

SGI Sustainable
Governance
Indicators

2014 Taxes Report

Tax Policy



Indicator Tax Policy

Question To what extent does taxation policy realize goals of equity, competitiveness and the generation of sufficient public revenues?

41 OECD and EU countries are sorted according to their performance on a scale from 10 (best) to 1 (lowest). This scale is tied to four qualitative evaluation levels.

- 10-9 = Taxation policy fully achieves the objectives.
- 8-6 = Taxation policy largely achieves the objectives.
- 5-3 = Taxation policy partially achieves the objectives.
- 2-1 = Taxation policy does not achieve the objectives at all.

Finland

Score 9 Finland's taxation policies by and large are effective. An individual's income is taxed on a progressive scale, which in 2013, ranged from 6.5% to 31.75%; municipal taxes range from 16.25% to 21.75%, depending on the municipal authority. As a result demands for vertical equity are satisfied; the same, however, is less true for horizontal equity. A net wealth tax was abolished in 2006, and recent efforts to boost employment (among other plans) through taxation have to some extent implied discrimination between economic actors. Adjustments in recent years have made Finland's taxation system less complex and more transparent. As evident from comparative data, Finland performs very well in regards to structural balance and redistribution effects; what's more, overall taxation policies generate sufficient government revenue. Finland, when compared to other countries, has a unique situation in which taxation policies are largely approved by the public, which understands that taxation is a necessary means for securing overall social welfare.

Citation:

http://www.vero.fi/fi-FI/Syventavat_veroohjeet/Henkiloasiakkaan_tuloverotus/Vuoden_2013_valtion_tuloveroa_steikko%2825864%29 for 2013 income tax schedule.

Norway

Score 9 Norway imposes a comparatively heavy tax burden on income and consumption (VAT). Corporate taxation is in contrast moderate in

comparison to other countries. The tax code aims to be equitable in the taxation of different types of capital, although residential capital remains taxed at a significantly lower rate than other forms. In general the tax code is simple and equitable, tax collection is effective, the income tax is moderately progressive and tax compliance is high. Most of the tax collection is done electronically, with limited transaction costs, and the tax system offers limited scope for strategic tax planning.

A large share of the country's tax revenues is spent on personal transfers in the context of the welfare state. This contributes to making Norway a low-inequality society, and also enables significant investment in infrastructure and the provision of public goods; however, the efficiency of these expenditures is often low.

Switzerland

Score 9

The Swiss tax ratio is significantly below the OECD average, and tax rates, particularly for business, are moderate. Taxation policies are competitive and generate sufficient public revenues. As a lean state with relatively low levels of public-sector employment, Switzerland at both the federal and cantonal level has less need for high tax revenue than do more ambitious states. Nonetheless, it is important to note that due to the principle of federalism, tax rates can differ substantially between regions, as individual cantons and local communities have the power to set regional tax levels.

However, one reason for Switzerland's apparently small government revenue as a percent of GDP is statistical. As typically cited, this share excludes contributions to the occupational pension system (the so-called second pillar) and the health insurance program, since these are non-state organizations. The share of government revenue as a percent of GDP would be about 10 percentage points higher if contributions to these two programs were included. This would bring Switzerland up to the OECD average in terms of public revenue.

With regard to equity, Switzerland's indicators correspond to the average of the 23 OECD countries of Western Europe, the United States, Canada, Australasia and Japan for the 2000 – 2009 period. Inequalities of market incomes and net incomes, as well as the extent of redistribution accomplished through tax and other public policies, are almost identical with the average values for this country group.

Tax policy does not impede competitiveness. Switzerland ranks at or near the top of competitiveness indexes, and given its low level of taxation is

highly attractive for corporate and personal taxpayers both domestically and internationally.

Tax policy has contributed to an excellent balance between revenues and expenditures. Switzerland has a very low public debt (39% of GDP in 2013) and a positive financial balance – that is, the government's revenues exceed government spending.

Denmark

Score 8

The extensive welfare state is funded through a tax burden equal to nearly 50% of GDP, which is among the highest within the OECD. The tax structure differs from most countries in that direct income and indirect (VAT) taxation serve as the predominant taxes, while social security contributions play a modest role.

Large and small tax reforms (1987, 1994, 1998, 2004, 2009 and 2012) have been implemented over the years following an international trend of broadening tax bases and reducing marginal tax rates. The latter has in particular been important for labor income taxation. Decreasing income tax rates have, to a great extent, been financed by broadening the tax base, especially by reducing the taxable value of negative capital income (the majority of house owners have negative capital income because of mortgage interest payments) from 48% to 73% in 1986 to approximately 33% in 2010. In 2004, an earned income tax was introduced to strengthen work incentives. Environmental tax has also been increasingly used.

An important issue in policy design is tax competition. This has led to reduction of some excise taxes to reduce "border" trade. Corporate tax rates have also been reduced from 50% in 1986 to a planned 22% in 2016 (a recent reform reduced it from 25%), although the tax base has been broadened.

The 2009 tax reform included a reduction in the top marginal tax rate (from 63% to 56%), but more importantly, the income limit for which the top tax rate applies was reduced. This resulted in a significant drop (350,000 persons) in the number of taxpayers who pay the top marginal tax rate. The changes were financed by broadening the tax base, via a reduction in the tax value of deductibles, and further increases in environmental taxes.

Under the new government the latest tax reform followed in the fall of 2012. It included an increase in the top tax bracket and a higher earned income tax credit. Some excise taxes were also increased.

A recurrent issue in tax debates has been the role of the so-called tax freeze introduced by the previous government and, which, among other things, has implied a freeze of property taxes (the taxation of the user value of owner-occupied housing based on the current value of the house). This tax freeze was a contributing factor to the house price boom prior to the financial crisis. There is at present no political support to change this, although the Economic Council has argued for a “normalization” of this tax.

Citation:

Andersen, T.M., H. Linderoth, Niels Westergaard-Nielsen og Valdemar Smith, *The Danish Economy*, DJØF.

De Økonomiske Råd, *Dansk Økonomi. Efterår 2011*. (www.dors.dk)

Lithuania

Score 8

In Lithuania’s tax system, a significant share of government revenue is generated from indirect taxes, while environmental and property taxes are relatively low. However, there is significant tax evasion. In terms of horizontal equity, there are mismatches between various groups of economic actors with similar tax-paying abilities. The labor force is taxed somewhat more heavily than is capital (although the tax burdens faced by both labor and capital are below the EU average), while specific societal groups such as farmers benefit from tax exemptions. Previous governments have reduced the number of exemptions given to various professions and economic activities with regard to personal income tax, social security contributions and VAT. Social-security contributions are high, exceeding 30% of wages, and while there are ceilings on payments from the social-security fund (pensions), there are no ceilings on contributions to it.

In terms of vertical equity, the Lithuanian tax system to a certain extent imposes a higher tax burden on those with a greater ability to pay taxes, insofar as larger companies pay larger sums than do smaller companies, but there is a flat income tax rate of 15%. However, an element of progressivity is introduced through the use of untaxed income, the amount of which is fixed at around €1,633 per year, thus favoring those receiving lower wages. The current government has discussed increasing this amount in such a way as to increase the progressivity of the income tax system.

In terms of revenue sufficiency, despite the fact that a process of fiscal consolidation has occurred on the expenditure side, some gap between tax revenues and government expenditure remains. Social-security contributions are a particular concern, as this gap has led to significant indebtedness within the State Social Security Fund. While the increase in economic activity in the post-crisis period is expected to generate more government revenue, some observers have proposed the creation of additional tax-revenue

sources in order to make Lithuania's fiscal position more sustainable. The country also has scope for making its taxation system less distortive and more growth-friendly. The current government has set a goal of reducing the tax burden on labor, which would increase the competitiveness of the economy. However, as of the time of writing, it had not made a specific proposal for achieving this objective, or explained how it would compensate for the consequent loss of revenue. The goal of introducing the euro in 2015 limits the country's ability to engage in major tax reforms, as the forecasted budget deficit for 2014 is already close to 3% of GDP.

Citation:

COMMISSION STAFF WORKING DOCUMENT on the assessment of the 2012 national reform programme and convergence programme for LITHUANIA, http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2012/02_staff_working_document/lt_2012-05-30_swd_en.pdf.

