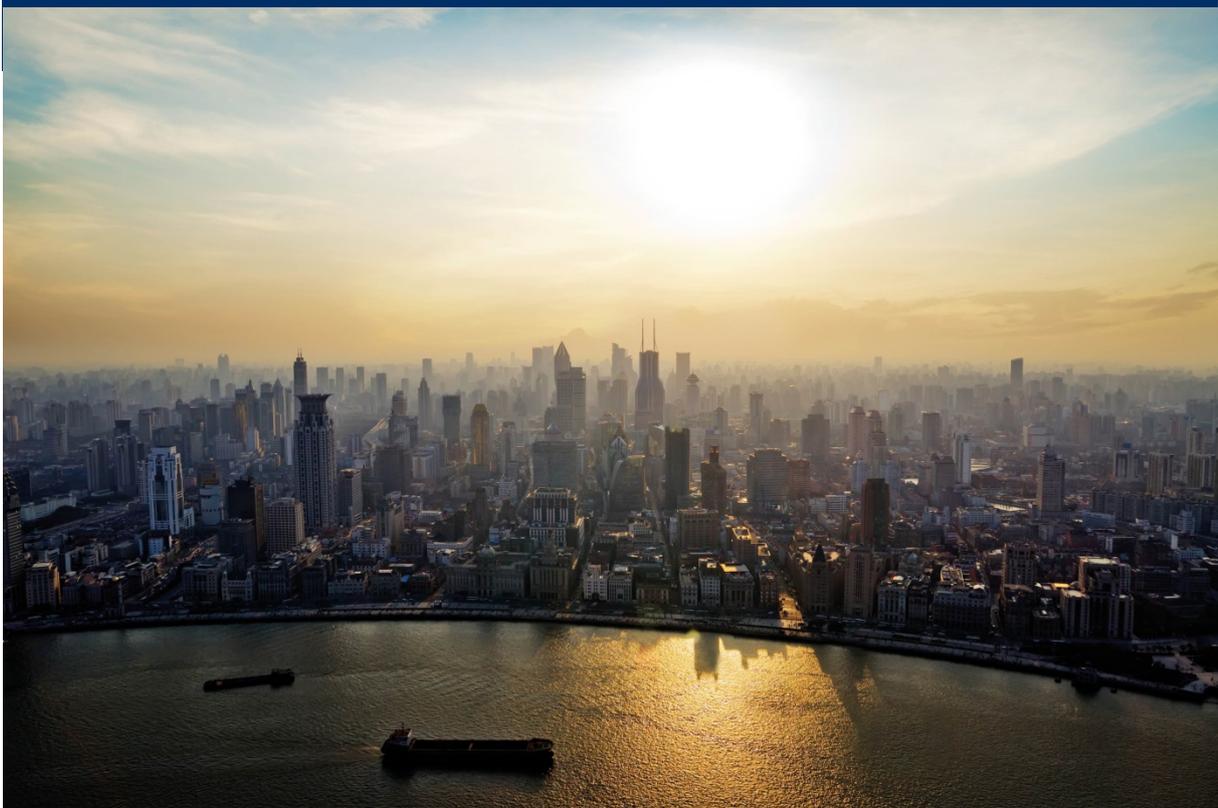


**SGI** Sustainable  
Governance  
Indicators

**2015 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** In Finland the state, municipalities, the Evangelic Lutheran Church and the Orthodox Church have the power to levy taxes. Taxation policies are largely effective. An individual's income is taxed on a progressive scale of between 6.5% and 31.75%, in 2013 and 2014. Meanwhile, municipal taxes range from 16.25% to 21.75%, depending on the municipal authority. As a result demands for vertical equity are largely satisfied. However, this 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 discriminated between economic actors. The corporate income tax rate was lowered in January 2014 from 24.5% to 20%. Adjustments in recent years have made Finland's taxation system less complex and more transparent. Finland performs well in regards to structural balance and redistribution effects, and overall taxation policies generate sufficient government revenue. Taxes are generally high in Finland, because the country has a high-quality, but expensive health care and social security system, and operates an efficient, but costly education system. When compared to most other countries, Finland has a unique situation in which public opinion understands that taxation is a necessary means for securing overall social welfare.

Citation:

[http://www.vero.fi/fi-FI/Syventavat\\_veroohjeet/Henkiloasiakkaan\\_tulove\\_rotus/Vuoden\\_2013\\_valtion\\_tuloveroa\\_steikko%2825864%29\\_for\\_2013\\_income\\_tax\\_schedule](http://www.vero.fi/fi-FI/Syventavat_veroohjeet/Henkiloasiakkaan_tulove_rotus/Vuoden_2013_valtion_tuloveroa_steikko%2825864%29_for_2013_income_tax_schedule); Tim Begany, "Countries with the Highest Taxes," <http://www.investopedia.com/>

## 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. 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 income equality, Switzerland's Gini coefficient for market income is around the OECD average. The redistributive impact of taxes and transfers seems to be limited.

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 (35% of GDP in 2013) and a positive financial balance – that is, the government’s revenues exceed government spending.

The country’s tax policy has come under pressure from the OECD and European Union because of the ability to treat national and international firms differently on the cantonal level. The federal government has responded to these pressures, beginning a reform of corporate-taxation policy.

## 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 taxes have 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 a 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. The valuation principle underlying this tax has been criticized and a new system is being planned.

The Growth Package 2014 included some cuts in corporate energy taxes and dividend taxes for unlisted companies, the purpose being to increase investments by small- and medium-sized enterprises (SMEs).

Citation:

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

De Økonomiske Råd, *Dansk Økonomi*. Autumn 2011. ([www.dors.dk](http://www.dors.dk))

“Danish Government Unveils Plan to Help Economy Exit Crisis,” <http://www.bloomberg.com/news/print/2014-05-07/denmark-set-to-unveil-growth-plan-to-drag-economy-out-of-crisis.html> (Accessed 16 October 2014)

## 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. As of 1 January 2012, the tax base has been broadened by taxing individuals owning residential real estate with a total value exceeding €290,000, with a 1% rate on the value above this amount. It has been proposed to reduce this value to €220,000 in 2015.

