Taxes Report

Tax Policy

Sustainable Governance Indicators 2018

SGI Sustainable Governance Indicators

BertelsmannStiftung

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. The state taxes individual incomes at rates falling on a progressive scale between 6.5% and 31.75% (2016). Municipal taxes range from 16.25% to 21.75%, depending on the municipal authority. In 2015, the average overall personal income-tax rate was 51.50%; it averaged 52.96% from 1995 until 2016. Generally speaking, demands for vertical equity are largely satisfied. However, this is less true for horizontal equity. The corporate income-tax rate was lowered in January 2014 from 24.5% to 20%, which is less, on average, than in the other Nordic and EU countries. Adjustments in recent years have made Finland's taxation system less complex and more transparent. Finland performs well in regards to structural-balance and redistributional effects and overall taxation policies generate sufficient government revenue. There has thus far been no major shift away from the taxation of labor towards environmental taxation; the environmental taxes' share of tax revenues remains moderate. Taxes are generally high in Finland because the country has expensive health care and social-security systems, and also operates an efficient but costly education system. In comparison to most other countries, Finland enjoys a situation in which the public understands that taxation is necessary in order to secure the overall social welfare. In polls in recent years, 96% of respondents agreed that taxation is an important means of maintaining the welfare state, and 75% agreed that they had received sufficient benefits from their tax payments.

Citation:
Tim Begany, "Countries with the Highest Taxes", http://www.investopedia.com/;
http://www.tradingeconomics.com/finland/personal-income-tax;
"Tax Rates Finland", www.nordisketax.net;
vm.fi/en/taxation;
www.investinfinland.fi/…Taxation/92709b8f-7464-4a39-b722.

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. Fiscal federalism (the responsibility of the municipalities, the cantons and the federation to cover their expenses with their own revenue) and Swiss citizens’ right to decide on fiscal legislation have led to a lean state with relatively low levels of public – sector employment so far. 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, it should be noted that Switzerland’s apparently small government revenue as a percent of GDP can be attributed in part to the way in which the statistics are calculated. Contributions to the occupational pension system (the so-called second pillar) and the health insurance program – which are non-state organizations – are excluded from government revenue calculations. 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.

Tax policy does not impede competitiveness. Switzerland ranks at 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 very low public debt (29% of GDP in 2016) and a positive financial balance – that is, the government's revenues exceed spending.

The country's tax policy has come under pressure from the OECD and European Union because it treats domestic and international firms differently on the cantonal level. The federal government has responded to these pressures, introducing a reform of corporate-taxation policy. This reform should have prohibited Swiss cantons from taxing the profits of domestic and international firms differently (so-called ring fencing). These international firms make a substantial contribution to Swiss tax revenue. In order to keep these firms in Switzerland, the government's proposal aimed to lower taxes on all firms, regardless of whether they are domestic or international. The reform does accept variation in cantonal tax rates. The Social Democrats have triggered a popular vote on this reform effort, which took place in February 2017 and which rejected the reform proposal. There were two major reasons for the no-vote. First, about a third of respondents said they felt insufficiently informed and were uncertain, and therefore the opted against the reform. Second, another large share of voters thought that the reform was too biased in favor of large enterprises and "the rich." The public's rejection of the reform forced the government to find a new solution given pressure from international organizations. After February 2017, the government has developed a new reform, which includes many of the elements of the original draft, but with less generosity for foreign and domestic firms and – in order to increase the likelihood of winning a majority in the popular vote – additional child allowances.

Canada

Score 8

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.

The income-tax system is reasonably progressive and continues to be useful in equalizing after-tax incomes in the lower income brackets. Some experts have argued that the multitude of overlapping tax expenditures benefit high income individuals at the expense of low-income households. According to the Conference Board of Canada, there are now almost 200 tax breaks for federal income-taxpayers, resulting in an estimated CAD 100 billion of foregone tax revenue annually. In an effort to create a more equitable tax system, the 2016 budget increased the federal marginal tax rate for top earners, decreased taxes for middle-income earners, and eliminated the Family Tax Credit, an income splitting regime introduced by the former Conservative government. For individuals with earnings above CAD 200,000 annually, the combined federal/provincial marginal tax rate now exceeds 50% in more than half the provinces but is still well below the top income-tax bracket in similar countries (notably the United States).

There is no double taxation at both the corporate 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 G7 countries and below the OECD average. Capital taxes have been largely eliminated.

In July 2017, continuing its "tax fairness agenda," the government introduced plans to increase the effective small business tax rate. The aim is to target high-income earners who shift their income to a Canadian-controlled Private Corporation (CPCC) to take advantage of a lower tax rate and incentives intended for small businesses. The proposed policy proved very controversial due to its potentially negative effect on small business growth and entrepreneurship, and was largely withdrawn. The federal government actually lowered the statutory tax rate for small businesses in the fall of 2017.

Citation:
The Conference Board of Canada, "Reinventing the Canadian Tax System: The Case for Comprehensive Tax Reform." March 23, 2012.

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Michael Wolfson, "Professionals and Private Corporations," May 2015. University of Ottawa working paper.

Zimonjic, Peter. "Trudeau pledges to push through tax fairness agenda and defends own family's use of tax rules." CBC, September 19, 2017. Retrieved October 5, 2017 from http://www.cbc.ca/news/politics/trudeau-fall-presser-tax-fairness-1.4296641

Denmark

Score 8

The extensive welfare state is funded through a tax burden above 50% of GDP. This is among the highest within the OECD, although it should be kept in mind that unlike many other countries, all transfers in Denmark are considered taxable income. 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 have been implemented over the years following an international trend of broadening tax bases and reducing marginal tax rates (implying less progression). 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). 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 22% at present, although the tax base has been broadened.

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. In 2017, a “house-tax” reform was approved. The new tax system will be based on an assessment of property values and the statutory tax rate will be lowered. A number of transition rules are associated with the reform to ensure that no home owner will experience an increase in tax on their property.

Further reductions in labor taxation are being discussed, but political views differ whether they should target low-income groups, or high-income groups (lowering the top marginal tax rate). The government’s policy is to reduce taxes, but it is unclear at the moment what tax reductions will be supported in parliament. It is an open question whether the government’s proposed tax reductions are well targeted and will address the most important problems under the present tax system.

The government has concluded that it has a financial space of DKK 36 billion. Of this, the government has proposed reducing direct and indirect taxes by DKK 7 billion.

Citation:
Andersen, T.M., J. Bentzen, S.E. Hougaard Jensen, V. Smith, and N. Westergaard-Nielsen og, The Danish Economy – In a global perspective, DJØF, 2017.

De Økonomiske Råd, Dansk Økonomi. Autumn 2016. http://www.dors.dk/vismandsrapporter/dansk-oekonomi-efteraar-2016 (Accessed 23 October 2016).

“Prime Minister Lars Løkke Rasmussens Opening Address to the Folketing on 3 October 2017,” http://www.stm.dk/_p_14597.html (accessed 22 October 2017).

Latvia

Score 8

Overall, Latvia has one of the lowest rates of tax in the European Union. However, more than in many other EU countries, the tax burden falls disproportionately on wage earners, particularly low-income wage earners. Tax reforms undertaken in 2016 and 2017 have begun to shift the tax burden away from low-income wage earners and increased the tax burden on the wealthy. These reform policies have included property tax increases and the introduction of a tax on dividends. A significant tax reform is planned for 2018.

In 2016, a “solidarity tax” was introduced, to be levied on any income exceeding the mandatory social security contributions ceiling. The rate of this tax was set at 34.09%, of which 23.59% was to be paid by the employer and 10.5% by the employee. The legality of this tax was challenged in the Constitutional Court by a group of plaintiffs subject to the new tax. In October 2017, the Constitutional Court ruled that while the solidarity tax itself is constitutional, the differentiated application across taxpayer groups was unconstitutional. The court mandated that the tax expire on 1 January 2019, granting the government time to plan an appropriate tax-policy change.

The tax reforms that come into force in 2018 aim to reduce income inequality and increase the total amount of tax revenues to 30% of GDP. A progressive income tax system will be introduced. The personal income tax rate of 23% will be replaced with a three-tier system: 20% for annual incomes below €20,000, 23% for incomes between €20,000 and €55,000, and 31.4% for incomes above €55,000. The maximum non-taxable minimum income will be increased from €115 to €200 per month, with further increases slated for 2019 and 2020. The non-taxable minimum for pensions will increase from €235 to €250 per month, with further increases slated for 2019 and 2020. The allowance for dependents will be increased from €175 to €200 per month. The personal income tax rate for income from capital and capital gains will be increased to 20% (with the exception of dividends taxed under corporate income tax).