Netherlands

Score 8

Taxation policy in the Netherlands addresses the trade-off between equity and competitiveness reasonably well. There is horizontal equity in that the taxes levied do not discriminate between different societal groups – especially men and women. The system is fully individualized. The Netherlands has a progressive system of income taxation which contributes to vertical equity. In general, income tax rates range between 30% and 52%. Personal income taxes are also levied on businesses that are not subject to the corporate tax system. The tax system includes only a limited set of deductibles, of which the one for interest payments on mortgages is widely considered to be overgenerous and to be contributing to enormous household debts. Furthermore, there are a number of subsidies that depend on taxable income. The most substantial are subsidies for child care, health care and renting a house. There is a separate tax for wealth.

The Rutte II Council of Ministers intends to further simplify the tax system, to decrease income taxes (the highest tax from 52% to 49%, and the next highest from 42% to 38%), and to stimulate a favorable business climate by simultaneously creating a separate profit box and eliminating a number of deductibles for entrepreneurs. Government finances and taxation are largely framed in terms of keeping the Dutch budget deficit within the 3% European Monetary Union norm, while simultaneously maintaining “sufficiency.” Some of the most important measures are a stepwise decrease of household deductibles for mortgage interest payments, a decrease of subsidies for health care and rents for housing, and an increase of the pension age to 67. Corporate income tax for foreign companies – an aspect of the trade-off between horizontal equity and competitiveness – has come under political scrutiny. An extensive treaty network of 90 tax treaties aims at protecting

foreign companies from withholding taxes. . In spite of these tax measures, the slightest economic setback forces the Dutch government to initiate new cutback measures. Therefore, achievement of “sufficiency” has become vulnerable under the continuing adverse economic conditions.

Citation:
Elsevier Fiscaal, Overzicht maatregelen Regeerakkoord Rutte II, 31 oktober 2012 (www.elsevierfiscaal.nl/fiscaal-actueel/themas/regeerakkoord)

Letter Government to Tweede Kamer 17 January 2013):
<http://www.rijksoverheid.nl/bestanden/documenten-en-publicaties/kamerstukken/2013/01/17/brief-naar-tweede-kamer-over-belastingheffing-internationale-ondernemingen/brief-naar-tweede-kamer-over-belastingheffing-internationale-ondernemingen.pdf>.

New Zealand

Score 8

Taxation policy has successfully continued to promote competitiveness and the generation of sufficient public revenues. Regarding equity, governments have followed a policy of equal treatment of tax types, including income earned outside New Zealand, but at relatively low rates. The National Party-led government reduced rates across the board in 2010, but at the same time increased the goods and services tax. Most services and products sold in New Zealand incur a goods and services tax (GST) at a uniform rate of 15% (with exceptions for financial services). The government has postponed plans for a new round of tax reductions in the face of its “zero budget” priority policy, with the determination to bring the economy back into surplus by 2014 – 2015, and has resisted pressure from some media outlets and other sources to introduce a stamp duty and/or capital gains tax on residential investment properties.

Citation:
Salmond, Rob. 2011. *The New New Zealand Tax System: New Zealand Taxes in Comparative Perspective*. Wellington: Institute of Policy Studies.

Sweden

Score 8

In terms of horizontal equity, this aspect of tax policy has improved over the last several years. The tax system has been reformed and simplified with fewer deductible items, which in turn has broadened the overall tax base. Combined with a less progressive tax rate and an overall reduction in taxes, horizontal equity has improved.

Vertical equity has significantly decreased, however. Studies show that differences between different socio-economic strata has increased over the past decade in most OECD countries, but more rapidly in Sweden. Current tax policy penalizes those who do not work, regardless of the reason for not

being part of the workforce. Thus, for instance, retirees have not been able to make deductions that the employed are allowed to make (this arrangement, however, is currently under review). This policy has served to incentivize people who are outside the workforce to seek jobs.

The government managed to balance public budgets quite successfully during the review period. Declining taxes were accompanied with spending cuts and privatization. Hence, the tax revenue has been sufficient so far, with the loss in revenue balanced by spending reductions. Nevertheless, spending cuts and the ongoing privatization efforts are a topic of the public debate.

Tax policy is less of a factor in national competitiveness today than it was 10 to 15 years ago when economists pointed to the high income tax levels as a major impediment to the competitiveness of Swedish businesses. Today, the Swedish tax levels are almost at par with those of its main competitors. In fact, taxation of business is comparatively low, which should increase its competitiveness in global markets.

Citation:
OECD (2011), *Divided we Stand: Why Inequality Keeps Rising* (Paris: OECD).

Australia

Score 7

At a broad level, the tax system achieves a reasonably high degree of horizontal equity, with income generally taxed at the same rate irrespective of the source of the income. The main exception arises in respect of capital gains taxation, where the family home is exempt from taxation and a 50% discount is applied to capital gains on other assets held at least one year. However, the rationale for the discount is that it is in lieu of adjusting for inflation. The income tax system is moderately progressive and, while it became less progressive over 15 years, until 2008, there was no significant change in income tax rates over the review period. The introduction of a broad-based consumption tax in 2000 decreased the progressivity of the tax system, but there was likewise no change in this tax over the review period.

Concerning efficiency, in 2008 the newly elected Labor government established a committee, chaired by Secretary to the Treasury Ken Henry, to review Australia's tax and transfer system and make recommendations to improve its functioning. The committee found that, in broad terms, the tax system functions well and does not unduly impede economic growth. Nonetheless, a number of inefficient and inequitable aspects of the existing tax system were identified, and the committee made 138 recommendations for changes. The government has yet to adopt more than a few of the recommendations, however.

With regard to sufficient inflow of tax revenue, for several decades the federal government has on average raised sufficient revenue from taxation to meet expenditure commitments. However, as outlined in detail in “sustainable budgets,” concerns have arisen in the review period that the federal government faces a structural deficit that will require difficult fiscal decisions in the near future, most likely involving a combination of reductions in spending and tax increases. Moreover, there is a long-standing concern about the fiscal sustainability of state and territory governments, which have very limited capacities for raising revenue. Growth in health and education expenditure demands on the states and territories have in particular outpaced revenue growth. During the course of the review period, the federal Labor government has moved to help address the growing shortfall in state and territory health and education budgets, but the underlying inadequacy of self-generated taxation revenue remains.

Citation:

Peter Whiteford, ‘Australia: Inequality and Prosperity and Their Impacts in a Radical Welfare State’ Crawford School of Public Policy, Australian National University, March 2013: https://crawford.anu.edu.au/public_policy_community/content/doc/Australia_Inequality-and-Prosperity_final-15-March-13.pdf

Australia’s Future Tax System, Report to the Treasurer. Canberra: Commonwealth Government, 2009. Available from <http://taxreview.treasury.gov.au/content/Content.aspx?doc=html/home.htm>.

Bulgaria

Score 7

Bulgaria’s government revenues are a mix of direct taxes, indirect taxes and social security contributions. The direct taxes, both personal and corporate, are a relatively small component of the tax revenues, and are based on a strategy of having very low rates which are uniformly spread over a very broad tax base. Both the personal and corporate taxes use a flat 10% rate, and there are a very limited number of exemptions. The system of indirect taxes is centered on a VAT with a flat rate of 20% for all products except tourist packages. The other important component of the indirect tax revenues is the excises. Here Bulgaria follows the requirements of the European Union, imposing rates at the low end of what is set out in its membership obligations. Social security contributions are directed mostly towards pension and health insurance. This system has a regressive component, since there is a legal maximal monthly income above which there is no obligation to pay contributions.

With its low rates and uniform and broad tax base, Bulgaria’s tax system fully achieves the objective of horizontal equity and creates relatively good conditions for improving competitiveness, though this is limited to some extent by red tape and a highly bureaucratic tax administration. Bulgaria has

been successful in collecting sufficient revenues to finance public expenditures, with the country having budget surpluses or small deficits for nearly all of the last 15 years. With its flat income tax and the low weight of direct taxes, however, Bulgaria's tax policy does not contribute significantly to achieving vertical equity.