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. Despite the recent review of the tax system, no specific reform measures have been adopted. The goal of introducing the euro in 2015 limited the country's ability to engage in major tax reforms, as the forecast budget deficit for 2014 is already close to 3% of GDP. In late 2014, proposals were made to lower the real-estate-tax threshold, and to reduce the tax rate. Social-security contributions have yet to come into effect for the special category of small enterprises that was introduced several years ago with the aim of fostering entrepreneurship and reducing the tax burden on new business activities.

Citation:

COMMISSION STAFF WORKING DOCUMENT on the assessment of the 2014 national reform program and convergence program for Lithuania: [http://ec.europa.eu/europe2020/pdf/csr2014/swd2014\\_lithuania\\_en.pdf](http://ec.europa.eu/europe2020/pdf/csr2014/swd2014_lithuania_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.

Under strong pressure from loyal opposition parties that actually support but do not formally belong to the cabinet, the Rutte II Council of Ministers intends to further simplify the tax system in the near future, 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. Some of the most important

measures to maintain “sufficiency” are a stepwise decrease of household deductibles for mortgage interest payments, a decrease of subsidies for health (by increasing the risk threshold for most ‘consumers’ of health care, and rents for housing, and a stepwise 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.

Citation:

CBS, *De Nederlandse economie*, Den Haag, 2014, pp. 140ff

Elsevier Fiscaal, *Overzicht maatregelen Regeerakkoord Rutte II*, 31 oktober 2012 ([www.elsevierfiscaal.nl/fiscaal-actueel/themas/regeerakkoord](http://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-led government reduced rates across the board in 2010, but at the same time increased the goods and services (GST) tax from 12.5% to 15%. Most services and products sold in New Zealand incur this rate of tax (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 goal (now delayed) of bringing the economy back into surplus by 2014 – 2015. It has resisted pressure from some media outlets, opposition parties 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.

Elliffe, Craig. 2014. Time to Examine the Sacred Cow of Capital Gains Tax. *New Zealand Herald*. 11 July 2014 ([http://www.nzherald.co.nz/brand-insight/news/article.cfm?c\\_id=1503637&objectid=11290494](http://www.nzherald.co.nz/brand-insight/news/article.cfm?c_id=1503637&objectid=11290494)).

## 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 financially turbulent years after 2008. 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. More recently budget deficits have increased somewhat, so much so that the surplus goal has not been attained for the last couple of fiscal years.

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, 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.

Tax cuts in recent years proved initially successful in encouraging the unemployed to re-enter the labor market. Further tax cuts would, however, presumably undermine this effect. In the run-up to the 2014 general election, even the government's own constituencies expressed growing criticism of further tax cuts, as cutbacks in public services became increasingly tangible.

Citation:

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

Kvist, Jon et al. (eds.) (2012), *Changing Inequalities. The Nordic Countries and New Challenges* (Bristol: Policy Press)

## 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 with very limited 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. At the same time, the flat income tax and the low direct-tax burden limit the extent of vertical equity. In 2013 – 2014, sagging value-added and excise-tax revenues meant a decreased ability to meet rising public-expenditure demands, producing a significant budget deficit as a consequence.

## Canada

### Score 7

Canada has seen a substantial rise in income inequality over the past few decades. Mirroring trends in the United States and other Western economies, the share of total income going to the top 1% of earners has increased dramatically since 1980. Moreover, there has been a technology- and trade-driven polarization of labor demand, with the earnings of male workers stagnating. Although Canada's top income-tax bracket is well below that in similar nations (notably the United States), the Canadian tax system largely achieves its objectives in terms of equity. 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. Capital taxes have been largely eliminated.

Canada scores high in terms of the generation of sufficient public revenues, and the federal government is currently on track to run a budget surplus in 2014 – 2015. Much of the credit for Canada's sound financial situation goes to the Conservative government's former finance minister Jim Flaherty, who received universal acclaim for his handling of the 2008 – 2009 crisis, and for moving toward a balanced budget after the structural deficit created by the Conservative's 2% reduction in the goods-and-services tax in 2006.

## Chile

### Score 7

Chile has a moderately complex tax system. A tax reform passed in September 2014 raised the corporate-income tax rate from 20% to 25% – 27% (since companies may choose between two tax regimes) and eliminated a tax credit (Fondo de Utilidades Tributarias, FUT). This latter measure expanded the base for taxes on capital income.

Thus, companies now have to pay taxes not only on distributed profits, but also on profit retained for future investments. This 2014 tax reform is expected to increase overall equity within the system.

With regard to personal-income taxes, the highest marginal rate is 40%. 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. Additional revenue stemming from newly introduced fiscal changes will finance reform within the education system. 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 fails to produce equity with regard to tax burden, as bigger companies and economic elites pay relatively low tax rates. This supports Chile's relatively good international competitiveness, especially for services and products of comparatively low sophistication. Thus, in general terms, Chile's tax system contributes to the country's competitiveness 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.

Citation:

<http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx>

<http://www.tradingeconomics.com/chile/highest-marginal-tax-rate-individual-rate-percent-wb-data.html>

For my additional information:

- Economist Intelligent Unit, Country Report CHILE, Generated on November 24th 2014.

- Luis Eduardo Escobar, "Michelle Bachelet en busca de la transformación de Chile," in: Nueva Sociedad, Nr. 252. julio-agosto 2014, 4-14.

## Germany

### Score 7

In recent years, German tax policy lost steam. This was caused by macroeconomic as well as political factors. On the one hand, severe structural challenges and sovereign debt crises in other European countries favored Germany as a business location, signaling that there was no need to overhaul the tax system for competitive reasons. Furthermore, buoyant tax revenues indicated that there was no need to raise tax revenues further. Although economic growth was very modest in 2012 and 2013, the growth rate of tax revenue remained high at 4%. Total tax revenues have risen steadily since 2008 (from 903 billion in 2008 to approximately 1 trillion in 2012) facilitating the proclaimed aim of the Ministry of Finance to achieve a balanced budget. In addition, the soaring labor market created significant surpluses in the social security system. As a consequence, the reform vigor of the previous decade gave way to a complacent uncertainty regarding the future direction of tax policy. The guiding principle of today is "steady as you go."