In order to increase health care financing, social security contribution rates will be increased in 2018, from 34.09% to 35.09% of which 24.9% is to be paid by the employer and 11% by the employee. The solidarity tax, which is in effect until 2019, will be applied only to income that exceeds the cap for mandatory social insurance contributions: €55,000 in 2018.

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 2013, the budget deficit was reduced to 1.0%, exceeding the target of 1.4%. In 2014, the deficit stood at 1.4%, declining to 1.3% in 2015. In 2016, the budget deficit was 0.0%.

Citation:
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2. Ministry of Finance (2017) Tax Reform in Latvia. Available at http://www.fm.gov.lv/files/files/2017-09-06_11_21_11_Tax%20Reform%20in%20Latvia%20FIN%2021082017.pdf. Last assessed 05.10.2017.

3. Constitutional Court (2017) Solidarity Tax Paragraph 6 does not conform to the Constitutional principle of equal treatment before the law (in Latvian). http://www.satv.tiesa.gov.lv/press-release/solidaritates-nodokla-likuma-6-panta-noteiktas-nodokla-likmes-neatbilst-satversme-nostiprinatajam-vienlidzibas-principam/. Last assessed 20.11.2017.

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. According to the World Economic Forum, tax rates have become the most problematic factor for doing business in the country. In particular, taxes on labor (personal income tax and social security contributions), which combined are above the average tax burden on labor in the European Union, have become a barrier to the competitiveness of Lithuanian businesses. Furthermore, there is significant tax evasion. According to the European Commission, the VAT gap (as a percentage of theoretical VAT liability) is significantly higher than the EU average. The European Commission has recommended implementing policies to improve tax compliance (particularly VAT compliance) and broaden the tax base by targeting sources that are less detrimental to growth.

In terms of horizontal equity, there are mismatches between various groups of economic actors with similar tax-paying abilities. Labor is taxed somewhat more heavily than is capital, 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. While there are ceilings on payments from the social-security fund (pensions), there are no ceilings on contributions to it. The implementation of the new "social model" reduced social security contributions for employers by 0.5% from 1 July 2017 and will gradually introduce a progressive cap for employers' contributions. Also, as of 1 January 2012, the tax base was broadened through a new tax on individuals owning residential real estate valued above €290,000, with a 1% rate on the value above this amount. In 2015, the value at which property tax must be paid was lowered to €220,000, while the rate was reduced to 0.5%.

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 large companies pay larger sums than do small companies, but there is a flat income-tax rate of 15%. However, an element of progressivity is introduced through the use of an untaxed income threshold currently fixed at around €1,633 per year, thus favoring those receiving lower wages. The government increased the income tax threshold from €200 per month to €310 per month from January 2017 to make the income tax system more progressive. In addition, there will likely be unforeseen benefits to raising the income tax threshold for families with children.

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. However, it is less an outcome of low taxation than a significant shadow economy, extensive tax avoidance, and insufficient structural reforms in education and health care (where budgetary resources are dispersed across many organizations, despite a declining population and low quality of service provision). 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. To make the tax system less distortive and encourage economic growth, the government could reduce the tax burden on labor, especially social security contributions and strengthen incentives for paying taxes. Despite the recent review of the tax system, the only specific reform proposal to have been adopted was a decrease in the real-estate tax threshold and parallel rate reduction. Social-security contributions came into effect for the special category of small enterprises that for several years were excluded from this responsibility under a policy intended to foster entrepreneurship and reduce the tax burden on start-up business activities. An improvement in VAT and excise-tax collection was noted by analysts in 2015, and attributed partly to improvements in tax administration, and partly to the reduction in the incidence of fuel and tobacco-product smuggling from Russia's Kaliningrad region and Belarus due to a general decline in trade with Russia.

In 2017, the Skvernelis government announced a new tax reform. The reform included a further increase in the income tax threshold, an adjustment to the VAT rate, and the introduction of a profit tax, social security contribution holidays for new businesses, several other tax exemptions and a progressive property tax on properties worth over €220,000. It is likely that the implementation of some reform measures that require additional budget expenditure (e.g., direct financial support for children) will be provided from the so-called change baskets. By the end of 2017, once these minor changes had been approved by the parliament, the debate on major tax and social security reforms began to gather pace.

Citation:
COMMISSION STAFF WORKING DOCUMENT, country report Lithuania 2017: https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-lithuania-en.pdf
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for economic growth and fiscal sustainability, September 2015, http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip008_en.pdf.
The 2017 – 2018 Global Competitiveness Report of the World Economic Forum: http://www3.weforum.org/docs/GCR2017-2018/05FullReport/TheGlobalCompetitivenessReport2017%E2%80%932018.pdf

New Zealand

Score 8

Taxation policy continues to successfully 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 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%. The government has postponed plans for a new round of tax reductions in the face of its “zero budget” priority policy, with the goal of bringing the economy back into surplus. While 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, in 2015 it was forced to respond to the property boom in Auckland by imposing a “bright line” tax on investors who sold their residential properties (other than the family home) within two years of purchase. As house prices continue to rise, quite dramatically in some regions, the Institute for Governance and Policy Studies in Wellington has argued that such a tax would increase government revenue and reduce distortions in the tax system. Moreover, it would address the issue of inequality in New Zealand.

In the lead-up of the 2017 general election campaign, the Labour Party promised to increase the period of eligibility for the “bright line” property tax from two to five years. Overall, tax policy emerged as one of the most divisive election issues, with the National and Labour parties offering significantly different proposals. Whereas the National Party focused on tax cuts, Labour promised to scrap those tax cuts in order to use the money for its policy pledges in areas such as fees (free education for tertiary students), a far more generous Working for Families package and a new universal payment of $60 a week for parents of newborn babies once paid parental leave runs out.

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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 socioeconomic 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. The first two budgets of the red-green government, however, signal a return – however modest – to a philosophy of higher levels of taxation and public spending, rather than incentives, as the engine of the domestic economy. Swedish tax levels are still largely on par with those of its main competitors – in fact, taxation of business is low from a comparative perspective.

Citation:
Finanspolitiska Rådet. Swedish Fiscal Policy. Fiscal Policy Council Report 2017 (http://www.finanspolitiskaradet.se/download/18.4c8bf10a160291805212159b/1512728204599/Swedish+Fiscal+Policy+2017.pdf)

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OECD (2015), In It Together: Why Less Inequality Benefits All (Paris: OECD)

Bulgaria

Score 7

Government revenue in Bulgaria is dominated by indirect taxes centered on a flat-rate 20% VAT for all products except tourism packages, social security contributions (mostly pension and health care contributions) and a relatively small share of direct taxes that are based on a very broad base with low rates. 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 rate and the low direct-tax burden limit the extent of vertical equity. As a result, the difference between income inequality before and after taxes and benefits is relatively small.

Tax revenues have continued to increase significantly in 2017 with boosts from both direct and indirect taxes. This has allowed the government to plan a balanced budget for the second year in a row. While the size of the shadow economy and the extent of tax evasion are decreasing, their levels remain relatively high.

Citation:
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Chile

Score 7

Chile has a moderately complex tax system. The tax reforms passed in September 2014 and February 2016 raised the corporate-income tax rate from 20% to between 25% and 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. These changes are expected to increase overall equity within the system, according to a World Bank study commissioned by the Chilean Ministry of Finance. However, the short- and long-term effects are not fully evident as a portion of the reform package has not measurably taken effect yet (e.g., elimination of the FUT tax credit).

The more ambitious aspects of Bachelet’s tax-reform initiative, seeking to increase revenues, reduce tax evasion and avoidance, promote company investments and private savings, and make the fiscal system more equitable, were partially introduced in the latest two reforms packages, but their impacts have not been shown yet.

The highest marginal rate for personal-income taxes 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) of 19% is the third highest in Latin America (after Uruguay and Argentina) and remains flat. It favors allocative efficiency but has a regressive impact. There is certainly tax evasion in Chile, probably at higher levels than the OECD average due to the prevalence of informality. Yet efforts to ensure tax compliance have generally been successful. Moreover, Chile probably has 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, at least at current spending levels. Additional revenue stemming from newly introduced fiscal changes is slated to finance reforms within the education and health systems. 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. The fiscal reform is expected to make improvements in this regard. Nevertheless, the tax system promotes vertical equity through redistribution at only a relatively low level in comparison to other OECD member states.

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 strong 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 or increase productivity, and thus endangers competitiveness in the long run.