Canada

Score 7

Canada has seen a substantial rise in income inequality over the past few decades. The share of total income going to the top 1% of earners has increased dramatically since 1980, mirroring trends in the United States and other Western economies. Although the top tax bracket is well below that in similar nations (notably the United States), in terms of equity the Canadian tax system largely achieves its objectives. The income tax system is reasonably progressive, many tax deductions have been converted to tax credits at the lowest tax rates, and tax credits have been introduced to offset regressive consumption taxes for low-income persons. The taxation of dividends has been adjusted to ensure there is no double taxation at both the corporation and individual level. In terms of tax competitiveness, Canada fares well. Statutory corporate-tax rates at the federal level and within the provinces have been reduced significantly in recent years. The marginal effective tax rate on investment has fallen, and is now the lowest among G-7 countries and below the OECD average. This development in part reflects the harmonization of provincial sales taxes in Ontario and British Columbia with the federal Goods and Services Tax (GST) (although this measure was reversed in BC on April 1, 2013). Capital taxes have been largely eliminated.

Canada scores high in terms of the generation of sufficient public revenues. Of course, these revenues depend on the state of the economy just as much if not more than on the level of tax rates. The rise in government deficits after 2008 was due to the economic crisis, not tax cuts. At full employment, defined as an unemployment rate around 5%, tax revenues in Canada would be more than sufficient to cover expenditures. With the reduction of the output gap in coming years, the federal deficit will be eliminated in 2015 – 2016. Had the GST not been cut 2 percentage points in 2007, the structural surplus at full employment would be even larger.

Germany

Score 7

In the past several years, a twofold shift in the German tax structure has demonstrated a strategic reorientation toward supply-side economic policies. First, earnings-related direct taxation and social-benefit contributions were

reduced or at least held constant, while indirect taxes such as value-added taxes rose considerably, and are now above the OECD average. Secondly, direct, earnings-related tax rates on businesses were cut as compared to personal income taxes. The overall corporate tax rate (including local-business taxes and solidarity surcharges) fell from around 40% in 2005 to around 30% today. The effective marginal tax rate (which takes details such as depreciation allowances into account) fell from 37.9% in 1998 to 22.5% in 2012 (ZEW 2012). These changes have shifted Germany into a medium rank within Europe with respect to effective corporate tax burden, thus making the country a more competitive location.

A key problem within the German tax system is that the combination of income-tax rates and social-security contributions present even middle-income earners with marginal rates far above OECD averages. According to OECD data, an average worker in Germany gives up 39.9% of his gross wage earnings, exceeding the OECD average by 15.1 percentage points. Income tax takes 19%, while social security contributions for employees amount to 20.9% of average gross wage earnings, respectively exceeding the OECD averages by 4.2 and 10.9 percentage points (cf. OECD, Income tax and social security contributions). The OECD reports that this unfavorable situation has persisted for a decade, particularly harming the labor-market integration of single parents (OECD, Taxing Wages). A further related problem originates from the complexity of the German tax system, which imposes high compliance costs on households and firms.

Although Germany's tax burden (excluding social security contributions) falls on the lower end of the OECD spectrum, the tax system is doing increasingly well in terms of revenue sufficiency, showing a strong increase of revenue over the last three years without any significant explicit tax-rate increases (but with the help of bracket-creep, as the tax system has not been adjusted for inflation). The positive employment situation, in combination with an effective tax administration, has translated into quickly increasing revenues. This has brought government budgets close to balance and has created significant surpluses in the social-security systems.

In sum, German tax policy performs well in terms of revenue generation and in making the country a competitive location for investment. However, the redistributive capacity of the tax system has decreased as indirect taxes have taken a larger role, effective corporate tax rates have fallen, and – as a consequence of inflationary bracket creep – the progressivity of the income tax structure has declined.

Iceland

Score 7

Iceland's post-crash left-wing government (2009 – 2013) introduced a new three-bracket tax system for individuals in 2009. This new regime took effect in 2010. Taxes for low-income earners were reduced, and taxes for other income groups increased; thus, on average, income tax rates rose following the collapse in 2008. Capital gains tax rates were also raised from 10% to 15%. The corporate tax remained at the same level as in 2008. These changes reversed the earlier trend toward increasing inequality.

The Icelandic government's crisis-management strategy, as supported by the IMF, involved significant cuts in public spending. The government committed itself to increasing total taxes from 38% of GDP in 2009 to 44% in 2014, and to reducing government expenditure from 53% to 41% of GDP over the same period. The policy reality turned out rather differently, however. In 2009, the first year after the crash, a government budget deficit of 14% of GDP was expected, but the actual deficit wound up being just 9%. Hence, faced with a less unfavorable fiscal situation than expected, the IMF-supported program aimed to cut government spending from 50% of GDP in 2009 to 40% in 2017, while keeping revenue at 41% of GDP from 2009 to 2017. This would amount to a fiscal adjustment equivalent to 10% of GDP in eight years, a tough program by any measure, especially in view of the unusual feature that the adjustment is confined to the expenditure side of the budget equation.

Three reservations are in order. First, Iceland's tax burden is understated in official statistics because the unfunded pension obligations of the government are not included, a problem that does not afflict most other OECD countries. Second, the public debt shot up from 29% of GDP in 2007 to 93% in 2010, making interest payments on the debt the second-largest single public-expenditure item in the government budget. Third, the post-crash government of 2009 – 2013 increased fishing fees significantly and budgeted further increases for 2013 – 2014, but the new government formed in May 2013 has decided to reduce fishing fees again. This will require an alternate source of revenue to be found in order to meet the IMF program goals.

Citation:
Statistics Iceland, "Lágtækjumörk og tekjudreifing 2003-2006" (Risk of poverty and income distribution 2003-2006), April 2009.

Latvia

Score 7

The overall tax burden in Latvia is among the EU's lowest. However, Latvia has one of the EU's highest tax burdens on wage earners, as a result of its flat rate. Overall taxation hits lower income groups disproportionately. With the aim of minimizing the tax burden for low incomes, the micro-enterprise was introduced during the economic and financial crises. Some government tax policies have sought to increase the burden on the wealthy, for example through the introduction of a tax on dividends or by raising property taxes. The government amended the personal-income tax law in 2012 to reduce personal-income tax, with rates dropping by 1% in 2013 to 24%; this will be followed by further decreases to 22% in 2014 and 20% in 2015. Tax allowances for dependents were also slated to increase in 2013.

In 2011, the Law on Declaration of Property and Undeclared Income of Private Persons was passed, requiring all individuals to file asset declarations in 2012. This policy measure was designed to combat the non-payment of taxes, reduce the risk that a shadow economy might develop, and improve anti-corruption measures.

Latvia's corporate income tax of 15% is one of the lowest in the European Union, and as such contributes to Latvia's ability to attract investment.

The country's economic recovery combined with structural reforms, improvements in tax collection and attempts to reduce the share of the undeclared economy have ensured the generation of sufficient public revenues. Budget deficits in 2011 and 2012 stood at 3.6% and 1.2%, respectively. The deficit target for 2013 is 1.4%.

Citation:

1. IMF (2012), Article IV Consultation and Second Post-Program Monitoring Discussions Report, Available at: <http://www.imf.org/external/pubs/ft/scr/2013/cr1328.pdf>, Last Assessed: 20.05.2013
2. European Commission (2013), EU BOP Assistance to Latvia – Second Review Under Post - Programme Surveillance, Available at: http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/pdf/lv_efc_note_2nd_pps_mission_en.pdf, Last assessed: 21.05.2013.

Luxembourg

Score 7

Luxembourg was particularly affected by the financial crisis and its public deficit has grown. From 2011 to 2013, the deficit rose from 18.2% to 23.6% of GDP. GDP growth in 2012 was 1%, from 3.5% in 2010. Luxembourg responded to the crisis with fiscal adjustments, including increasing the withholding tax to 35% in 2011, and in 2013, increasing a special solidarity tax, which is paid on income tax liability, from 5% to 7% (or to 9% for high-

income earners and commercial entities). In December 2011, the government decided to suspend the automatic wage indexation mechanism and to allow for only one annual increase. Furthermore, the composition of the index will be changed. In 2011, the top tax rate was increased by 1% to 40%.