With respect to some major indicators, Germany is performing well at the moment. Earnings-related direct taxation and social security contributions are lower than, or have at least held constant with, previous levels. Indirect taxes, such as value-added taxes, are above the OECD average. Direct and 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 approximately 30% today. The effective marginal tax rate (which takes into account particularities such as depreciation allowances) fell from 37.9% in 1998 to 22.5% in 2012 (ZEW 2012). These changes have shifted Germany into the middle of the pack 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 the high marginal tax rate for employees. The combination of income tax rates and social security contributions burdens even middle-income earners with marginal tax 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, harming particularly the labor market integration of single parents (OECD, Taxing Wages) and creating substantial work disincentives for the second earner of a married couple. A related problem originates from the complexity of the German tax system, which imposes high compliance costs on households and firms.

The non-wage labor costs for employers are currently back to 2010 levels. In 2010 and 2013 employers had to pay respectively 28% and 27% of gross earnings, consistently ranking Germany below average within the EU (currently rank 15). For workers, social security contributions have been steadily declining since 2011 (from 20.9% in 2011 to 20.4% in 2013), but in 2014 increased slightly to 20.6% (OECD). Notwithstanding, the balanced insurance funds have had a positive effect in this regard. In contrast, the expansion of the low-wage sector, where less social security contributions are paid, is a worrying trend.

In spite of the German tax system's overall positive performance, there is room for improvement beyond the key challenge of too high a marginal tax rate for workers. For example, the efficiency of Germany's municipal tax investments is very much in doubt. For example, the German association of taxpayers criticized that the amount of companies owned by municipalities increased by 25% over the last ten years, often not budgeting as efficiently as they should (Schwarzbuch 2014: 3-13). Nevertheless, the municipalities generated a surplus of €1.1 billion in 2013 (Destatis). Furthermore, the current system of inheritance taxation has been accused of granting excessive privileges to company assets; a case is now pending at the Constitutional Court.

Despite perennial discussions envisaging a tackling of bracket creep, the topic has been neglected by the government and the Finance Ministry over the last four years. At least at the moment, the actual effect of any legislative measures would be marginal anyway, since inflation remains at a very low level.

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

Citation:

Bund der Steuerzahler Deutschland (2014): Schwarzbuch 2014, Bonn.

Destatis (2014): Pressemitteilung Nr. 109 vom 21.03.2014. Online: [https://www.destatis.de/DE/PresseService/Presse/Pressemitteilungen/2014/03/PD14\\_109\\_71137.html](https://www.destatis.de/DE/PresseService/Presse/Pressemitteilungen/2014/03/PD14_109_71137.html) (last checked on 12/11/2014).

OECD (2013): Income tax and social security contributions. Online: <http://www.oecd.org/tax/tax-policy/tax-database.htm#ssc> (last checked on 12/11/2014).

## Ireland

Score 7

About two-thirds of the fiscal improvement since the crisis of 2009 was attributable to cuts in expenditure and reductions in services, while one-third was due to

increased taxation. The goal of fiscal consolidation has had to be given a high priority in formulating tax policy over the years.

The burden of direct taxation has been increased since country's financial collapse, with high-income groups paying a proportionately greater share than lower-income groups.

In compliance with the 2011 Troika agreement, a new local-property tax was introduced in 2012, and was successfully launched despite strong and broad-based opposition.

The rapid improvement in the economic situation and the general optimism prevailing as 2014 drew to a close allowed the minister for finance to claim that the 2015 budget (passed by the Dáil on 14 October 2014) marked the end of the era of fiscal austerity. Apart from an increase in the excise tax on tobacco products, this budget contained no tax increases, and even introduced a small reduction in the high marginal income-tax rates facing many taxpayers. Despite this relatively mild budget, the fiscal deficit for 2015 was projected to fall to 2.7% of GDP in 2015, below the target set in Ireland's stability program.

Ireland's income-tax system is steeply progressive, and the measures introduced in the 2015 budget even accentuated this somewhat. After the budget's changes are implemented, it is estimated that the top 1% of income earners will pay 21% of all income tax, while the bottom 76% of income earners will pay only 20% of the total.

The openness of the economy and relative ease of cross-border shopping and smuggling dictate that the main indirect-taxation rates be aligned fairly closely with those in the United Kingdom.

The indirect-tax system is less progressive than the income-tax system, and appears to weigh relatively heavily on those in the lowest deciles of the income distribution. This is due in part to heavy excise taxes on alcohol and tobacco products, as well as to the higher savings rates in the higher income groups.

As previously noted, Ireland has long relied on a low corporate-tax rate as an instrument to attract foreign direct investment (FDI). This policy has been highly successful and is supported across the political spectrum. However, it has attracted an increasing volume of hostile comment from other areas, which assert that some features of the Irish corporate-tax regime constitute "unfair" competition, and have encouraged tax-base erosion and profit-shifting within their own countries. In response to criticism of this nature, the 2015 budget contained measures closing the so-called double Irish loophole that allowed some of the world's largest corporations to reduce their global tax liability by attributing huge profits to companies registered – but not liable for tax – in Ireland.

Citation:

On the progressiveness of the Irish income tax system see Donal De Buítléir,

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

On the issue of the incidence of the overall tax burden (direct and indirect) on households see

Michael Collins

<http://www.neroinstitute.net/research/total-tax-estimates-for-ireland/>

For a review of how the burden of the adjustment during the period of ‘austerity’ was distributed by income class see John FitzGerald,

<https://www.esri.ie/UserFiles/publications/RN20140204.pdf>

## Latvia

### Score 7

Overall Latvia has one of the lowest rates of tax in the EU. However, more than in many other EU countries, the burden of tax falls disproportionately on wage earners and, in particular, low income groups, as a result of its flat rate of tax. With the aim of minimizing the tax burden for low income groups, legislation introduced during the economic and financial crises, reduced the tax rate for micro-enterprises. However, in November 2013, the parliament voted to gradually reverse this reduction, with rate of tax for micro-enterprises increased from 9% to 15% by 2017. Meanwhile, some tax policies have sought to increase the burden on the wealthy. Such policies have included the introduction of a tax on dividends or an increase in property tax. In 2012, the government reduced the rate of personal income tax for 2013 by one percentage point to 24%. Further reductions were planned to reduce the rate of personal income tax to 20% by 2016. However, the additional reductions were revised in 2013. The rate will now remain at 24% for 2014, before being reduced to 23% in 2015 and to 22% in 2016. In addition, tax allowances for dependents were increased in 2014.