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 check 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:
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Czech Republic

Score 7

The Czech tax-to-GDP ratio is low from a comparative perspective. While revenues have been sufficient to generate a small fiscal surplus in 2016 and 2017, it will be challenging to ensure sustained financial support for areas such as education, R&D, and environmental protection after 2020, when EU structural funding terminates. The Czech tax system broadly ensures horizontal equity. One exception is the blanket tax allowance given to the self-employed to cover operating 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. While revenues from direct taxes are low and there is a flat personal income tax, a degree of vertical equity is achieved by a tax allowance on personal income taxes, a solidarity surcharge on higher incomes and some differences in VAT rates. Tax rates for enterprises are modest, but tax compliance costs relatively high. During the period of review, the most controversial tax reform has been the gradual implementation of a 2016 law on the electronic registration of sales. This had been pressed for especially by the Social Democrats since the 1990s, claiming that it would prevent widespread evasion of VAT by retailers, but had been opposed by small businesses, claiming it to be an annoying and unnecessary bureaucratic burden.

Estonia

Score 7

Estonia is internationally recognized for its straightforward and transparent tax system. The individual income tax is proportional and corporations only pay income tax on profits that are not reinvested. Beginning in January 2018, the personal income tax will be radically altered as the basic exemption will depend on annual income. Low earners will benefit from generous exemptions whereas high earners will have no exemptions at all. Neoliberal opponents of this reform claim that it marks a veiled move from a proportional to progressive income tax.

The Estonian welfare system is financed almost entirely through social insurance contributions. This Bismarckian principle has both advantages and weaknesses. First, high labor costs may weaken the country’s economic position and sometimes lead to labor-relations abuses. Second, social-insurance contributions alone cannot provide sufficient financing for social services given Estonia’s shrinking labor force. Pension funds have persistently accumulated debt, and the health insurance fund is under long-term financial austerity. Major reforms of both health and old age financing are being discussed.

France

Score 7

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 expenses, as public spending is exceptionally high by western standards (56.8% of GDP in 2015, compared to the EU-28 average of 47.4%).

The previous government's preference for tax increases rather than budgetary savings has had lasting economic effects, for example, on investment and consumption, as well as political effects. The tax policy of the Hollande administration was inconsistent; raising taxes both for individuals and for companies in the beginning before starting to alleviate the tax burden in 2015 and 2016. On the whole, the Hollande era has been perceived as a period of over-taxation and of mediocre results by a large majority of the public. However, driven by the rather dramatic situation faced by French companies, the Hollande government made an important step to lower their tax burden. A rather cumbersome and complex system, simplified in 2014, granted substantial tax reliefs of about €30 billion for companies.

Once elected Macron had to review the overall budget and to make severe cuts in order to present a budget with a deficit lower than 3% of GDP. The 2018 draft budget includes measures in line with Macron's commitments and proposes both tax cuts and a major restructuring of the tax system. Three measures to be adopted are particularly relevant: the abolition of the taxe d'habitation (a local tax paid by all inhabitants, owners or tenants) over a period of three years for 80% of the taxpayers, the abolition of the wealth tax and its transformation to a less economically damaging tax on real estate properties, and the substitution of the progressive but discouraging tax on dividends for a flat-rate tax. The tax relief for companies set up by the Hollande administration will be continued, and transformed into a permanent, simpler system of reduced taxes and social contributions. The overall objective is to put in place incentives rather than obstacles to investment and wealth creation, and improve lower-income salaries by eliminating the social taxes paid by some employees.

Germany

Score 7

In recent years, German tax policy lost steam. As a consequence of falling interest rates on public debt and buoyant public revenue growth, the reform vigor of the previous decade gave way to a complacent uncertainty regarding the future direction of tax policy. Between 2010 and 2017, total tax revenues rose by more than 38% from €531 billion to €735 billion (Bundesfinanzministerium 2017). Since 2014, this has enabled the ministry to achieve its aim of balancing the public budget, despite considerable costs related to the refugee crisis. In addition, the soaring labor market created significant surpluses in the social security system. The guiding principle of today is “steady as you go.” Legislative changes to taxation have largely been limited to areas that the Federal Constitutional Court had ruled were unconstitutional, such as inheritance tax and privileges for corporate wealth. With regard to the former, following a ruling by the Constitutional Court, a revised inheritance tax provides new regulations that spare company capital (Bundesfinanzministerium 2016).

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. The top marginal personal income tax rate (47.5%) is comparable to the OECD average (47.8%), but the average marginal rate continues to be a key challenge for Germany’s competitiveness since it is 15 percentage points higher than OECD average. The OECD report concludes that this is particularly harming the integration of single parents into the labor market (OECD 2016) as well as creating substantial work disincentives for a household’s second earner. Furthermore, the complexity of the German tax system imposes high compliance costs on households and firms.

Germany’s inefficient municipal tax system requires much needed reform, though municipalities have created budget surpluses in the past couple of years. Also, despite perennial discussions envisaging a tackling of bracket creep, there is no effective regulation for a systematic dissolution of the problem in sight. However, a one-off measure took effect in 2016 through an adjustment of the income tax schedule, which compensates taxpayers for a bracket creep effect of approximately two years. Finally, the German Council of Economic Experts has criticized the fiscal equalization scheme between states as inefficient and harmful to growth (Sachverständigenrat 2017/18: 293).

In summary, German tax policy performs well in terms of revenue generation. However, especially for middle income earners the system generates excessive work disincentives. The redistributive capacity of the tax system has decreased as indirect taxes have taken a larger role. The Global Competitiveness Report considers Germany’s tax rates and tax regulations to be the most problematic factors for doing business in Germany. However, given the overall positive economic environment these challenges have not as yet undermined Germany’s relative attractiveness. With the far-reaching U.S. tax reform, and the perspective of lower corporate tax rates in France and the United Kingdom, Germany’s tax-related competitiveness is in a process of erosion. So far, political parties seem to be unaware of this new wave of tax competition.

Citation:
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https://de.statista.com/statistik/daten/studie/166381/umfrage/steuereinnahmen-laut-steuerschaetzung/

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Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung (2017/2018): Für eine zukunftsorientierte Wirtschaftspolitik, Jahresgutachten 17/18, Sachverständigenrat: Wiesbaden. Online: https://www.sachverstaendigenrat-wirtschaft.de/fileadmin/dateiablage/gutachten/jg201718/JG2017-18_gesamt_Website.pdf

Ireland

Score 7

The goal of fiscal consolidation has had to be given a high priority in formulating tax policy over recent years. The burden of direct taxation was increased after the country’s financial collapse and a new local property tax was introduced in 2012.

In view of the rapid improvement of the country’s fiscal situation, and with an eye on the 2016 general election, it was hardly surprising that the 2016 budget contained no tax increases (apart from a rise in the excise on tobacco products) as well as a significant reduction in the Universal Social Charge (USC), which is levied in addition to income tax. Incomes over €70,000 did not benefit from this change, which further increases the progressiveness of this levy. After the budget reforms 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 new local property tax is steeply progressive with respect to property values.

The 2017 budget included few substantial tax reforms. Though the small reduction to the USC and the commitment to lower it further in future budgets indicates the Fine Gael-led government’s concern with the burden of direct taxation on taxpayers.

The indirect tax system is less progressive than the income tax and property-tax systems and weighs relatively heavily on those in the lowest deciles of the income distribution. This is due, to a significant extent, to the heavy excise taxes on alcohol and tobacco products, expenditure on which looms relatively large in poorer households’ budgets, as well as to the larger proportion of income saved by those on higher incomes.

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 critics in foreign jurisdictions who assert that some features of the way Ireland taxes corporations constitute "unfair" competition and encourages profit shifting by multinational corporations. The OECD published a detailed report on this topic in October 2015. In an initial response to this report, Budget 2016 introduced a requirement that multinational corporations with Irish parent companies must file country-by-country reports on their income, activities and taxes beginning 1 January 2016. This information may ultimately be confidentially shared with foreign tax authorities.