A PriceWaterhouseCoopers (PWC) 2012 business report ranked Luxembourg favorably. At 21%, the total tax rate (after deductions and exemptions) is the lowest among European and European Free Trade Association countries. Luxembourg's taxation system is still attractive for businesses, and only some 20% of companies actually pay business tax. To maintain the competitiveness of the financial sector, the government decided not to introduce a tax on financial transactions (the Tobin tax). At 15%, Luxembourg offers the lowest VAT in Europe; supported by the consumption of cross-border commuters, around 24% of the state budget comes from VAT revenue.

The government has also taken some restructuring measures to improve the country's economic attractiveness to foreign investors. Luxembourg extended an exceptional tax deduction for eligible costs of highly skilled migrant workers. International companies can deduct expenses over a period of five years. Furthermore, in 2013 VAT declarations will be simplified by an electronic information system (eVAT).

Citation:

<http://epp.eurostat.ec.europa.eu/tgm/graph.do?tab=graph&plugin=1&language=de&pcode=tsdde100&toolbox=type>

http://ec.europa.eu/europe2020/pdf/nd/nrp2012_luxembourg_en.pdf

http://www.mf.public.lu/publications/programme/13th_update_stability_growth_programme.pdf

<http://chd.lu/wps/portal/public/RoleEtendu?action=doDocpaDetails&backto=/wps/portal/public/LesRapportsPublies&id=6500#>

PriceWaterhouseCoopers Ranking (2012): www.pwc.com/gx/en/paying-taxes

<http://chd.lu/wps/portal/public/RoleEtendu?action=doDocpaDetails&backto=/wps/portal/public/LesRapportsPublies&id=6500#>

Malta

Score 7

The Maltese income tax system ensures that a portion of income is non-taxable for all three tax categories (€8,500 for single individuals, €11,900 for married individuals and €9,300 for parents). This exception is already a significant measure when considered from a social equity perspective. Parents also receive a tax rebate on school fees paid. There is no tax on the sale of one's primary residence, and the 2013 budget also removed inheritance taxes on a primary residence. Other measures which might contribute to more equity include the extension of the favorable 15% income tax rate enjoyed by part-time pensioners working in the private sector to similar pensioners working in government entities.

In addition, the 2013 budget the income ceiling for those paying tax of 35% was raised to €60,000.

Yet the burden of taxation is mainly carried by people in fixed and registered employment, a result of Malta's large informal economy (more than 25% of GDP) and ineffective tax evasion controls. With a corporate taxation rate of 35% (equal to the maximum personal tax rate), Malta has one of the highest tax rates applicable to companies in the EU. Nonetheless, Maltese tax policy does not charge additional tax on dividends paid to shareholders, apart from that they are entitled to tax credits.

Fiscal incentives are one of the very few means available to the Maltese government to enhance the competitiveness of various economic sectors, not least as a tool for attracting more foreign direct investment. Special incentives are also available for research and development-related projects, which also makes companies eligible for tax credits for industrial research, experimental development and the registration of intellectual property.

Measures enacted during the review period aim to strengthen Malta's competitiveness in high value-added knowledge economy sectors, by offering a flat income tax rate of 15% to international professionals in the digital games industry as well as to academics and researchers in the research and development sectors. Micro or small enterprises (with a maximum of 10 employees) are entitled to a 40% tax credit if they invest in new technologies or create new jobs. For small to medium-sized businesses on the island of Gozo, off the coast of Malta, this tax credit is 60%. This is particularly important when one considers that micro-enterprises form the backbone of Malta's economic system.

According to the European Commission's latest fiscal sustainability report, "Malta does not appear to face a risk of fiscal stress in the short-term." However, in the medium- and long-term, Malta faces moderate sustainability risks, as government debt, 70.9% of GDP in 2011 and expected to rise to 72.7% in 2014, is substantially above the threshold of 60% of GDP.

A major concern in relation to public expenditures is related the government's age-related expenditures and the size of the informal economy, at 25.3% of GDP.

Importantly, Malta has experienced an almost 20% jump in tax revenue, when expressed in terms of its share of GDP between 2000 and 2010; the increase in direct taxation was particularly notable, as revenue there grew by 45%. This is coupled by the fact that revenues from consumption taxes amount to 13.2% of GDP, compared with the EU-27 average of 11.9%. Nonetheless, the Commission report goes on to state that "the amount of

revenue raised from taxation on labor is the second lowest in the Union (Malta, 10.7% of GDP, EU-27 17.1%) which is mainly due to the low employer's social security contributions.”

Citation:

<http://www.ird.gov.mt/>

Taxation trends in the European Union, 2012 Edition p. 126

Taxation Trends in the European Union, 2012 Edition p. 126

Malta National Reform Programme April 2012 p.120

Budget Speech 2013, p.13, p.14, p.18, p.19

Malta A Regional Centre for Strategic Investment and Doing Business p.4, p.5

National Reform Programme April 2012 p. 142

Fiscal Sustainability Report 2012 December 2012 p.114

Council Recommendation on the National Reform Programme 2012 and delivering a Council opinion on the Stability Programme of Malta, 2012-2015, July 2012 p.7

Tax Reforms in EU Member States 2012 Report p.75

Taxation Trends in the European Union 2012 Edition p.125

Malta: Update of Stability Programme 2012-2015 April 2012 p.17

Pre Budget Document 2013, August 2012 p. 10

Slovakia

Score 7

The introduction of a flat tax regime in 2004 played a major role in establishing Slovakia's reputation as a model reformer and an attractive location for investment that led to many imitators in East-Central Europe. Whereas the first Fico government left the flat tax regime untouched despite earlier criticism, the second Fico government reintroduced a progressive income tax and raised the corporate income tax. As part of its attempts at fiscal consolidation, it added a second rate of 25% on higher incomes to the hitherto uniformly valid personal income tax rate of 19% and increased the corporate income tax from 19% to 23%. The decision to increase direct rather than indirect taxes – as the Radičová government had done in 2010 – was justified with concern about horizontal equity. With an estimated increase of government revenues by 0.5% of GDP in 2013, the revenue effects have been limited. At the same time, they have raised concerns about the direction of economic policy in Slovakia and the country's competitiveness.

South Korea

Score 7

The Korean tax system is fairly effective in generating sufficient public revenues without weakening the competitive position of the national economy. Korea has one of the lowest tax rates in the OECD. Although taxes on business are relatively high compared to personal income taxes, they do not seem to reduce overall competitiveness. Tax instruments are used to

nurture FDI, R&D and human resources development. Its main weakness, however, is equity. Compared to other OECD countries, the tax burden in Korea is very low. As of 2010, tax revenues were at about 25% of GDP.

Tax revenue has been growing slowly and is likely to increase in the future because social security contributions have increased relatively quickly since the middle of 1990 and will likely continue to do so. In comparison with other OECD countries, Korea has a relatively high corporate tax and a low tax burden on labor income. At the same time taxes contribute little to a more equal society as social transfers are low.

The strong reliance on the value added tax gives the tax system an inequitable, regressive nature, and lessens its ability to improve equity. One of the major reasons for the weak income-tax base is the relatively high number of self-employed individuals and the low levels of income tax paid by this group; another is the sizeable income-tax deduction for wages and salaries. However, in the last two years, the Lee administration has further weakened the ability of the tax system to achieve equity by reducing progressive income taxes and real-estate taxes paid by the relatively wealthy. Since late 2011, the discussion has slightly shifted as the government failed to further deliver on tax reductions for the wealthy due to opposition. In January 2012, parliament increased taxes on those earning more than KRW 300 million (9,000). The so-called “Korean Buffet Tax” was passed three months before the parliamentary election against the opposition of many in the ruling party and the government. Following an international trend, Korea has signed tax treaties to get access to information on tax dodgers – for example, the 2012 treaty with Switzerland. Taxes on problematic consumption items such as energy or cigarettes remain relatively low, and the government has so far failed even to discuss an ecological tax reform.