In 2011, the Law on Declaration of Property and Undeclared Income of Private Persons was passed. By requiring all individuals to file asset declarations in 2012, the policy aimed to combat tackle tax avoidance, prevent the development of a shadow economy and improve anti-corruption measures. While tax collection has improved, no data is available on how these declarations may have contributed to this improvement.

Latvia’s corporate tax rate of 15% is one of the lowest in the EU, which contributes to attractiveness for inward investment into the economy.

Economic recovery, structural reforms, improvements in tax collection and a reduction in the overall share of the informal economy have enabled the government to exceed its target for reducing the budget deficit. In 2011 and 2012, the budget deficit was equal to 3.6% and 1.2% of GDP, respectively. In 2013, the budget deficit was reduced to 1.0%, exceeding the target of 1.4%. This success came in spite of an increase in public expenditure, resulting from a government guarantee for the failed steel company Liepajas Metalurgs. Following Liepajas Metalurgs’s default, reforms to the sovereign guarantee system were introduced.

Citation:

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## 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 23.1% of GDP. GDP growth in 2013 was 2.1%, compared to 3.1% in 2010 and -0.2% in 2012. 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). With the change in tax law in 2014, withholding tax on capital is no longer refundable. In 2011, the top tax rate was increased by 1% to 40%.

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. According to Prime Minister Bettel, the reforms to the wage-indexation system imposed during the financial crisis, in which there will be a maximum of one wage adjustment per year (ordinarily, the system adjusts wages every time the CPI rises by more than 25%), will continue in 2015.

A PriceWaterhouseCoopers (PWC) 2014 business report ranked Luxembourg favorably. At 20.7%, the total tax rate (TTC) after deductions and exemptions is the second-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. Property tax rates are the lowest in the EU-28 aside from Malta and Croatia. To maintain the competitiveness of the financial sector, the government decided not to introduce a tax on financial transactions (the Tobin tax). Luxembourg is known for easy access to government bodies and competitive tax burdens, as it has sought to maintain an attractive tax environment.

Supported by the consumption of cross-border commuters, around 26% of the state budget comes from VAT revenue. This is an important revenue source, with Luxembourg achieving a VAT revenue ratio of almost 1.13 (2012) 100%. With a 10.8% capital-tax rate to GDP (2012), Luxembourg has the highest capital-tax to GDP ratio in EU-28. A total of 27.5% of total taxation in 2012 was related to taxes on capital. This shows the size and systemic importance of the financial sector in Luxembourg.

The EU Commission has modified Luxembourg's business-friendly e-commerce VAT regime, leading to a decline in revenues in this area in 2015. To improve public finances, Luxembourg is implementing new tax rates. The reduced tax rate will

increase from 6% to 8%, the parking-tax rate (applied principally to fuel products) will increase from 12% to 14%, and the general VAT rate will rise from 15% to 17%. Luxembourg nevertheless continues to have the lowest VAT rate in Europe. Taking into account the impact of the higher VAT, which went into effect 1 January 2015, the inflation rate is expected to peak in 2015, reaching an annual average rate of 2.7%.

In October 2014, Prime Minister Bettel announced a major tax reform, seeking to improve coherency in the individual- and corporate-tax systems. The government has also implemented restructuring measures seeking to improve the country's economic attractiveness for 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 2015 VAT declarations will be simplified by an electronic information system (eVAT). In September 2014, Luxembourg introduced a VAT-free-zone regime (Freeport, at Luxembourg airport). As a new example of niche policy, the Luxembourg financial center has been designed to host added-value activities in Europe, and has already become the most important trading center for the so-called Renminbi trade (RMB). Luxembourg is the second most important location for investment funds worldwide after the United States. In August 2014, the Luxembourg investment fund industry was home to €2.97 trillion in net assets, across 13801 fund units.

In 2014, the so-called Lux-leaks scandal on tax rulings threw Luxembourg into the international news for weeks. The EU Commission mounted further investigations (Fiat and Amazon) into tax rulings, seeking to prevent conditions of unfair competition, which is externally regarded as state aid. The European Union is working with national tax authorities to improve coordination and harmonize the taxation systems of the so-called Sociétés 6. The outcomes of these proceedings and upcoming audits within new framework have not yet been determined.

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## 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, €1,900 for married individuals and €9,300 for parents). 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 raised the income ceiling to €60,000 for those paying the 35% tax rate.

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, though tax incentives provided to foreign companies registered in Malta in reality reduce the tax burden by a considerable amount. Nonetheless, Maltese tax policy does not charge additional tax on dividends paid to shareholders, apart from the fact 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.

The 2015 budget contained an increase in indirect taxes, an extension of the free child-care service, a removal of taxes on ecologically sustainable goods, and reductions in the income tax and property-sale tax.

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## South Korea

Score 7

The South Korean tax system is fairly effective in generating sufficient public revenues without weakening the competitive position of the national economy. South Korea has one of the lowest tax rates in the OECD. Although taxes on businesses are relatively high, compared to personal income taxes, they do reduce overall competitiveness. The corporate tax rate is relatively low, compared to the OECD average. Tax instruments are used to nurture foreign direct investment, research and design, and human resource development. Its main weakness, however, is equity. Compared to other OECD countries, the tax burden in South Korea is very low. As of 2012, tax revenues were 26.8% 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. However, tax exemption continues to persist, as of 2011 the rate of tax exemption was a very high 36.1%. As a result, income tax as a proportion of overall GDP is very low, only 3.6% compared to an OECD average of 8.4%.

The strong reliance on value added tax gives the tax system an inequitable, regressive nature, and lessens its ability to improve equity. Major reasons for the weak income-tax base include: the relatively high number of self-employed individuals, the low levels of income tax paid by this group and the sizable income-

tax deduction for wages and salaries. However, Lee Myung-bak's administration had previously 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 300 million won (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.