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

Citation:
Tim Callan, Maxime Bercholz, Karina Doorley, Claire Keane, Mark Regan, Michael Savage and John R. Walsh 'Distributional Impace of Tax and Welfare Policies: Budget 2018. ESRI Quarterly Commentary, Winter 2017.
Budget 2016 contains an annex that discusses the progressiveness of the Irish tax and welfare system in some detail: http://www.budget.gov.ie/Budgets/2016/Documents/Budget%20Book%202016%20-%20full%20document.pdf
The conclusion is reached that "it is evident that, compared to other countries, the Irish tax and welfare system contributes substantially to the redistribution of income and a reduction in market income inequality. The income tax system is more progressive relative to comparator countries with the tax burden from income tax and USC falling in large part on households with the highest incomes."
See also Donal De Buitléir
http://www.publicpolicy.ie/wp-content/uploads/Budget-2013-Progressivity-of-Irish-Income-Tax-System1.pdf
and
Michael Collins
http://www.nerinstitute.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
The OECD report on Base Erosion and Profit Shifting is available here
http://www.oecd.org/tax/beps-reports.htm

Italy

Score 7

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 limited incentives and no compelling reason to declare revenues. 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 government in office has fundamentally pursued the same path as the Renzi government, benefiting from the persistently low interest rates on government debt. The tax credit for people on low incomes, which was introduced in 2014, has been maintained and has shown some redistribution effects, resulting in an improvement in Italy's Gini coefficient. The same applies to the marginal increase in tax on financial assets, and reductions to income and corporation taxes. The stabilization of these measures has had a modest beneficial effect on the fiscal system, but more needs to be done. The antiquated land register is yet to be reformed, despite repeated promises. As such, inequities in the property tax system continue to persist.

The online system for submitting income tax declarations, the 730 precompilato, has gained momentum. The online system has replaced the paper forms for the majority of income taxpayers and has made it possible to double-check tax returns. The shift to electronic invoices within public administration and the new payment method for VAT have increased the effectiveness of fiscal oversight.

New fiscal measures (accelerated write offs) to encourage investments in technological innovation introduced by the government took effect in 2017. Major reductions in personal income tax, repeatedly announced, have been postponed for lack of resources.

Overall, the Italian tax system is able to generate a sufficient amount of resources, but is still in need of a deeper reform to increase horizontal equity, reduce obstacles to competitiveness, and facilitate foreign direct investment.

Citation:
http://www.sviluppoeconomico.gov.it/images/stories/documenti/Industria_40%20_conferenza_21_9
http://www.istat.it/it/files/2017/06/CS_-Redistribuzione-reddito-in-Italia_2016.pdf

Luxembourg

Score 7

Over the last years, Luxembourg has struggled under new EU and OECD tax regulations that make it difficult for the country to maintain its largely secret and advantageous tax deals for companies. However, after a series of delaying tactics, the country accepted the new international transparency rules, seeking to avoid greater damage to Luxembourg's role as a financial center.

In 2016, most global players in the country had negotiated positions that exempted them from corporate income taxes (2017: 19%), municipal business taxes (6.75%), a special contribution (solidarity surtax 7%), and net wealth taxes (0.5%). More than 50,000 companies had negotiated tax deals with the government which allowed them to channel profits through Luxembourg and to reduce their overall tax obligations. The EU penalty payments of Fiat Chrysler, Starbucks and the European headquarters of Amazon (with 1,500 employees, one of the big players in Luxembourg) were unexpectedly beneficial for Luxembourg as the penalty payments (totaling €250 million) land with the state treasury. To clarify the principle of legal certainty, Luxembourg appealed to the European Court of Justice against the ruling.

The effects of these proceedings and ongoing audits under the new rules will have a major impact on state revenues over the long term. The EU and OECD are working toward harmonizing the tax systems of EU member states. After being listed as a tax haven in 2013, the Global Forum removed Luxembourg from its blacklist in October 2015.

In 2015, the European Commission implemented new e-commerce rules for the EU, which state that value added tax is payable in the country in which the services are carried out or the product is sold, effectively undermining Luxembourg's business-friendly e-commerce VAT regime. To boost public finances, Luxembourg has implemented new tax rates. Several tax rates were increased, including the general VAT (from 15% to 17%). The higher VAT rate and low interest rates will lead to a slight increase in the inflation rate (about 1.7% in 2017). Nevertheless, Luxembourg continues to have the lowest VAT rate in Europe.

Important milestones during the period under review include a major tax reform in 2017, which focused on harmonizing individual (including cross-border worker) taxation with higher allowances (pension plans and so-called bausparvertrags) to increase second earners. The government implemented a corporate tax system and a restructuring program to attract more foreign investment. In 2015, the process of declaring VAT was simplified by the introduction of an electronic system. Long-outstanding tax arrears were used to consolidate the 2017 budget. Despite losses in e-commerce (-€225 million in 2017) and tax reform cuts, CIT arrears and an early 2017 index tranche are compensating lost tax revenues.

Luxembourg is known for its fast framework conditions and flexibility in global competition. For example, in 2014 Luxembourg introduced a freeport (VAT free zone) at Luxembourg airport and reduced tax rates by 8% on imports and intra-EU acquisitions of antiques, art, and collectibles. In 2016, Bitstamp opened the first EU compliant cryptocurrency exchange in Luxembourg. In addition, Google may open a new €1 billion data center in Luxembourg. Luxembourg, as an early adopter, has covered another niche product, so-called "asteroid mining," offering a regulatory-legal business framework. While this may sound very futuristic, Spire Global has already announced plans to open a European headquarters in Luxembourg with 250 employees, with strong support from the Luxembourg Future Fund.

Luxembourg's financial center (mostly foreign-owned) is the most important locus of the so-called renminbi trade. Luxembourg's global fund management industry is the second most important location for investment funds worldwide after the United States. In October 2017, the Luxembourg investment fund industry was home to €4,135 trillion in net assets (€3,664 trillion in Oct. 2016), with 4,098 funds, including 14,711 fund units. Following a massive slump in the previous year, Luxembourg's investment funds deposits increased by 9.8% since January 2017. Furthermore, Luxembourg is the European leader for responsible investment fund management. Overall, the number of employees in the financial sector rose from 45,097 in 2016 to 47.411 in June 2017.

The PwC 2017 business report ranked Luxembourg in top place. The total tax rate (TTCR), after deductions and exemptions, is currently 20.5%. This is the lowest total tax rate among European and European Free Trade Association (EFTA) countries, before Croatia (20.6%) and Cyprus (22.7%). Luxembourg's taxation system is very attractive for businesses with only 20% of companies paying business taxes. In 2012, property taxes accounted for 1.3 % of GDP and represented 3.3 % of tax revenue. At 0.1% of GDP, Luxembourg's recurrent property taxes is the third lowest by GDP share among EU member countries after Malta and Croatia. However, in terms of administration, Luxembourg and Cyprus lag behind other OECD countries.

Luxembourg has the highest capital-tax-to-GDP ratio among EU member states. This demonstrates the size and systemic importance of the financial sector in Luxembourg. To maintain the competitiveness of the financial sector, the government has decided not to introduce the Tobin tax on financial transactions. Following international standards on tax competition, Luxembourg has reduced the corporate tax by 2% to 19% in 2017 with a reduction to 18% in 2018. Meanwhile, higher personal tax allowances and income tax reductions will benefit middle class taxpayers.

Citation:
18th Update of the Stability and Growth Programme of the Grand Duchy of Luxembourg for the 2017 – 2021 Period. Le gouvernement du Grand-Duché de Luxembourg, 2017. www.mf.public.lu/publications/programme/18th_update_stability_growth_programme.pdf. Accessed 14 Dec. 2017.

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Malta

Score 7

Malta's income tax system ensures that a portion of income is non-taxable for all three tax categories (€9,100 for single individuals, €12,700 for married individuals and €10,500 for parents). Parents also receive a tax rebate on school fees, cultural activities, and creative education. No sales or inheritance tax is levied on a person's primary residence. Moreover, first-time property buyers have been benefiting from a capped duty waiver since 2014, while similar benefits for second-time property buyers will be available beginning in 2018. Other measures that contribute to greater equity include the extension of the favorable 15% income tax rate enjoyed by pensioners working part-time in the private sector to pensioners working part-time in the public sector as well as the staggered removal of taxation for some working pensioners in the 2018 budget. In addition, there has been an annual increase in the income ceiling for those paying the 35% tax rate. An optional flat rate of 15% was also introduced for income from residential and commercial property rentals.

However, the burden of taxation falls mainly on people in fixed and registered employment. Malta's informal economy is almost equivalent to 26% of GDP, estimated to have exceeded €280 million in 2016, though economists contend that the actual percentage is much higher. A 2016 ECB study shows that Malta has the highest number of cash transactions in the EU, in all likelihood resulting from rampant tax evasion. Tax evasion controls remain ineffective. A number of mitigating measures have recently been introduced to consolidate previously introduced actions in this area. Among others, these include possible measures to reduce the use of cash. A new joint task force that encompasses the Inland Revenue, VAT and Custom departments along with the Tax Compliance Unit has been established with the aim of ameliorating information sharing. In addition, property lease and renewal agreements are now subject to registration with the Inland Revenue Department.