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Belgium

Score 6

The tax structure of Belgium is not equitable as it puts too much pressure on wages (Belgium has the highest effective tax rate on labor in the OECD), a policy which produces strong incentives to avoid or evade taxation (and also encourages a “gray” economy of undeclared activities that do not feed public revenues, and further exacerbate public finance difficulties). On the other hand, capital is only moderately taxed, thanks to tax loopholes both in personal income and corporate tax. With each income source (labor, capital, corporate), horizontal and vertical equity are guaranteed on paper, but differential treatment between income sources weaken this. As the Belgian economy was relatively stable during the economic crisis, competitiveness was better achieved than equity. Belgium has managed to secure a comparatively low level of public debt despite the economic crisis and extensive problems in the financial sector. In this sense, it is clear that the country’s taxation policy does ensure relatively sufficient public revenues.

Chile

Score 6

Chile has a moderately complex tax system. The corporate income tax rate, at 17%, is less than half of the highest marginal personal income tax rate. This implies that high-income wage earners have a high tax burden compared to low-income earners in general, and to high-income non-wage earners in particular. Few exemptions are applied to corporate and income taxes, reflecting a relatively high level of horizontal equity within each income tax category. High-income non-wage earners can legally avoid high-income taxes through incorporation. The value-added tax (VAT) is high and flat, with few exemptions, which argues in favor of allocative efficiency and horizontal equity. There is certainly tax avoidance in Chile –probably at higher levels than the OECD average, due to informality. Yet efforts to ensure tax compliance have been generally successful. Moreover, Chile has probably one of the most efficient computer-based tax payment systems in the world.

The government’s tax and non-tax revenue is sufficient to pay for government expenditure, according to current spending. By and large, Chile has been successful in generating sufficient public revenue. There are flaws in the efficiency of tax spending but in general the national budget corresponds to the claims of different sectoral ministries. However, most of the tax income generated by corporate and personal taxpayers is based on VAT and therefore has a very regressive effect. Thus, the tax system does not promote vertical equity through redistribution. Expenditures for education and social security are far too low compared to other countries in the region and to the demands of the lower middle class and the poorer population. Tax

policy is failing to produce a higher equity in tax burden as bigger companies and the economic elites do pay relatively low tax rates, which favors Chile's relatively good international competitiveness, especially for less sophisticated services and products. In general terms, Chile's tax system adds to the country's competitive position with respect to world trade and investment flows. On the other hand, taxation policy does not foster innovation and increase productivity.

The only reasonable way to assess whether Chile's tax system and actual revenue collection is sufficient to finance a welfare state equivalent to 50% of GDP is to ask whether Chile's ratio of government expenditure to GDP – at its current level of per capita income – is within the empirical cross-country range suggested by Wagner's law, which predicts that the development of an industrial economy will be accompanied by an increased share of public expenditure in GDP. This is the case.

Cyprus

Score 6

Cyprus' tax system is comparatively uncomplicated, both with respect to individual provisions and structure. The floor for taxable individual income is €19,501, with tax rates gradually increasing to a maximum of 30% for sums beyond €36,300. Tax deductions and benefits further alleviate the weight of taxes. Horizontal equity is negatively affected by tax evasion and avoidance. Due to institutional capacity problems within the administration, income tax is primarily collected from salaried employees, who proportionally contribute much more than do self-employed or liberal professionals.

The state offers benefits to businesses such as deductions for professional equipment or automobiles. Companies have historically paid a standard 10% corporate tax rate on profits, the lowest such in the European Union, while avoiding double taxation. Even with an increase in the corporate tax rate to 12.5% in 2013, the country remains very competitive.

Horizontal tax equity is to some extent achieved through the progressive increase in individual income tax rates from 20% to 30%. However, companies are treated more favorably, as the flat rate for companies is only 12.5%. Thus, a physical person can become a (low-paid) employee of a company she creates, deriving benefits from the company and paying only 10% on profits. The flat rate for businesses means that very profitable companies do not pay a higher tax share.

Though the tax system appears successful in general terms, it does have loopholes and suffers from institutional and regulatory weaknesses. It enables tax evasion and avoidance, and contains distortions; thus, it does

not ensure the collection of sufficient public revenues in a sustainable way, and does not fully achieve equity goals.

Citation:

1. <http://www.eoi-tax.org/jurisdiction/s/CY#peerreview>.

Czech Republic

Score 6

The Czech tax system broadly ensures horizontal equity. One exception is the blanket tax allowance given to the self-employed to cover notional expenditure with no checks on what is actually spent. This leads to a lower tax rate on the self-employed rather than employed and an incentive to convert employment contracts into contracts for individual services. As this leads to a loss of tax revenue, the Ministry of Finance has favored inspections to ensure that those in an effective employment relationship are taxed as such.

A degree of vertical equity is achieved by a tax allowance on personal income taxes and some differences in VAT rates. However, the Nečas government policies worked to limit both of these effects, albeit with political and economic pressures leading to the continuation of a number of progressive elements. A flat tax at 22% of gross pay as usually measured is deliberately intended to minimize redistributive effects, although tempered by an allowance equivalent to about 8% of average pay. This was supplemented in 2013 by a “solidarity” tax of an extra 7% of incomes for those earning over four times the average. This is seen as a temporary measure in difficult economic times, intended to be withdrawn in 2015. VAT rates increased in 2012, with the lowest of two rates rising from 10% to 14%. The intention was to unify these at 17.5% in 2013, but that was changed to a 1% increase in both. Further changes, intended to reduce the tax on personal and business incomes, have been postponed until 2014.

The tax system is based on limiting progressiveness and minimizing tax levels on business and personal incomes and appears to raise sufficient revenue to maintain a budget deficit of under 3% of GDP with declining GDP. It is not sufficient to finance public investment on the scale achieved in previous years and hence to give the prospect of a balanced budget in a growing economy.

Estonia

Score 6

Estonia is internationally known for its simple and transparent tax system. The income tax for individual tax payers is proportional, and corporations only have to pay income tax if their profits are not reinvested. Dividends are not levied with social insurance and, therefore, many small enterprises prefer to pay dividends instead of fair wages. Thus, the taxation policy does not fully meet the criteria for horizontal or vertical equity.

The Estonian welfare system is almost entirely financed out of social insurance contributions. Although this Bismarckian principle has some advantages, it also has some weaknesses. First, high labor costs may weaken the country's economic position, and second, this strategy will probably be unsustainable for sufficient financing of social services in the future given Estonia's shrinking labor force. Some economic experts also draw attention to the modest share of taxes in the state budget. In 2011, income from taxes and social insurance contributions composed 65% of the budget, and 67% in 2013 (forecasted).

Ireland

Score 6

The collapse of tax revenue after 2007 led to the emergence of a budget deficit equal to 12% of GDP. By 2012, new income levies and increases in the "universal social charge," combined with cuts in public service pay and reductions in the provision of public services, had reduced the deficit to a projected 7.4% of GDP in 2013. About two thirds of the fiscal improvement is attributable to cuts in expenditure and reduction in services, while one third has been due to increased taxation. This mix is expected to continue to apply as the country moves towards the goal of reducing the deficit to 3% of GDP by 2015.

The structure of taxes and charges for public services figures prominently in the 2010 agreement with the Troika. A new local property tax has been introduced and will be payable on almost all residences in the country from May 2012. Whether these measures will be sufficient to reach the 2015 target depends heavily on the evolution of the economy over the next two years.

The income tax system is very progressive by international standards and the tax system as a whole is broadly progressive. Over 30% of the overall adjustment was borne by the richest 10% of the population and approximately 70% by the richest four deciles.

Ireland has long relied on a low corporate tax rate as an instrument to attract foreign direct investment (FDI). This policy has been based on the a philosophy of generating tax revenue from a low tax rate on firms with a high turnover in Ireland, which has been vindicated over time and is broadly supported by the electorate.

Indirect taxes are somewhat higher than in the neighboring jurisdiction (the United Kingdom), but the possibility of cross-border shopping and smuggling ensures that the main tax rates are kept fairly closely aligned with those in the United Kingdom.

Citation:

On the progressiveness of the Irish income tax system see

Donal De Buitléir,

<http://www.publicpolicy.ie/wp-content/uploads/Budget-2013-Progressivity-of-Irish-Income-Tax-System1.pdf>

Israel

Score 6

A study executed by the Knesset's research institute in 2010, analyzing budget plans for 2011 – 2012, showed Israel's direct tax burden for companies and individuals to be among the OECD's lowest. This is part of an ongoing policy aiming to reduce direct taxes. The top income tax rate has been lowered from 47% in 2008 to 45% in 2010, and the corporate tax rate was lowered from 27% in 2008 to 25% in 2010.