On 6 August 2014, the Finance Ministry announced proposals for a reform of the tax system. A new corporate accumulated earnings tax was proposed on excess cash accumulated by large corporations whose equity capital exceeds 50 billion won (million) and corporations that are members of an enterprise group with restriction on mutual investment. The new tax is designed to encourage corporations to distribute profits as dividends to shareholders and reinvest cash towards the salary and wages of employees and investment, rather than accumulating and holding them in reserve. SMEs are exempt from this new tax regime. In September 2014 the government unveiled plans to raise residence tax and taxes on commercial vehicles and tobacco products. The proposed tax increases put a heavier burden on low income earners and will make distribution of tax responsibility more inequitable. At the same time, the government has decided to postpone taxation of religious groups for two years.

Following an international trend, South Korea has signed tax treaties, such as the 2012 bilateral treaty with Switzerland, to gain access to the information of suspected tax dodgers. 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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## Australia

### Score 6

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 the only significant change in income tax rates over the review period was a 2 percentage point increase in the top marginal income tax rate, to apply only in the 2014-15 and 2015-16 tax years.

The main weakness of the tax system is that it is pro-cyclical, which is particularly problematic given Australia's dependence on cyclical commodities. Specifically, both Labor and Coalition governments have failed to create a future fund in order to prepare for the end of the resources boom.

Concerning efficiency, in 2008 the Labor government established a committee 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 recommended 138 changes. Few of the recommendations, however, have been adopted.

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 heightened 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.

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## Belgium

### Score 6

The tax structure of Belgium is not equitable as it puts too much pressure on wages (with Italy, Belgium has the highest effective tax rate on labor in the OECD), a policy which produces strong incentives to avoid or evade taxation. 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 weakens this.

Yet, low (measured) inequality places Belgium among the most “equitable” countries. As the Belgian economy was relatively stable during the economic crisis, one can conclude that its competitiveness, although eroding progressively, was less a problem than in peripheral EU countries. The public deficit also remained quite well contained. This is, however, in part a product of the fact that some public sectors (e.g., judiciary, higher education) are chronically underfunded.

## 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 35% for sums above €60,000. Tax developments included an increase in VAT from 17% to 18% in 2013, and to 19% in 2014; a special levy on salaries above €2,500 per month, and a new real-property tax. The tax on interest income for bank deposits rose to 30% in April 2013. Some tax deductions and benefits are provided, alleviating the weight of taxation. Equity is negatively affected by tax evasion and avoidance. A reform of services and tax-collection mechanisms is in progress, including an integration of the VAT and inland-revenue departments in 2014. Income tax, which is primarily collected from salaried employees, proportionally represents a higher contribution than that coming from self-employed or liberal professionals.

Benefits provided to businesses have made Cyprus very attractive to international companies. These include deductions for equipment and a corporate tax that remains the lowest in the European Union, though it rose from a standard 10% rate on profits to 12.5% in 2013. Bilateral treaties also prevent double taxation.

Tax equity is to some extent achieved through the progressive increase in individual income-tax rates from 20% to 35%. However, the favorable flat rate for companies can lead to distortions, where liberal professionals can benefit by creating their own company, thus paying only 12.5% on their corporate profits. In addition, the flat rate for businesses means that highly profitable companies do not pay a higher tax share as individuals do.

Though the tax system appears successful in general terms, the ongoing process of reform aims at filling loopholes, addressing institutional and regulatory weaknesses, and tackling tax evasion and avoidance. A more efficient system of tax collection would ensure the collection of sufficient public revenues and better achieve equity goals.

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## 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. 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 personal income 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 was seen as a temporary measure in difficult economic times, intended to be withdrawn in 2015. The Sobotka government tried to increase the progressiveness of the tax system with the creation of a third, 10% rate of VAT, valid from 2015. It will apply to books, baby food and medicine. Thus the tax system has developed from the conflicting pressures toward greater or lesser degrees of progressiveness. The changes appear to raise the revenue required to maintain a budget deficit of under 3% of GDP, but is not sufficient to finance the level of public investment needed for reaching adequate levels of sustainable economic growth.

## 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 likely be unable to provide sufficient financing for social services in the future, given Estonia’s shrinking labor force. Pension funds, which are persistently accumulating debt, represent the most serious problem today.

## Iceland

### Score 6

The previous government introduced a new three-bracket tax system for individuals, which came into effect in 2010. On average, income tax rates rose from 2008, despite reductions for the lowest income earners. Capital gains tax rates were also raised from 10% to 15% in 2009 and to 20% in 2011. In contrast, corporate tax rates remain at their 2008 levels.

The previous government's crisis-management strategy, supported by the IMF, involved significant cuts in public spending. The previous government committed itself to increasing total tax revenue from 38% of GDP in 2009 to 44% in 2014, while also reducing government expenditure from 53% of GDP to 41% over the same period. However, the policy reality turned out rather different. In 2009, the public budget deficit was expected to equate to 14% of GDP, but the actual deficit was just 9%. Faced with a less unfavorable fiscal situation than expected, the IMF-supported program aimed to cut government expenditure from 50% of GDP in 2009 to 40% in 2017, while keeping tax revenue at 41% of GDP from 2009 to 2017. This would amount to a fiscal adjustment equivalent to 10% of GDP over an eight year period. This is an especially tough program given that the adjustment is limited to reducing expenditure and not increasing tax revenues.

Four reservations are in order. First, Iceland's public debt burden is understated in official statistics because the unfunded public pension obligations are not included, which is rare among OECD country data. Second, the ratio of public debt to GDP shot up from 29% in 2007 to 93% in 2010, which has led to interest payments on public debt becoming the second-largest single public expenditure item. Third, the previous government increased license fees for fishing significantly and budgeted further increases, which the new government have since reduced. Last, many public institutions are in dire financial circumstances, which in the case of the State University Hospital is putting lives at risk.

Under the new government, tax policy has been reversed from a progressive to a regressive system.