With a corporate taxation rate of 35%, Malta has one of the highest tax rates applicable to companies in the EU. However, as a result of the full imputation system and the tax incentives provided to companies registered in Malta, the actual tax rate is estimated to be as low as 5%. Moreover, the Maltese tax policy does not include additional taxes on dividends paid to shareholders, apart from the fact that they are entitled to tax credits. Fiscal incentives enhance the competitiveness of various economic sectors and attract foreign direct investment. Special tax incentives are also available for industrial research and development projects, experimental development and the registration of intellectual property.

The 2018 budget, while not introducing any new direct or indirect taxes, introduces new tax reduction incentives for SMEs and schemes for Malta-based companies.

Citation:
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Times of Malta 04/11/2013 Tax exemption for first-time property buyers announced
Malta Independent 10/10/2017 Budget 2018: Housing - Second time buyers' scheme launched
Times of Malta 13/10/2015 Changes in income tax
Budget Speech 2018 (English) p.17, 20, 61
https://ird.gov.mt/faq/rentalfaq.aspx
Times of Malta 09/10/2017 No new taxes or tax increases in Budget 2018
European Semester Thematic Factsheet – Undeclared Work (Updated 2016) p. 3
Times of Malta 09/10/2017 Undeclared economy 'much larger' than €280m
Tax Reforms in EU Member States 2012 Report p.75
Commission Staff Working Document - Country Report Malta 2016 SWD (2016) 86 final p. 14, p. 15
Commission Staff Working Document - Country Report Malta 2017 SWD (2017) 83 final p.14
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Malta Independent 09/07/2016 EU anti-tax avoidance directive: Measures to be introduced aimed at curbing abuse
Malta A Regional Center for Strategic Investment and Doing Business p.4, p.5
Times of Malta 28/11/17 Malta is European Cash Capital says European Central Bank

Netherlands

Score 7

Taxation policy in the Netherlands addresses the trade-off between equity and competitiveness reasonably well. Pre-taxes the Netherlands have a Gini coefficient of 0.563 (in 2015), after-taxes (and other redistributive measures) it is only 0.295 (in 2015). The Netherlands has a progressive system of income taxation which contributes to vertical equity. In general, income tax rates range between 30% for lower and 52% for higher income levels. There is a separate tax for wealth. Indirect taxes and local taxes hit lower income groups most. Yet, tax pressure for every income group, from low to high, allegedly is approximately 37%. Yet, partly as a result of ad hoc measures to alleviate crisis impacts, the tax system loses credibility because of its increasingly unequal treatment of different groups. For example, between self-employed and employed workers, between entrepreneurs operating as sole traders or private limited companies, between single-parent families and families where both parents earn a living, and between small savers and the very wealthy. There is more inequality than meets the eye. In particular, middle-income families only manage to make ends meet because women are working more; increasing the number of hours worked per household and the female labor participation rate.

The Dutch state is taking a number of measures designed to ease budget pressures, including a gradual decrease in allowable mortgage-interest deductions, a decrease in health care and housing-rent subsidies, and a gradual increase of the pension-eligibility age to 67. Under strong pressure from opposition parties, the Rutte II cabinet intended to further simplify the tax system. However, this plan was postponed until after the 2017 elections. Due to the considerable increase in local governments' implementation responsibilities, a possible shift from national to local taxes has been added to the tax-reform agenda.

Corporate income tax for foreign companies – an aspect of the trade-off between horizontal equity and competitiveness – has also come under political scrutiny. An extensive treaty network that encompasses 90 tax treaties aims at protecting foreign companies from paying too much tax, effectively making the Netherlands a tax haven. After tax scandals involving Google and Starbucks, and increasing pressure from the OECD and the European Commission to reduce treaty shopping and transfer pricing, the Dutch government will gradually have to change these corporate-tax laws for foreign companies.

Citation:
CBS, Nederland in 2016. Een economisch overzicht, Den Haag/Heerlen, 2015, pp.31ff

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South Korea

Score 7

The South Korean tax system is fairly effective in generating sufficient public revenues without weakening the national economy’s competitive position. South Korea has one of the lowest tax rates in the OECD, with tax revenues totaling about 25% of GDP as of 2014. The Moon administration is expected to impose higher tax rates on wealthy people and businesses that can afford to pay more, with the aim of paying for expanded job-creation and social-welfare policies. In August 2017, the Ministry of Strategy and Finance announced new tax-reform proposals designed to redistribute wealth and increase the tax-revenue base. Under these plans, the income-tax rate for those whose taxable income exceeds KRW 500 million (5,700) will be raised from the current 40% to 42%, with people in the new income bracket of KRW 300 million to KRW 500 million to be subject to a tax rate of 40%. The government will additionally add a new 25% corporate-income tax bracket for companies with taxable income exceeding KRW 200 billion and above. If the bill is passed by the National Assembly, companies earning between KRW 20 billion to KRW 200 billion will be subject to the current rate of 22%. Tax reform is hotly debated in South Korea by various interest groups. For example, the country’s high tax-exemption rate of 48.5% is highly controversial.

Citation:
Kim, Boram, August 2, 2017: S.Korea implements tax hike policy to back income-led growth. Yonhap News.
OECD (2016), Tax revenue (indicator). doi: 10.1787/d98b8cf5-en (Accessed on 30 October 2016)
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United Kingdom

Score 7

The United Kingdom has a progressive income-tax system. The balance between direct and indirect taxes is reasonably fair, as measured in terms of horizontal equity. The system is, however, very complex. 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 and have been increased for purchases of high value houses, but labor taxes are low compared with many other EU countries. The financial crisis and the ensuing economic downturn sharply reduced tax revenue with the squeeze on wages contributing to a lower yield from income tax. However, overall tax revenue has risen in the past years and is projected to be sufficient to continue to narrow the public deficit over the course of the current parliament. A risk factor is, though, that the potential costs of leaving the European Union are still unclear and therefore not calculable yet.

The Autumn Budget 2017 included some reduction of stamp duties imposed on sales of lower priced houses, but critics have argued that this will not improve the housing shortage and may even increase market prices for flats and houses – especially since at the same time the government has also postponed its investment in loan support for home builders and small-building companies.

Citation:
World Economic Forum 2017: The Global Competitiveness Report 2017-2018.

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. A further significant exemption arises in respect to retirement savings (known as superannuation), which are minimally taxed. That aside, the income-tax system is moderately progressive. Only minor changes to income tax occurred in the review period. A temporary (two-year) “deficit repair levy” of 2% of income in excess of AUD180,000 expired on 30 June 2017, while a 0.5% increase in the Medicare Levy (paid on all income by those earning moderate or higher incomes) was introduced to support the National Disability Insurance Scheme, effective 1 July 2019. The government has also moved to increase taxation of superannuation for those on high incomes or with high superannuation balances, and has also begun implementing reductions in the company tax rate from 30% to 25%, with the new lower rate applying to companies with annual turnover of less than AUD 25 million from 1 July 2017, and applying to companies with annual turnover of less than AUD 50 million from 1 July 2018.

The tax-to-GDP ratio in Australia is among the lowest of any OECD economy. Arguably, the low level of taxation creates bottlenecks in infrastructure development, which have not been sufficiently addressed. Particularly Sydney and Melbourne are exposed to infrastructure bottlenecks.

With regard to sufficient inflow of tax revenue, as outlined in detail in “sustainable budgets,” concerns have again heightened 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 in particular have outpaced revenue growth.

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

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http://www.treasury.gov.au/Policy-Topics/Taxation/Pocket-Guide-to-the-Australian-Tax-System/Pocket-Guide-to-the-Australian-Tax-System/Part-1

Belgium

Score 6

By OECD standards, Belgium's tax structure is inequitable. The tax base is too narrow, and puts excessive pressure on labor income (along with Italy, Belgium has the OECD's highest effective tax and social-security wedge on labor), which in turn produces incentives for tax avoidance and evasion. Conversely, much capital income (e.g., housing rents, capital gains, and some multinationals' profits – a significant sum given the presence of a large number of such firms in the country) is either inefficiently taxed or not taxed at all.

Several factors have prevented the country from tackling these issues. There is a lack of political willingness to engage in significant tax-system reform, and no wealth registry that would enable detection of mismatches between declared income and spending. Moreover, federal-level fiscal administration is decidedly suboptimal, with the government seemingly unable to effect improvements in performance.