However, Israel's taxation strategy, Israel's taxation strategy of elevating indirect taxes such as VAT, which in Israel is distributed equally on all products, makes its overall taxation system less progressive than some. In addition, although the direct income tax is progressively structured, and a large part of the population makes too little to pay any tax at all, the system is constructed in such a way that instead of being progressive throughout, it creates a curve, which means that middle-income individuals pay more tax than do high-income individuals. The current system thus lacks a certain degree of vertical equality. However, the apparent distortion is in fact an intentional economic strategy meant to induce growth by reducing the tax burden associated with investments and companies. While controversial, it is not necessarily unfair as such.

Nor is Israel's taxation system entirely characterized by horizontal equity. For example, unlike some other OECD countries, parental tax reductions are provided to mothers but not to fathers. However, many women with children often fail to earn enough money to pay income tax in the first place.

Like most other countries, Israel utilizes its tax system as a political instrument. For instance, it offers tax reductions to veterans. Since Arab

citizens do not serve in the army, this could be construed as an unequal opportunity. However, defenders of the system argue that soldiers lose income while serving. From this standpoint, the tax reduction serves as a restorative tool. In most instances the Israeli tax system has a valid rationale for tax reductions that otherwise appear to violate the principle of horizontal equality. Some argue that lowering the overall direct tax burden in favor of indirect taxes produces the highest degree of equity; however, an analysis of the tax burden produced by indirect taxes, at least as viewed as a percentage of household expenditure, finds that this too poses a problem for vertical equality.

Israel's strategy of lowering direct taxation on companies and individuals led to an expected decrease in income. Initially, the extra growth produced by the tax cuts covered the gaps left by reductions in income. However, this has changed due to local and international economic fluctuations, as well as by political guarantees to the 2011 protestors and other social groups. In 2013, Israel's central bank announced a need to increase tax revenue by ILS 6 billion. As of the time of writing, this matter had come under heated debate. However, due to Israel's commitment to OECD guidelines, as well the influence of its powerful central bank, it seems likely that the state will again reach a point of revenue sufficiency in the near future.

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Japan

Score 6

Generally speaking, Japan has a modern and reasonably fair tax system that in the past has allowed its corporate sector to thrive.

In terms of competitiveness, the 35% corporate tax rate is clearly too high in international comparison. With the 2013 Tax Law, the LDP-led government

made some efforts to lower such taxes, but most of the measures are temporary and cannot be considered to represent full-scale reform.

Japan has the lowest overall level of tax revenue of any OECD nation, totaling just 17% of GDP. Moreover, two decades of sluggish economic growth and continuous fiscal-support programs have produced a situation in which the yearly tax income falls significantly short of national expenses. For instance, government bonds accounted for 48% of national government revenue in 2011. Raising the remarkably low consumption tax is seen as one key to addressing this problem. While earlier governments avoided this step for fear of ballot-box retribution, the DPJ-led government announced plans in early 2012 to raise the consumption tax rate to 8% in April 2014, and again to 10% in October 2015. As of the time of writing, the LDP-led government appeared determined to carry out its predecessor's policy. However, this increase is far too small to counter the country's entire revenue shortfall.

The country's tax system achieves a reasonable amount of redistribution. However, compared to self-employed professionals, farmers and small businessmen, salaried employees can take advantage of far fewer tax deductions. The government's 2013 Tax Law sought to partly offset the negative redistributive effects of lower corporate tax rates and the scheduled consumption tax increase. This was accomplished by raising the inheritance and income taxes; however, the latter policy may have a somewhat negative effect on economic incentives.

Poland

Score 6

Poland's tax system is characterized by a gradually progressive personal income tax with rates of 18% and 32%, a relatively high standard VAT rate and high social insurance contributions. Compared to other East-Central European countries, the corporate tax burden and the extent of red tape in the taxation of enterprises have been relatively high. Tax reforms during the review period have left the basic structure of the tax system unchanged, aiming largely at increasing revenues. Personal income tax thresholds in 2011 and 2012 remained frozen at their 2009 levels, while disability pension contributions paid by employers was raised from 4.5% to 6.5% of gross wages in 2012, and a new tax on the extraction of certain minerals came into effect in April 2012. The government also increased VAT rates, a move that had already been approved in 2010. In December 2012, the Tusk government complemented these rate changes with a large-scale reform of the VAT administration to go into effect January 2014. A number of changes in invoicing, in the definition of taxable amounts and in tax points are likely to reduce the administrative burden on enterprises and the extent of tax evasion.

United Kingdom

Score 6

The United Kingdom has a progressive income tax system and a balance between direct and indirect taxation that is regarded as reasonably fair from the perspective of horizontal equity. The system is, however, criticized for its complexity. In relation to vertical equity, there are too many opportunities for tax avoidance, bordering on evasion for the rich.

The financial crisis and the ensuing economic downturn have cut revenues sharply, so that sufficiency is currently in doubt, but the tax system should be expected to perform quite well when recovery takes hold.

Citation:

World Economic Forum 2012: The Global Competitiveness Report 2012-2013.

Austria

Score 5

Austrian tax policy is characterized by a significant bias, as the source of tax revenue is overwhelmingly skewed toward the personal income of the working population. As employees and self-employed individuals pay the maximum tax rate beginning at a level of income considered to be only middle class, and the country has virtually no property taxation and no inheritance taxes, the system of taxation as a whole seems to be unbalanced.

The Austrian tax system has a rather minimal redistribution effect. As the maximum income tax rate is today paid by a significant and increasing proportion of income-tax payers, the tax system seems to be less responsible for any redistributive effect than are the welfare system and other direct transfers designed to reduce inequality and improve the living standards of the poor.

The tax burden for economically rather weak actors such as single parents with two children increased by three percentage points between 2009 and 2012, according to the most recent OECD data.

The tax system and its supposed imbalances have become a controversial political issue. Politically conservative actors have sought to reduce the income tax generally, while politically leftist and economically more interventionist actors are promoting a shift from the income tax to greater reliance on property and inheritance taxation.

France

Score 5

Taxes and social contributions amount to 48% of GDP, one of the highest levels in the OECD. This is the consequence of extraordinarily generous political and budgetary commitments, which has led to continuously rising taxes. Nonetheless, tax revenues do not cover costs, as public spending is high (57% of GDP in 2012).

A narrow income-tax base and a wide range of fiscal exemptions have resulted in an opaque, confusing and inequitable taxation system. The constant search for additional revenue has further complicated an already cumbersome system. A small number of people actually pay income tax (13 million) and 90% of the total tax is paid by 10% of the taxpayers. To alleviate the burden on this taxpaying minority, many “outs” have been created with the additional purpose of directing exemptions toward targeted sectors (housing, small companies, overseas territories). But this of course has just further complicated an already complicated tax system.

Corporate tax and other levies are too high in international comparison, a clear handicap for the competitiveness of French companies.

The entire tax system requires an overhaul, but the political cost would be such that most governments have preferred instead a policy of constant and somewhat incoherent minor adjustments, rather than thoughtful, long-ranging reform. This has been true for the Sarkozy administration (2007 – 2012) but also for the Hollande administration as well. The Socialist government at the time of writing has cancelled or reduced tax loopholes and triggered an outcry by announcing a “super tax” on the wealthiest individuals (75% marginal tax rate on over €1 million). Although the Constitutional Council stopped these plans, they induced some capital flight from the country. In sum, the tax policies of the Socialist-led government seem to have followed short-term political, or clientelistic, aims.

Italy

Score 5

The Italian tax system remains characterized by the need to sustain the burden of high public expenditures and to pay very high interests on the public debt accumulated over the past decades. It is also defined by its inability to significantly reduce the very high levels of tax evasion or the size of the black economy. As a result levels of fiscal pressure have increased over the years, and the tax burden is far from equitable. Fiscal pressure is very high on those households or companies that do regularly pay taxes, and is on the contrary very low for all those who want to and can evade taxation

(for instance, many enterprises, and large shares of independent workers and professionals). Families with children also receive very limited exemptions. One of the most negative aspects of this situation is that it results in significant competitive distortions that advantage the non-compliant earners.