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## Israel

### Score 6

In previous years Israel followed a consistent policy of low-income taxes and small government. Accordingly, it initiated cuts on direct taxes for individuals and companies and reduced public spending. In 2011 and 2012, Israel's direct tax burdens for companies and individuals were among the OECD's lowest, with the top

income tax rate lowered from 47% in 2008 to 45% in 2010 and the corporate tax rate lowered from 27% in 2008 to 25% in 2010. The current minister of finance, Yair Lapid, who was elected on a pro-middle class ticket, continued this tax policy in the 2015 budget debates. Despite pressures to raise the income tax rate in order to finance the 6 billion dollar operation “Protective Edge” in Gaza, Lapid refused to do so. Instead, he preferred that a third of the cost be carried by a universal budget cut in all ministries. Current plans to expand the tax base seek revenues through efforts to counter tax evasion and aggressive avoidance strategies and by canceling existing tax exemptions that do not profit low-income workers.

Israel taxation policy is somewhat regressive. It includes elevating indirect taxes such as VAT, which is distributed equally on all products. Furthermore, although the direct income tax is progressively structured, and a large portion of the population earns too little to pay any income tax at all, the system creates a curve so that middle-income individuals pay more tax than high-income individuals. Thus, the current system lacks a certain degree of vertical equality. This apparent distortion is an intentional economic strategy meant to induce growth by reducing the tax burden associated with investments and companies. While controversial, from this line of reasoning it is not necessarily unfair as such.

Israel’s taxation system is not entirely characterized by horizontal equity. One example is that, unlike other OECD countries, parental tax reductions are provided to mothers but not to fathers. Like most other countries, Israel utilizes its tax system as a political instrument. For instance, it offers tax reductions to veterans. This approach is exhibited in a new and contested law that aims to assist first time home buyers and young families by offering a VAT exemption on the purchase and substantial advantages to veterans. Since Israeli Arabs, ultra-orthodox men, new immigrants and others do not serve this could be construed as an unequal tax policy. However, supporters of such laws argue that soldiers lose income while serving and deserve special assistance. 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 appear to violate the principles of horizontal or vertical equality. Due to Israel’s commitment to OECD guidelines and the influence of its powerful central bank, it seems likely that the state will continue to manage a responsible tax policy. Even if spending will have to be reduced further than is advisable, it is likely that the system will continue to operate sufficiently.

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## Italy

Score 6

The Italian tax system continues to be stressed by the need to sustain the combined burden of high public expenditures and payment of interests on the very high 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 paradoxically very low for all those who can and do evade taxation (e.g., many businesses and large numbers of independent contractors and self-employed professionals). Families with children have very limited exemptions. Labor and business are also heavily taxed, which results in fewer new businesses and job opportunities. Italian tax policy provides nearly zero incentives and no compelling reason to declare revenues but instead encourages tax evasion. The monitoring of and fight against tax evasion within this system are insufficient and far from successful. One of the biggest problems is that the system results in significant competitive distortions that benefit 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 – 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 improved the equity of the tax system somewhat and ensured the supply of financial resources needed to reach the budget deficit

targets agreed at the European level under Monti's administration. But these measures did not represent any significant step towards greater competitiveness for the Italian economic system.

After some limited steps taken by the Letta government, the Renzi cabinet has introduced measures that favor the lowest income brackets, increase taxes on financial assets and reduces that of businesses. Should these measures be sustained, they might have introduced some needed corrections in the fiscal system.

Overall, the Italian tax system is able to generate a sufficient amount of resources, but must be reformed to increase horizontal equity, reduce obstacles to competitiveness, and facilitate foreign direct investment.

## Japan

### Score 6

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

In terms of competitiveness, the 35% corporate tax rate is clearly too high in international comparison. According to reform plans announced in June 2014, the government wants to cut the top marginal rate to less than 30% over several years, beginning in FY 2015. While the measure may lead to a significant boost in growth, sceptics within the Ministry of Finance point to the certain negative short-term effect on the budget deficit.

Japan has one of the lowest overall tax-revenue levels among OECD nations. 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 46% of national government revenue in 2013. In addition, only around 30% of Japanese firms pay corporate tax, with the rest exempted due to poor performance. Raising the remarkably low consumption tax has been seen as one key to addressing this problem. The government indeed raised the consumption tax rate from 5% to 8% in April 2014, and plans to raise it further to 10% in April 2017. Yet even if this step is indeed taken, the increase appears to be too small to counter the country's 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.

## Poland

**Score 6** Poland's tax system is characterized by a personal-income tax with two rates: 18% up to an income of PLN 85,528 and 32% for those who are above this level. Moreover, the system features a corporate-income tax of 19%, 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 associated with the taxation of enterprises have been relatively high. Tax reform has not featured very prominently on the agendas of the Tusk and Kopacz governments. The single most important measure adopted by the Tusk government was a reform of VAT administration that aimed at reducing the administrative burden on enterprises and the extent of tax evasion. This took effect in January 2014.

## Slovakia

**Score 6** 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. Whereas the first Fico government left the flat-tax regime almost untouched despite earlier criticism, the second Fico government in 2012 reintroduced a progressive income tax and increased the corporate-income tax from 19% to 23%. In the period under review, tax policy has been erratic. In July 2014, the Fico government suspended an envisaged reduction in the standard VAT rate from 20% to 19%, although it had fiercely opposed the temporary increase in the first place. Moreover, the government reduced the corporate-income tax rate by one percentage point and announced a possible further reduction to come in 2015. However, this rate cut was accompanied by changes in the depreciation rules with a retroactive impact that increased corporations' tax burden. The opposition criticized this policy as unconstitutional, and appealed it to the Constitutional Court.

## 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, with the results bordering on evasion for the rich. Property taxes are high, but labor taxes are low compared with many other EU countries.

The financial crisis and the ensuing economic downturn cut revenues sharply, and the squeeze on wages is blamed for aggravating a shortfall in revenue. In part, however, the shortfall is attributable to the government's reluctance to raise taxes

and its decision to ease the income-tax burden by raising the personal allowance and cutting the top tax rate. The size of the fiscal deficit suggests that sufficiency is currently in doubt, but the tax system should be expected to perform quite well when recovery, notably in wages, 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 is unbalanced.

The Austrian tax system - compared to transfers - 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.

Taxation has become a hot-button issue within the coalition cabinet. The social democrats – in alliance with the unions – favor a significant shift away from the burden employees have to bear. The conservatives as the party of “fiscal discipline” are very skeptical of any changes as long as the budget cannot be balanced, and are generally against any form of property or inheritance taxes.