Consequently, while horizontal and vertical equity within each income source (i.e., labor, capital and corporate income) are guaranteed in theory, differential treatment and a lack of information undermine this principle in practice. Belgium is technically numbered among the most equitable countries worldwide on the basis of measured inequality, but this is based on official taxed income, which is blind to untaxed incomes. Since taking office, the present government has additionally tasked itself with reducing government spending as a share of GDP. Its efforts have been disproportionately focused on health care and social security spending, which may increase purchasing-power inequality in the medium term.

Nonetheless, some significant and positive developments must be noted. Due to increasing pressure from the European Union, Belgium is engaging in deep reforms of its corporate tax structure. According to PwC, "the standard corporate-income tax rate of 33% would be lowered to 29% in 2018 and to 25% as from 2020. SMEs would even see a decrease in the rate to 20% as from 2018 for the first bracket of €100,000 profit."

In its March 2016 recommendations, the Council of Europe wrote that "Belgium did not make sufficient progress toward compliance with the debt rule in 2015. […] The [Belgian government's] revised medium-term budgetary objective, set at a balanced budgetary position in structural terms, is expected to be reached by 2018. However, the recalculated structural balance still points to a structural deficit […] in 2018. […] The macroeconomic scenario underpinning these budgetary projections is plausible. However, the measures needed to support the planned deficit targets from 2017 onward have not been sufficiently specified." This body also emphasized that, "[t]here is still considerable scope for improving the non-cost dimension of external competitiveness. To safeguard and enhance current welfare levels, more emphasis should be placed on productivity gains and investment in knowledge-based capital."

Citation:
Lack of administrative information on wealth: http://www.lecho.be/actualite/archive/L_absence_de_cadastre_des_fortunes_complique_la_tache_du_fisc_belge.9828652-1802.art?highlight=cadastre%20fortunes

Council of Europe's recommendations: http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017H0809(01)&from=EN

https://www.pwc.be/en/news-publications/news/tax-reform.html
http://www.doingbusiness.org/data/exploreeconomies/belgium#enforcing-contracts)

Cyprus

Score 6

In spring 2016, the process integrating the Inland Revenue Department and the Value-Added Tax (VAT) Service into a new scheme was completed, now called the Tax Department. This was part of reforms aimed at addressing weaknesses of the tax collection and processing mechanisms, including auditing, tax evasion and avoidance.

Cyprus's 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 ranging from 20% to 35%, for sums above €60,000. The VAT rate is 19% since 2014. Termination of a special levy on salaries was expected in 2017 and political parties voted in 2016 to drastically reduce a real-property tax imposed in 2013 and end it in 2017. A tax imposed on interest income for bank deposits increased to 30% since April 2013. Some tax deductions and benefits are alleviating the weight of taxation. Principles of equity are negatively affected by continued tax evasion and avoidance, with uncollected taxes amounting to €2.5 billion in 2016.

Benefits provided to businesses have over time made Cyprus very attractive to international companies. These include deductions for equipment and a corporate tax of 12.5% on profits since 2013, which remains the lowest in the EU. Bilateral treaties aim to avoid 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 appears to lead to distortions, where liberal professions can benefit by creating their own company, thus paying 12.5% only, on corporate profits. In addition, the flat rate for businesses means that highly profitable companies do not pay a higher tax share as individuals do.

Beyond efforts to improve tax collection, the European Commission characterizes the Cyprian tax-benefit system as the least effective in reducing inequalities (February 2017).

Citation:
1. EU Commission, Semester Report, February 2017, https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-cyprus-en.pdf
2. Global Forum, Cyprus Tax Transparency Review Report – Phase 2, 30 October 2015, http://www.oecd.org/tax/transparency/cyprus-supplementary.pdf
3. Government collects 87m back taxes, Cyprus Mail, 3 October 2017, http://cyprus-mail.com/2017/10/03/government-collects-e87-back-taxes/

Iceland

Score 6

Tax revenue shot up from 42% of GDP to 58% of GDP in 2016 as a result of the stability contributions made by stakeholders in the old banks to the treasury. These contributions were a condition for being released from the capital control restrictions that had been in place since 2008. Tax revenue is projected to return to 42% of GDP in 2017 and remain stable thereafter. The government in office from January to November 2017 did not change significantly from the tax policy of the 2013-2016 government. Fishing fees remain far below potential as only 10% of the common property resource rent of fisheries accrues to the taxpayer while 90% accrues to vessel owners.

Citation:
International Monetary Fund, 2017 Article IV Consultation, IMF Country Report No. 17/163, 22 June 2017, https://www.imf.org/en/Publications/CR/Issues/2017/06/22/Iceland-2017-Article-IV -Consultation-Press-Release-Staff-Report-and-Statement-by-the-44998. Accessed 21 December 2017.

Indriði H. Thorláksson, “Veiðigjöld 2015. Annar hluti” (Fishing Fees 2015. Part Two), http://herdubreid.is/veidigjold-2015-annar-hluti/. Accessed 24 December 2017.

Israel

Score 6

Israel taxation policy is somewhat regressive. It includes increasing indirect taxes such as VAT, which is levied equally on all products. Furthermore, although the direct income tax is progressively structured, and a large portion of the population makes too little money to pay any income tax at all, the system creates a curve that forces middle-income individuals to pay proportionately more tax than high-income individuals. This apparent distortion is an intentional economic strategy meant to induce growth by reducing the tax burden associated with investments and companies. While controversial, it is not necessarily unfair as such.

Like most other countries, Israel utilizes its tax system as a political instrument. For instance, it offers tax reductions to army veterans. In most instances the Israeli tax system has a valid rationale for tax reductions that appear to violate the principle of horizontal or vertical equality. Recently, Prime Minister Benjamin Netanyahu hinted that Israel may initiate tax cuts for the business sector, following the U.S. Senate's landmark tax reform. However, the Bank of Israel Research Department's director said that cuts would have little effect on economic activity.

Israel has had annual tax surpluses, relative to forecasts, for the last five years. In 2017, the tax surplus was estimated at ILS 16 billion, stemming largely from the sale of the controlling stake in Keter Plastic, the sale of Mobileye, and Israel Tax Authority collections operations that yielded more tax revenue than forecast. Although a recent OECD report advised policymakers to devote tax revenues to improving social services, the current government has advocated tax cuts. In December 2017, Finance Minister Moshe Kahlon announced the abolishment of customs and purchase taxes totaling ILS 800 million per year.

Citation:
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Japan

Score 6

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

In terms of competitiveness, the previous 35% corporate-tax rate has clearly been too high in international comparison. In 2016, the combined national and local corporate effective income-tax rate declined from 32.11% to 29.97%, with a further reduction to 29.74% slated for in April 2018.

The fact that authorities are following up on their initial promise to lower corporate-tax rates despite the fiscal tension is a positive signal. It should be noted, however, that only around 30% of Japanese firms actually pay corporate tax, with the rest exempted due to poor performance.

Raising the comparatively low consumption tax is important for easing budgetary stress, particularly given the huge public debt and the challenges of an aging population. The government raised the consumption-tax rate from 5% to 8% in April 2014, while plans to increase it to 10% have been shelved several times ahead of elections. In June 2016, Abe postponed the tax hike to October 2019, and reconfirmed this date in mid-2017, when announcing a snap election for October of that year. However, Abe also announced that the proceeds from the tax hike would not be fully deployed to reduce the public debt; instead, half would be used for education and child care, he said. This served to deepen worries about fiscal reliability and prudence.

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.

Citation:
Nikkei, Japan to cut effective corporate-tax rate below 30% in FY17, Nikkei Asian Review, 11 October 2015, http://asia.nikkei.com/Politics-Economy/Policy-Politics/Japan-to-cut-effective-corporate-tax-rate-below-30-in-FY17

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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 standard corporate-income tax of 19%, a relatively high standard VAT rate (23%) and high social-insurance contributions. Compared to other East-Central European countries, the corporate tax burden and the extent of red tape as well as frequent temporal changes associated with the taxation of enterprises have been relatively high. In its first year in government, the PiS government reduced the corporate-income tax rate from 19% to 15% for small taxpayers and taxpayers in their first year of existence and increased the tax-free allowance for personal income tax, a measure that went into effect at the beginning of 2017. In its second year in office, the PiS government largely focused on fighting tax evasion and tax fraud, which have been comparatively high. In March 2017, the government created the National Revenue Administration by merging tax administration, fiscal control and customs service. Moreover, tax auditors were given more authority to prevent and fight fraud through electronic controls, and harsher penalties were introduced. These changes contributed to stronger revenues in 2017. The government's plan to raise the petrol taxes by about 6% was controversial. Justified as a means to mobilize resources for renovating local roads, this plan was widely perceived as breaking an election promise and was abandoned by the government because of mass protests.