The Monti government – under pressure from the eurozone sovereign debt crisis and the need to ensure the sustainability of the public debt – has increased the global tax pressure by reintroducing the tax on property abolished by the Berlusconi government, raising the taxation of financial assets and strengthening the fight against tax evasion. These measures have undoubtedly improved the equity of the tax system somewhat and have ensured the resources needed to reach the budget deficit targets agreed at European level. But they have not made any significant step towards greater competitiveness for the Italian economic system.

Labor and business are heavily taxed, which results in fewer new businesses and job opportunities. Italian taxation policy gives nearly no incentive and no stimulus to declare your revenue but encourages tax evasion. The monitoring of and fight against tax evasion within this difficult system are insufficient and far from successful.

Overall one can say that the Italian tax system is able to generate a sufficient amount of resources but needs significant changes to increase its equity and to reduce obstacles to competitiveness.

Spain

Score
value_6

On the fiscal front, two major reform packages have been announced by the current center-right Spanish government. The first one was decided in December 2011, only a few days after Prime Minister Mariano Rajoy took office, and the second was passed in July 2012, when the risk that Spanish public debt may become unsustainable – forcing a Greek-style haircut or/and bailout that could trigger a collapse of the euro – was scaring away international investors. Both packages consisted of tax increases (above all, VAT but also direct income taxation) and remarkable spending cuts adopted to control the budget deficit. Thus, decisions concerning tax policy during these years have been strongly influenced by the economic crisis and short-term considerations, without a comprehensive underlying logic driving the process. These reforms have improved slightly the goal of generating sufficient public revenues even if the recession and subsequent fall of domestic demand might not result in substantial additional revenues capable, at least, of reducing public deficit.

At the same time that individuals suffered tax increases, small- and medium-sized companies have profited from a tax cut intended to help stimulate the economy. However, the goal of competitiveness has not improved overall since the increases in indirect taxation have negatively affected the already diminished rate of private consumption. Finally, Spanish taxation policies do not appropriately discriminate between groups with similar tax-paying abilities who belong to different categories or by making those with much higher economic capacity pay more. This is basically the consequence of tax engineering and even evasion – which is much easier for companies and professionals – reinforcing the deficiencies of the system in terms of horizontal and vertical inequity. It will not be the wealthier sector of the population, but medium- and low-income workers who will be penalized with comparatively higher tax wedges.

United States

Score 5

The U.S. tax system is distinctive in several important respects. Specifically, it does not produce enough revenue to reduce the deficit, tax policy is highly responsive to special interests (resulting in extreme complexity and differing treatment of different categories of income) and the redistributive effect of the tax system is very low. The tax system has performed poorly with respect to equity, both horizontally and vertically. Certain industries, such as the oil industry, receive special benefits worth billions of dollars. More specifically, a “percentage depletion allowance” compensates firms merely for selling a natural resource. Additionally, certain kinds of consumption are favored: for example, a mortgage interest tax deduction favors homeowners over renters. And many high-income earners pay an effective tax rate that, after deductions, is lower than the rate for middle-class earners. Despite these shortcomings, the U.S. tax system performs very well with respect to competitiveness, since the overall tax burden ranks near the bottom of the OECD rankings.

In the 2012 year-end negotiations to prevent the so-called “fiscal-cliff” tax increases and spending cuts, Congress and the president agreed on limited increases in revenues. They modified the alternative minimum tax, permanently limiting its impact on high-income taxpayers, and made permanent the otherwise expiring Bush-era reductions in tax rates for most brackets. Increased revenues came mainly from raising the top rate to 39.6% for individuals earning more than \$400,000 and families earning more than \$450,000, though the president had sought to raise rates on individuals earning more than \$250,000. Still, with increased revenues expected from the economic recovery, the Congressional Budget Office estimated that the budget deficit will decline to 5.3% of GDP in 2013, down from 8.7% in 2011 and 7.0% in 2012.

Citation:

Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2010 to 2020, February 5, 2013. Accessed on May 5, 2013. <http://www.cbo.gov/sites/default/files/cbofiles/attachments/43907-BudgetOutlook.pdf>

Croatia

Score 4

In Croatia, the share of tax revenues in GDP is low compared to other EU countries. This is partly due to a high degree of tax evasion and an inefficient tax administration. While Croatia has a progressive personal income tax, the redistributive effects of the tax system are limited by the fact that the tax system relies strongly on VAT and social insurance contributions, which each account for about a third of all tax revenues. In contrast, personal income tax generates only 9% of total tax revenues, as does corporation tax. Property tax, which generates only 1% of total tax revenue, is a very underdeveloped form of taxation in Croatia. The amount of tax reliefs, exemptions and incentives in the Croatian profit tax system has been growing year after year. The main aim is to engage in international tax competition to attract foreign investment by reducing the effective rate of profit tax set at 20%. However, allowing tax reliefs reduces the tax revenue available to finance public expenditure, and also increases the administrative costs of tax collection. The various reliefs and exemptions are moreover distortionary and reduce the efficiency of the tax system as a whole.

The Milanović government has tried to shift the tax burden from social insurance contributions to consumption taxes, with a view to making the tax system more employment friendly. On the one hand, it cut social insurance contributions; on the other, it raised the standard VAT rate from 23% to 25% and introduced a new VAT rate of 5% for goods and services that were not previously taxed – such as basic foods, books and medical aids. In order to limit the regressive effects of these changes, the government introduced a new 10% VAT rate for necessities such as water and sugar as well as for children's food, and slightly raised the personal income tax allowance.

Mexico

Score 4

Tax policy, tax reform and the insufficiency of tax collection have been on the political agenda in Mexico for at least the past fifty years. During this long period there has been little progress either in collecting more tax revenue or making the tax system more equitable. According to some observers, Mexican tax collection is 6% – 8% of GDP short of where it should be at its corresponding stage of development. One reason for low tax collection is the large share of the economy taken up by the informal sector, which is

notoriously tax resistant. Another factor is that most Mexicans distrust their government and do not think that money paid in taxation will be spent wisely, so they manage to evade paying taxes. Additionally, the market-reforming economists who have been running Mexico over the past thirty years have not prioritized raising revenue, putting more emphasis on controlling government spending to decrease the size of the government.

Furthermore, many also feel that, as an oil exporting country, Mexico can earn a significant amount of public revenue by taxing oil income. Lawmakers are thus less focused, than they might otherwise be, on imposing other kinds of taxation. Some Mexicans have expressed concern, however, about Mexico's financial situation if world oil prices were to decline in the future. The issue of tax evasion would certainly increase in importance if oil revenues decline.

On the positive side, the low level of taxation has at least been helpful for Mexico's international competitiveness. Non-oil tax revenues are not oppressively high and do not present a barrier to enterprise. There is not enough tax being collected to damage competition.

Public revenues are barely sufficient to provide the resources necessary to tackle the challenge of social fragmentation effectively. But Mexico has the option of increasing public sector prices, such as gasoline prices, if it were necessary for macroeconomic stability. Equitable tax collection is not really on the agenda due to the low level of direct tax collection. It is nevertheless true that the new Peña Nieto government has signed into law tax reform legislation passed by both houses of Congress in late 2013, which will take effect only in 2014.

Romania

Score 4

The vertical equity of Romania's tax system is very low: it has a flat income tax rate of 16% and one of the highest VAT rates in Europe, both of which have regressive distributional consequences. The situation worsened as a result of the 2010 austerity measures when the VAT was further increased from 19% to 24%. During the 2012 electoral campaign, Prime Minister Ponta proposed a return to a progressive income tax structure with the profit tax at the current level (16%) and VAT reduced from the original to 19% but it is unclear whether these changes will actually occur, given that the opposition Democratic Liberal Party (Partidul Democrat-Liberal, PD-L) as well as the National Liberal Party (Partidul National Liberal, PNL) – the second largest party in the ruling Social Liberal Union (USL) coalition – favor a continuation of the flat tax system.