## Spain

Score 5

Tax policy only partially achieves the objectives of equity, competitiveness and sufficiency in Spain. The country’s currently high level of public deficit and debt (see “Budgets”) underscores a deeply unbalanced relationship between public

revenues and spending. Although this may be attributed to the crisis that has hit the country since 2008, previous budget surpluses (from 2005 to 2007) derived from the real estate boom vanished once the bubble burst and expenditures continued to grow. Spain collects less in taxes relative to wealth (37% GDP in 2014) than most other European countries.

Tax policy with regards to equity and competitiveness is more difficult to assess. Vertical equity exists in principle (with strongly progressive income taxes and different VAT rates on products and services), but horizontal equity suffers because of (a) corporate tax engineering, (b) fraud (which is much easier for companies and professionals to commit than it is for medium- and low-income taxpayers) and (c) the underground economy, from which the state does not collect taxes at all. Although the Spanish taxation agency (AEAT) is generally efficient, it has limited resources to collect taxes (its staff rate is only 0.61 per 1,000 inhabitants which is the second lowest in the EU only after Italy). Recent increases in indirect taxation introduced during the review period have rendered the tax system less competitive.

The current center-right Popular Party (PP) government has passed three big controversial tax reform packages since assuming power in late 2011. The two first reforms were implemented in 2012, when there was a clear risk of Spanish public debt becoming unsustainable. These reforms involved tax increases (primarily VAT but also direct income taxation) and remarkable spending cuts adopted to limit the budget deficit. The third reform package was decided in 2014 and consisted of generous tax cuts: the top rate of corporate tax fall from 30% to 25% and the top rate of income tax from 52% to 45%. According to Spain's finance minister, this is compatible with the goal of reducing the public deficit at the same time (assuming that the stimulating effect on the economy can counterbalance reductions in some taxes).

Nevertheless, decisions concerning tax policy during these years have been strongly influenced by the economic crisis and short-term considerations, including elections, without a comprehensive underlying logic driving the process. A more radical reform of the taxation agency (expanding its human, ICT and financial resources) is clearly needed.

Citation:

Queralt, D. 2013. "Una política fiscal eficaz y progresiva" Agenda Pública

[www.eldiario.es/agendapublica/blog/politica-fiscal-eficaz-progresiva\\_6\\_88601151.html](http://www.eldiario.es/agendapublica/blog/politica-fiscal-eficaz-progresiva_6_88601151.html)

## Turkey

Score  
value\_6

Government revenue increased from 36.4% of GDP in 2011 to 37.8% of GDP in 2012, and further to 39.7% of GDP in 2013. In 2011, 55.1% of government revenue was derived from taxes. This share decreased to 53.3% in 2012, and increased to 53.9% in 2013. As a result, tax revenue totaled 20.1% of GDP in 2011, 20.2% in

2012, and 21.4% in 2013.

The taxation system can be divided into three categories: direct taxes such as the individual-income tax and corporate-income tax; indirect taxes such as the value-added tax (VAT), the banking and insurance-transaction tax, the special consumption tax, and the telecommunications tax; and other government revenues drawn from factor incomes, social funds and privatization revenues. In 2014, individual-income tax rates varied from 15% to 35%. The standard corporate tax rate is 20%, while capital gains are usually treated as regular income, and taxed accordingly.

Biased toward indirect taxes, Turkey's taxation system does not take into consideration horizontal or vertical equity. This gives the government more flexibility to react to changes in Turkey's highly dynamic and volatile economy, but at the same time decreases fiscal stability and political credibility, particularly concerning the special consumption tax. In 2011, 67.3% of total tax revenues were derived from indirect taxes. This share fell in 2012 to 66.6%, and increased to 69% in 2013.

In May 2014, a World Bank report emphasized the need for fiscal reforms in Turkey in order to balance economic growth, employment and social security, and increasing fiscal debts. It advised the government to diversify its main revenue resources, broaden its tax base; collect taxes efficiently; prioritize efficient, sustainable public investments; increase private investment; increase the national savings rate; and lower labor and consumption tax rates, while increasing the capital tax rates. The government appears open to these suggestions, and as of the time of writing, the income-tax law was being revised in parliament.

The Revenue Administration continues to promote voluntary compliance by simplifying procedures, improving enforcement and improving taxpayer services.

Citation:

World Bank, 'Turkey in Transition: Time for a Fiscal Policy Pivot?', Turkey Public Finance Review, Report No. 85104-TR (May 20, 2014)

## United States

### Score 5

The U.S. tax system 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. 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 3% of GDP in 2014, down from 8.7% in 2011.

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, the personal-income tax generates only 9% of total tax revenues, as does the 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.

During its first years in office, the Milanović government tried to shift the tax burden from social-insurance contributions to consumption taxes. No substantial changes in the tax system were made in 2013 and 2014. Because of opposition by the Croatian People's Party (HNS), a major coalition partner, the government has not expanded the property tax. The government has announced plans to reduce the income tax in 2015, with the view of increasing disposable income and thus boosting the personal consumption of the middle class. However, this move would deprive local governments of an important part of their revenue.

## France

### Score 4

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 have 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 tax 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) as well as for the Hollande administration. The Socialist government increased value-added tax, eliminated loopholes, increased income taxes, introduced additional levies on companies’ profits and adopted a “super tax” on the wealthiest individuals (75% marginal tax rate on over €1 million). Although the Constitutional Council stopped the plans for this latter project, the tax increases triggered a tax-flight among the wealthiest, a diffuse tax revolt among companies and the middle class and fostered disillusionment among those with lower incomes who, for the first time, had to pay income tax. Paradoxically but not unsurprisingly, state revenues in 2013 were much lower than expected (€4.6 billion less than budgeted) as a result of the economic crisis, lack of growth, tax evasion and a growing black market.

The rather dramatic situation faced by French companies forced the government to adopt a plan for rescuing them by lowering taxes and levies. The rather cumbersome and complex system put in place might create some breathing space for companies but does not guarantee increases in investment, innovation or competitiveness. It is paradoxical, for instance, that the company which has benefited most from this is the post-office public company, not the best example of companies confronted with international competition. The 2015 budget plans to exempt from income tax nearly 1.8 million taxpayers after having added 1.3 million taxpayers to the taxroll in 2014.