Citation:
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Slovakia

Score 6

The introduction of a flat-tax regime in 2004 played a major role in establishing Slovakia's erstwhile 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, thereby increasing vertical equity to the detriment of competitiveness. Under the third Fico government, the focus has rested on the fight against tax evasion and improvements in tax collection. In addition, the government adopted a number of minor tax changes, including a lowering of the corporate-income tax rate from 22% to 21%, increases in the caps on social insurance contributions and a temporary doubling of the special levy on businesses in regulated industries (energy, telecoms, public health insurance, etc.). The introduction of reverse charge on VAT for imported goods was deferred and made subject to a pre-defined level of public budget deficit, which means it will likely not come into effect before 2020. These changes have lacked a clear direction and have further undermined the reliability of the tax system. While corporate-income tax revenues in 2017 were lower than expected, stronger-than-expected revenues from VAT, personal income tax and social insurance contributions helped to reduce the fiscal deficit.

Citation:
European Commission (2018): Country Report Slovakia 2018. SWD(2018) 223 final. Brussels, 16-17 (https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-slovakia-en.pdf).

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Spain

Score 6

Spain collects less in taxes relative to wealth than do most other euro zone countries. In 2016, Spain exhibited a tax-to-GDP ratio of 34% compared with the EU average of 40% (48% in France, 43% in Italy and 40% in Germany). The tax-to-GDP ratio in Spain increased slightly from 33.2% in 2000 to 33.5% in 2016. The tax reform of 2014, which came into force in 2015, amended the personal-income-tax system with generous tax cuts before the inconclusive elections held in December. According to Spain's finance minister, who was caretaker during 2017, this change was compatible with the goal of reducing the public deficit, as it is assumed that the economic stimulation would counterbalance reductions in some tax rates.

Tax policy is more difficult to assess with regard to equity and competitiveness. Vertical equity exists in principle (with strongly progressive income taxes and different VAT rates on products and services), but horizontal equity suffers due to 1) corporate-tax engineering, 2) the prevalence of fraud and 3) the scope of the underground economy, from which the state does not collect taxes at all. After years of reducing spending in public administration, the human resources of the AEAT have been increased. Nevertheless, a reform of the taxation agency expanding its human, ICT and financial resources is clearly needed.

Citation:
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June 2017, El País: “Spain losing €26bn in tax revenue due to fraud, says economists’ report”
https://elpais.com/elpais/ 2017/06/15/inenglish/1497545884_038 119.html

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 taxes and no inheritance taxes, the system of taxation as a whole is unbalanced. The new government (to be formed at the very end of 2017) has declared that it will shift this burden. However, ÖVP and FPÖ (the new coalition alliance) have also declared they will aim to achieve a zero-budget deficit. In order to create incentives for business, the new government will also reduce the tax burden on businesses (e.g., for startups). As tax cuts and a balanced budget are difficult to reconcile even during an economic boom, these ambitious goals may be difficult to achieve simultaneously.

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 taxpayers, 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. Taxation is clearly secondary – the Austrian social system relies more on welfare transfers.

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 became a hot topic during the last years of the grand coalition alliance between the SPÖ and ÖVP. The new coalition (ÖVP, FPÖ) will face less internal contradiction – at least in the beginning. In the long run, the new government might be tempted to exclude more and more foreigners – who live, work and pay taxes in

Austria – from the benefits of the welfare system. As this would (within the rules of the European Single Market) not be possible for EU citizens, it is realistic to assume not much can be achieved by focusing on non-EU citizens.

Croatia

Score 5

Tax reform has been among the top priorities of the first Plenković government. Immediately after coming to office in November 2016, it presented a comprehensive reform package. Drawn up by Minister of Finance Zdravko Marić already under the previous government, it aimed at amending a total of 15 tax acts. The measures adopted that became effective already in 2017, included cuts in the corporate income tax from 20% to 18% (and 12% for small and medium-sized enterprises), the adoption of two rates of personal income tax (36% and 24% instead of 12%, 25% and 40%) combined with an increase of non-taxable income from HRK 2,600 to HRK 3,800, as well as adjustments to VAT and excises. The reforms have made the Croatian tax system more transparent and competitive. At the same time, the personal income tax has become less progressive. This has further limited the redistributive effects of the tax system, which relies strongly on VAT and social insurance contributions. The postponement of the introduction of a property tax originally planned for the beginning of 2018 has also spelled for a limitation on redistribution. The budgetary effect of the tax changes has been relatively low, with direct revenue losses estimated at 0.6% of GDP in 2017 and 0.3% of GDP in 2018.

Citation:
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Mexico

Score 5

Tax policy, tax reform and the insufficiency of tax collection have been on the political agenda in Mexico for at least the past 50 years. During this long period there has been little progress either in collecting more tax revenue or making the tax system more equitable. While some may argue that the low level of taxation has been helpful for Mexico’s international competitiveness, increasing taxation is necessary for improving public good provision by the Mexican government.

While some taxes are collected at the state and municipal levels, the most important tax collector is the federal government. A new tax-reform law was passed under President Peña Nieto and took effect on 1 January 2014. While well-targeted and effective within its limited scope, the reform was rather modest given the challenges that Mexico faces. The government expected the new law to increase the national government's tax revenues by around 2.5% of GDP. According to a new OECD study, the reform did indeed increase tax collection by 3% in 2015 and 2016, thus contributing to a reduction in the borrowing requirements of the public sector.

Nonetheless, according to observers, Mexican tax collection remains between six and eight percentage points of GDP short of where it should be given the country's current level of development. Tax evasion and tax avoidance in the formal sector is one cause, as is the large size of the informal sector, which is notoriously tax resistant. Most Mexicans distrust their government and do not believe that money paid in taxation will be spent wisely. Additionally, the market-reforming economists who have run Mexico over the past 30 years have not prioritized raising revenue, putting more emphasis on controlling government spending in order to decrease the size of government. Many also assert that as an oil-exporting country, Mexico should earn a significant amount of public revenue by taxing oil income. However, Mexico's exportable oil surplus has declined due to falling production, a collapse in global oil prices and an increase in domestic oil consumption. Overall, further efforts are needed to better coordinate income tax collection with social security, improve the use of property taxes and broaden the overall tax base.

As of 2017, possible changes in the tax policy of the U.S. have increased pressure on Mexico's tax policy. The corporate tax advantages that the new U.S. laws might provide have raised concerns about companies and firms fleeing from Mexico – and this puts pressure on its tax policy.

Citation:
http://www.americasquarterly.org/content/why-us-tax-reform-threatens-mexicos-financial-future

Portugal

Score 5

The very high levels of taxation on income and consumption noted in the previous SGI reports have remained in this period. The Costa government's 2016 budget initiated a gradual phasing out of the extraordinary income surtax introduced during the bailout period. The changes to the surtax meant that the tax burden as a percentage of GDP fell in 2016 for the first time in four years, from 34.6% of GDP in 2015 to 34.4% of GDP in 2016. However, levels remain very high by historic comparison, a consequence of the massive tax increase of 2013, which boosted the tax burden from 31.8% of GDP (below the OECD average) to 34.1% of GDP (above the OECD average). Indeed, the average tax burden between 2000 and 2012 was about 31.1% of GDP.

The Costa government's 2017 budget continued the gradual phasing out of the income surtax, removing it beginning in January 2017 for taxpayers in the second-lowest bracket (annual incomes of €7,091 to €20,261); beginning in July 2017 for the third-lowest bracket (up to €40.522 annual income); and beginning in November

2017 for taxpayers in the higher brackets. However, even with this change, tax policy continued to fall short of achieving horizontal and vertical equity during this period.

While the government has adopted measures to combat tax avoidance, the problem is far from being eradicated regarding income tax. Moreover, at the corporate level, the effective tax rate often remains disproportionately low for comparatively profitable companies. Furthermore, the public finances' considerable dependence on indirect taxation measures such as the value-added tax fails to satisfy the vertical-equity criterion.

Citation:
Dinheiro Vivo, "Carga fiscal recua para 34,4% à boleia da descida da sobretaxa," available online at: https://www.dinheirovivo.pt/economia/galeria/estes-sao-os-paises-da-europa-com-a-carga-fiscal-mais-pesada/

Slovenia

Score 5

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 enough to prevent high budget deficits from emerging. Tax revenues stem from a broad range of taxes, with a high percentage of about 40% of all tax revenues stemming from social insurance contributions. A progressive income tax with rates of 16%, 27%, 34%, 39% and, since 2013, 50% provides for some vertical equity. As the thresholds are set rather low, however, the majority of middle class citizens fall into the second- or third-highest category. The tax burden for enterprises is below the EU average, but higher than in most other East-Central European countries. Moreover, tax procedures for both individuals and companies are complex.

