, a subset of Hungarian businesses characterized by their size tends to neglect the strict separation of tax and accounting records, thereby saving resources. Our analysis indicates that company size is a driver of this choice; specifically, smaller entrepreneurs are more inclined to demonstrate tax-book conformity.

5.2. Takeaway for the regulator

The following findings can be derived from the analysis of Hungarian legislation. Our primary finding is that Hungarian regulation constitutes a hybrid system. On one side, we can ascertain that the Hungarian system remains predominantly principle-oriented; nevertheless, a system has been implemented—the simplified reporting rules for micro-entities—that has established a rigorous rule-based framework for reporting by significantly limiting the scope for choice. Regulation in this domain (smaller entities) has shifted from the principle of providing a dependable and fair broad view to a focus on consistency and uniformity. This reduces the transaction costs of reporting by eliminating the necessity to uphold records based on various criteria; however, numerous studies indicate that the transition from principled to rule-based regulation correlates with a decline in the quality of financial statements, rendering the information within these statements less beneficial for stakeholder decision-making and reporting judgment. Research and experience indicate that preparers do not uniformly seek to select the simplest solution, as evidenced by the disparity between those eligible for simplification and those who opt for it. This implies a continued demand for a solution that delivers a reliable and accurate overall representation, even if its development requires substantial spending.

It became also evident that the introduction of this simplified system, which will inevitably reduce reporting quality, is only used by those entities where the detoriation of the reporting quality does not pose a serious risk due to the size and number of affected stakeholders. However, it is important to stress that solid research results can not be substituted by intuitive reasoning when implementing such modifications; hence, these researches should be conducted ex ante even if data might be limited at that point in time.

The research results have considerable consequences for Hungarian tax and accounting policymakers. The use of simplified reporting methods has reduced administrative costs for micro-entities; yet, this study underscores possible detrimental impacts on financial transparency and the quality of decision-making.

To tackle these difficulties, regulators can consider:

- Defining more specific criteria for streamlined reporting eligibility to guarantee that only firms with negligible stakeholder risks utilize the system.

- Implementing hybrid frameworks that integrate streamlined reporting with focused disclosures for essential financial components, including asset valuations and tax adjustments.
- Supporting for training initiatives aimed at smaller organizations to improve their ability to uphold dual reporting criteria while minimizing costs.

Hungary ought to improve its accounting structure by balancing legislative simplicity with quality assurance, while preserving stakeholder trust and compliance.

5.3. Limitations of this study

This study acknowledges several limitations. First, the analysis relies on data from 2021, which may not fully capture longer-term trends in tax-book conformity. Additionally, the findings are context-specific to Hungary and may not generalize to other jurisdictions without further comparative studies.

Future research could explore:

- Longitudinal studies to identify evolving patterns of tax-book conformity.
- Cross-country analyses to compare regulatory approaches and their impacts on reporting quality.
- The role of technological advancements, such as digital reporting systems, in mitigating the costs of maintaining dual accounting records.

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