In sum, the Socialist-led government's policies reflect the pursuit of short-term political, or clientelistic, aims.

## Greece

### Score 4

Improving tax revenue administration has been a key emphasis of the Troika overseeing the bailout conditionality for Greece. The dysfunctionalities and scope of corruption within the administration had been sustained for decades – and many have suggested that without the negative impacts of the current debt crisis, it is doubtful that much reform would have been achieved. The bailout memorandums have detailed very specific changes required of Greece, and the Troika reports have identified improvements.

While the tax base has been expanded, because of the imposition of new taxes on wealth (e.g., landed property), a considerable sum of income goes untaxed. During the tourist season, income raised in small and very small businesses remains undeclared. The same holds for income raised in the liberal professions, by practicing engineers, lawyers, medical doctors and dentists as well as craftsmen, plumbers, electricians and computer technicians.

There has been some progress in narrowing the gap between tax-paying salaried individuals and the tax-evading self-employed. The tax administration, which since 2013 has been subjected to mergers of administrative units and transfers of personnel in order to save on government spending, is simply not in a position to collect adequately from non-salaried individuals. Frequent changes in tax legislation have not helped either. Tax revenue still derives primarily from indirect taxes, such as taxes on the use of oil products (gasoline, heating oil) and VAT. The VAT on restaurant and coffee shop bills was brought down from 23% to 13% in 2013 in order to boost consumption and help the tourist sector. In short, although tax revenues have grown during the review period, not much progress has been achieved in improving horizontal or vertical equity.

## 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. A new tax-reform law was passed under President Pena Nieto, taking effect on 1 January 2014. This was well-targeted, but is in fact rather modest given the task that Mexico faces. The government believes the new law will increase the national government's tax revenues by around 2.5% of GDP. However, according to observers, Mexican tax collection is between six and eight percentage points of GDP short of where it should be given its current stage of development.

One reason for low levels of 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 tax. Additionally, the market-reforming economists who have been running Mexico over the past 30 years have not prioritized raising revenue, putting comparatively more emphasis on controlling government spending in order 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. However, Mexico's exportable oil surplus has been on the decline due to falling production and slowly increasing consumption. Lawmakers are less focused than they should be on imposing other kinds of taxation.

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 this were necessary for macroeconomic stability. Equitable tax collection is not really on the agenda due to the low level of direct tax collection; reform fatigue is thus likely to cement social inequality in the country.

## Portugal

### Score 4

The most recent Global Competitiveness Index ranked Portugal at 15th place out of 28 countries in Europe, below Spain's 13th place. The World Bank rates Portugal at 10th out of 189 countries analyzed on this issue, and the report highlights recent progress in the following terms: "Portugal made paying taxes less costly for companies by reducing the corporate income-tax rate and introducing a reduced corporate-tax rate for a portion of the taxable profits of qualifying small and medium enterprises."

However, it must be noted that the very high levels of taxation on income and consumption noted in the previous report remain, even after the end of the bailout period. The budget for 2015, presented in October 2014, uses tax receipts extensively to reach the goal of a 2.7% deficit, with at least half of the consolidation in 2015 projected as coming from the revenue side, including the use of a host of new "green taxes."

Likewise, tax policy continues to fall well short of the goal of horizontal and vertical equity. While the government has adopted measures to combat tax avoidance, this problem is far from eradicated with regard to the personal income tax. Moreover, at the corporate level, the effective tax rate often remains lower for

comparatively more profitable companies. Finally, the considerable dependence of public finances on indirect taxation – notably on the value-added tax – falls to satisfy the vertical equity criterion.

Citation:

Klaus Schwab, *The Global Competitiveness Report, 2014-2015*.

The World Bank, *Doing Business 2015: Going Beyond Efficiency*, Washington, DC: 2014, p. 162.

## Romania

### Score 4

The vertical equity of Romania's tax system is very low. The country has a flat income-tax rate of 16% and one of the highest value-added-tax (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, while retaining the current tax level on corporate profits (16%) and reducing the VAT to 19%. However, these promises were not kept even after the National Liberal Party (PNL), which favored a continuation of the flat-tax system, left the government in February 2014. One partial exception was the reduction of the VAT on bread to 9%. Prime Minister Ponta has promised to expand this rate to other food categories (including fruit and vegetables and possibly meat) in 2015.

Romania's fiscal income is among EU's lowest, hampering the financing of public services and infrastructure. The primary reason for this shortfall is the high degree of tax evasion, which peaked at 16.7% of GDP in 2012 and improved only marginally (falling to 16.2%) in 2013. This persistent fiscal evasion, which is considerably above the EU average, is attributable to the large informal economy (which accounts for over a quarter of employment and GDP) and endemic corruption within the country's tax-collection institutions.

## 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. As part of its effort to limit the budget deficit, the Bratušek government increased the value-added

tax, and sought to introduce a new tax on real estate, which forecasts predicted would result in additional annual tax revenues of about €400 million. In late March 2014, however, the Constitutional court unanimously annulled the Real Estate Tax Act, arguing that key parts of the law, including the envisaged method of assessing property values, were unconstitutional.

## Hungary

### Score 3

Hungary's tax system has become less equitable under the Orbán governments, as the tax burden has shifted from direct to indirect taxes. The taxation of corporate income has been characterized by a high degree of differentiation and frequent changes. Many changes have been directed at foreign enterprises, since they have served as an ideal collective bogeyman for a populist government. After the 2014 parliamentary elections, the government introduced a controversial tax on media advertising (Act XXII of 2014, 17 June 2014), and proposed a tax on Internet traffic. This proposal was shelved at the end of October 2014 following massive public protests.

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Contact:

Bertelsmann Stiftung  
Carl-Bertelsmann-Straße 256  
33311 Gütersloh

Dr. Daniel Schraad-Tischler  
[daniel.schraad-tischler@bertelsmann-stiftung.de](mailto:daniel.schraad-tischler@bertelsmann-stiftung.de)

Dr. Christian Kroll  
[christian.kroll@bertelsmann-stiftung.de](mailto:christian.kroll@bertelsmann-stiftung.de)