Romania faces serious challenges with respect to the effectiveness of the tax collection process. A far-reaching investigation against the former president of the Agency for Fiscal Administration (ANAF), Sorin Blejnar, and a number of other officials revealed the extent of corruption within the ANAF, the institution in charge of managing the tax and contribution regime. Eight months later, the World Bank approved a €70 million loan aimed at bettering the efficacy of the tax/contribution collection structures and reducing the taxpayers' administrative burdens. Such measures are crucial for improving Romania's international competitiveness, given that in the 2012/13 Global Competitiveness Report Romania ranked 142nd out of 144 in terms of the extent and effects of taxation.

Without significant progress in tax collection, the Romanian government will have to continue to resort to new taxes to generate sufficient public revenues for its expenditures. Thus the recent amendments to Romania's fiscal code, introduced by Emergency Ordinance no. 8/2013, imposed new taxes for energy companies. Moreover, the government has recently announced the introduction of a flat tax for hotels, restaurants and other service providers based not on profits but on the type of economic activity. Such an approach might yield additional revenues (since it reduces tax evasion opportunities) but it further undermines tax equity and may place excessive burdens on certain businesses.

Slovenia

Score 4

Slovenia's tax system was overhauled in the 2004 – 2008 term, and has changed only gradually since then. Tax revenues have been relatively high in relation to GDP, but have not been sufficient to prevent the emergence of high budget deficits. Tax revenues stem from a broad range of taxes, with a high percentage of about 40% of all tax revenues coming from social insurance contributions. A progressive income tax with tax rates of 16%, 27% and 41% provides for some vertical equity. As the thresholds are set rather low, however, the majority of middle-income class citizens fall into the highest category. The tax burden for enterprises is below the EU average, but higher than in most other East-Central European countries. The Pahor and the Janša governments refrained from making any tax increases and did little to reform the tax system. However, the Janša government tried to make Slovenia more attractive to foreign investors by adopting a gradual lowering of the corporate income tax from 18% in 2012 to 15% in 2015. The Bratušek government has increased indirect taxes in order to reduce the fiscal deficit.

Turkey

Score 4

Total government revenue totaled 25.5% of GDP in 2010, fell to 25.3% in 2011, but increased to 26.2% in 2012. In 2010, 84.1% of government revenue was derived from taxes. This share increased to 86.7% in 2011, and fell to 85.5% in 2012. As a result, tax revenue totaled 21.5% of GDP in 2010, 21.9% in 2011, and 22.4% in 2012.

The taxation system, with direct and indirect taxes, can be divided into three categories: income taxes, such as individual income tax and corporate income tax; taxes on expenditures, such as value added tax (VAT) or banking and insurance transaction tax or stamp tax; and special consumption taxes (luxury products, tobacco products, alcoholic beverages, petroleum products and so on). In 2013, individual tax rates varied from 15% to 35%. The standard corporate tax rate is 20%, while the capital gains tax for a corporation is usually added to the corporation's regular income.

Turkey's taxation system in practice does not take into consideration horizontal or vertical equity. The ratio of direct taxes to the national income in Turkey was about 19% in 2012, well below the OECD average of 34%. The ratio rises to 26% if other fees and charges are calculated.

Turkey's tax system is biased toward indirect taxes. In 2010, 69.4% of total tax revenues were derived from indirect taxes such as the special consumption tax (SCT), the value added tax (VAT) and a communications tax. This share fell in 2011 to 68.7% and further in 2012 to 67.9%.

The government during the review period addressed tax issues through a number of strategies. Work on a new income tax law at the time of writing is on-going; from the draft law, the government plans to expand the tax base by increasing the number of officially registered taxpayers. Along with reducing exemptions, the new law is aimed at creating a simpler and more comprehensible tax system, through simplifying rules and reducing bureaucratic burdens. In October 2011, new government regulations outlined the operational structure of a Tax Inspectors Board, while the Ministry of Finance merged several tax auditing functions to ensure uniformity and reliability in tax audit planning and practices.

Greece

Score 3

Historically, the state has operated to exacerbate differences between groups for clientelistic and electoral reasons and the state administration itself has been riven with operational dysfunctions. Thus, tax policy has

been grossly ineffective in Greece, as shown by the chronic incapacity of the Greek state to collect taxes. The size of Greece's underground economy is calculated to be as much as 30% of the official economy.

Horizontal equity was not attained as tax payers of similar tax-paying ability contributed so differently to tax revenue. While the medium- and high-income salaried strata regularly paid taxes, tax payers raising income in the liberal professions (doctors, lawyers, engineers etc.) and in the tourist, restaurant and other businesses, refrained from declaring their actual income and were tolerated in this by tax authorities.

Despite the existence of progressive tax coefficients, tax evasion had a negative impact on vertical inequality too, as the richest Greek strata – essentially those engaged in business and in liberal professions – repeatedly made smaller direct tax contributions than the poorer strata, namely the salaried workers and employees of the public and the private sectors. In this respect, the fact that, as OECD data shows, Greece has one of the smallest marginal taxes imposed on businesses, is not helpful either. In Greece, taxation limits income inequality to a much lesser degree than in other OECD countries.

The relationship between public revenues and expenditures was also hampered, as demonstrated by the long-term borrowing requirements of the Greek state, which date back to the 1980s and the 1990s. The last year in which public revenue exceeded public expenditure was 2002. In the 2000s this long-term problem was aggravated by the policy decision to invest in costly government-led projects, such as staging the Athens Olympics in 2004. The result was that by the end of 2009 Greece was perceived by the international markets as being close to default. The recent OECD data on structural balance confirms this.

Since 2010, under pressure from the EC–ECB–IMF Troika, successive Greek governments have tried to expand the tax base, to increase indirect taxes (VAT raised to 23% for most services), to impose new landed-property taxes (such as a new poll tax on all flats, houses or spaces with an owner paying an electricity bill) and to reorganize tax authorities in order to limit tax evasion. Increased taxation contributed to the suffocation of economic activity, leading to depression. For instance, in 2013, the sixth year of depression in a row, the economy was predicted to contract by more than 4%. However, increased taxation was combined with severe cuts in all types of public spending in 2011 – 2013. This led to fast fiscal consolidation, as the budget deficit decreased by six percentage points in a span of two years (2010 – 2011) and it continued to decrease in 2011 – 2013, albeit more slowly.

Hungary

Score 3

The Orbán government has sought to increase revenues without touching the flat personal income tax rate of 16%, one of its key reform projects introduced in January 2011. In January 2012, the government raised the main value-added tax (VAT) rate from 25% to 27%, making it the highest in the European Union. In addition, it increased a number of excise duties in 2012 and 2013, and introduced a new telecommunications tax in 2012 and financial transaction duty in 2013. As the tax burden has shifted from direct to indirect taxes, the tax system has become less equitable. The taxation of corporate income has been characterized by a high degree of differentiation and frequent changes. While most of the “crisis taxes,” sectoral surcharges on corporate income tax that were adopted in 2010 and largely targeted multinational enterprises, were gradually phased out, new optional tax schemes for small business were introduced in 2013.

Portugal

Score 3

Portugal is ranked by foreign investors as one of the least competitive countries in Europe, and private investment has been decreasing since 2003. The most recent Global Competitiveness Index ranks Portugal at 49, above only Greece (96th) in western Europe, and below Spain (36th) and Italy (42nd). In 2011 it was ranked 45th. Taxes have increased considerably as a result of the country’s attempts to achieve balanced public accounts in the 2011 – 2013 period. The 2013 budget included a tax increase that was publicly described by the country’s finance minister, Vítor Gaspar, as being “enormous.” Overall, some 80% of the consolidation in the 2013 budget is to be achieved from the revenue side – a significant departure from the original plan for the adjustment to be achieved by cutting expenditure (two thirds) and raising revenues (one third). In a recession context, tax receipts are not increasing as much as the rising tax rates would suggest, with high budget deficits suggesting that public receipts fall well short of public expenditure. Similarly, tax policy falls short of the goal of horizontal and vertical equity. There continues to be widespread tax avoidance in the realm of personal income tax, placing a tax burden mostly on employees. At corporate level, studies indicate that the effective tax rate is often lower for more profitable companies. The insufficient revenue from corporate and personal income taxes leads to a greater dependence on indirect taxation to sustain public expenditure – thus running against the vertical equity criterion.

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