The Cerar government had announced comprehensive tax reform for 2016. However, the coalition partners eventually reached common ground on relatively modest changes only, focusing on tax relief for the middle class. Beginning in 2017, the tax burden on personal income, including performance and Christmas bonuses, was reduced, in part by introducing a new tax bracket and by replacing the previous 41% tax rate with two rates of 34% and 39%. Contrary to the original proposition of the Ministry of Finance, the top income tax rate of 50% was retained. In order to compensate for the decline in personal income tax revenue, the corporate income tax rate increased from 17% to 19% in 2017. Business associations have complained that this increase will add to an already relatively high tax burden on enterprises. The quarrels over tax reform contributed to the resignation of Finance Minister Dušan Mramor in July 2016. His successor, Mateja Vraničar Erman, proposed a minor tax reform in 2017, targeting above all taxes paid by small companies, but couldn't find enough support in the government.

Turkey

Score 5

General government revenue increased from 31.9% of GDP in 2014 to 32.6% in 2016. While taxes accounted for 82.9% of central-government revenue in 2014, the share declined slightly to 82.7% in 2016. As a result, tax revenue totaled 17.7% of GDP in 2016.

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 2016, 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 2016, 69.6% of total tax revenues were derived from indirect taxes.

United States

Score 5

The U.S. tax system does not produce enough revenue to eliminate 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. Many high-income earners pay an effective tax rate that, after deductions, is lower than the rate for middle-class earners. The United States derives a large share of revenue from corporate taxes, a fact that has encouraged some firms to move operations abroad. Despite these shortcomings, the U.S. tax system performs well with respect to competitiveness, since the overall tax burden ranks near the bottom of the OECD rankings.

During the 2016 campaign and in 2017, President Trump and congressional Republicans promised major tax cuts and/or "tax reform." Their ostensible major objectives were to reduce corporate tax rates, reduce rates paid by high-income taxpayers (including those in the highest brackets), eliminate the inheritance tax, reduce taxes for middle income taxpayers, and make up for the losses of revenue by eliminating certain credits and deductions. Through most of 2017, they promised that their tax legislation would be "revenue neutral" and would not increase future budget deficits. Both liberal and conservative economists largely derided the Republican proposals as being unrealistic about revenue effects; liberals sharply criticized them as regressive.

Congress enacted a sweeping “tax reform” measure in mid-December (after the end of the current SGI assessment period), which will go into effect in January 2018. Official estimates from the nonpartisan Congressional Budget Office and the Joint Economic Committee’s bipartisan staff indicate that the law will produce a $1.5 trillion increase in budget deficits over 10 years. Republicans have discussed cuts in spending, especially entitlement programs such as Social Security and Medicare, to make up some of the losses. It is, however, likely that the effect of the December 2017 tax reform will be a significant loss of long-term fiscal sustainability (which is not reflected in the current indicator).

Greece

Score 4

Regarding the redistributive effects of taxes, Greece fares average compared to other OECD countries. Regarding the complexity of the tax system, there has been some progress, as Greek tax payers mostly use an electronic Ministry of Finance platform to file tax declarations and obtain personalized information on their tax-related obligations. The imposition of capital controls in 2015 led to an increase in the use of credit and debit cards. This in turn led to a strong increase in reported private consumption leaving an electronic trail for tax collectors in a country known for rampant tax evasion.

According to Greece’s Third Adjustment Program, raising government revenue should have been affected through a combination of tax increases and privatizations. Boosting budget revenue included measures like ending fuel tax benefits for farmers and ending VAT (sales tax) discounts applied on Greek islands.

Measures to increase taxes are easier announced than implemented. During the tourist season, income raised by small and very small businesses remains undeclared, while throughout the year an unknown share of income for liberal professions also remains undeclared. Thus, engineers, lawyers, medical doctors and dentists as well as craftsmen, plumbers, electricians and computer technicians rarely declare an income above €5,900 per year, which in 2017 was the threshold below which no personal income tax was imposed.

Further, the frequency with which tax laws are amended by the government is astonishing. As long as tax regulations are constantly under revision, the business environment in Greece will remain unstable and progress will not be achieved in improving horizontal or vertical equity.

Moreover, in relation to other OECD countries, Greece receives lower tax revenues from direct taxation. Tax revenue still derives primarily from indirect taxes (57%, which is the highest percentage in Europe), such as taxes on the use of oil products (gasoline, heating oil) and VAT. The VAT rate in restaurants and catering businesses, which are very active in the tourism sector, remain at the prohibitively high level of 24%, while Greek companies have to pay 100% of their estimated annual taxes up front. Such taxation measures and arrears in paying suppliers of goods and services to the public sector (a practice followed by many different governments at least since the start of the economic crisis), have contributed to Greece achieving a primary budget surplus of 0.5% in 2016.

A very serious problem is tax arrears. Independent Authority for Public Revenue data showed that 3.85 million taxpayers and corporations owe the state a total of €98.2 billion, an amount that increases every month and is likely to exceed €100 billion by the end of 2017. The electronic confiscation of bank accounts and assets (700 per day) does not seem to provide a viable solution.

A higher dividend tax will follow in 2018, as the government is bound by Greece's Economic Adjustment Program, which requires the country to keep a budget surplus, in order not to aggravate an already very high public debt (180% of the GDP in 2016, according to October 2017 data). The government also needs to increase tax revenue, because it strives to sustain its electoral clientele. It periodically recruits governing party supporters to the public sector and distributes additional one-off allowances to select groups. For example, in December 2016, Prime Minister Tsipras handed out a whole additional monthly pension to every pensioner whose pension was lower than €850 per month.

Meanwhile, the tax on landed property (ENFIA) negatively effects the real estate market. ENFIA is important for the state budget since it raises €2.5 billion – 3.0 billion per year. However, ENFIA has also contributed to a fall in house prices and led to disinvestment in the housing industry, an important sector in the Greek economy. In the period under review, households and businesses, including those required to pay installments on loans obtained from Greek banks, refrained from fulfilling their financial obligations to the Greek state on time.

Citation:
Comments on the redistributive effects of Greek taxes and the time spent to file tax declarations and pay taxes are based on the comparative data on OECD countries, available on this SGI platform.

Hungary

Score 4

Hungary's tax system has become less equitable under the Orbán governments, as the tax burden has shifted from direct to indirect taxes. While the government adopted substantial tax reductions in 2016 and 2017, the tax-to-GDP ratio is still above the level of regional peers, and the tax wedge remains one of the highest in the EU. With the introduction of the lowest corporate income tax rate in the EU (9%), the tax burden especially on larger companies has substantially decreased. However, companies still struggle with frequent changes in taxation and complex tax regime, including the high sectoral taxes. The NAV's new scheme of classifying businesses as "reliable," "average" or "risky," combined with the promise of preferences for "reliable" taxpayers, has been criticized for its tendency toward favoritism. So has the government's attempt to induce companies to contribute to sport organizations by granting them tax deductions ("tao"), but also secrecy and a special taxpayer status.

Citation:
European Commission (2018): Country Report Hungary 2018. SWD(2018) 215 final, Brussels, 11-13 (https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-hungary-en.pdf).

Romania

Score 4

In the period under review, substantial tax changes were passed and/or enacted. In early 2017, along with a plethora of minor changes, the standard VAT rate was lowered from 20 to 19%, the income tax allowance for pensioners was almost doubled, and the cap for social insurance contributions was eliminated. In late 2017, parliament passed a decrease in the flat personal income tax rate from 16% to 10% as of the beginning of 2018, combined with an increase in the income tax allowance and a far-reaching shift in the distribution of social contributions from employers to employees. These changes have been accompanied by attempts at strengthening tax administration and fighting massive tax evasion in the country. In the first half of 2017, Romania's National Tax Administration Agency (ANAF), for the first time in its history, exceeded its collection plan. As a result of the tax cuts, Romania's tax revenues-to-GDP, already one of the lowest in the EU, has further fallen, thus raising fears about the sustainability of public finances. At the same time, the changes have done little to raise the relatively low level of redistribution. The frequency of – adopted and, even more, announced – changes and the lack of a clear reform direction have undermined the credibility of the tax system. In 2017, 22 different adjustments were made to the country's tax code.

Citation:
IMF (2018): Romania: Selected Issues. Country Report No. 18/149, Washington, D.C. (http://www.imf.org/en/Publications/CR/Issues/2018/06/06/Romania-Selected-Issues-45944).

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