Taxes Report

Tax Policy

Sustainable Governance Indicators 2017

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 53.10% over the 1995 – 2014. 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%, and 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. 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 unique situation in which the public understands that taxation is necessary in order to secure the overall social welfare. In recent polls, 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

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 (34% of GDP in 2015) 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 EU 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 will prohibit 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 aims at lowering 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 will take place in February 2017. They argue that this reform package lowers capital costs and will result in either a further decrease of public revenues or increase in costs (taxes) for employees. In addition, they oppose amplifying tax competition between the cantons.

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 tax payers 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.

Canada generally scores high in generating sufficient public revenues. The previous

government's late finance minister Jim Flaherty received universal acclaim for his handling of the 2008 to 2009 crisis, and for moving toward a balanced budget after the structural deficit created by the Conservative's 2% reduction in the goods-and-services tax in 2006. The Liberal government elected in October 2015 has an ambitious spending agenda for the next five years, however, which will lead to large deficits unbalanced by tax revenues. With the growth of nominal GDP due to real GDP growth and inflation, however, the debt-GDP ratio is not projected to rise significantly.

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

2016 Federal Budget "Growing the Middle Class," posted at http://www.budget.gc.ca/2016/docs/plan/budget2016-en.pdf

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

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 a planned 22% in 2016 (a recent reform reduced it from 25%), 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 the autumn, the government announced plans for a new valuation system and reforms of the property taxation

scheme (eventually removing the “freeze”). At the moment, the status of these proposals is uncertain.

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).

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).

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

Lithuania

Score 8

In Lithuania’s tax system, a significant share of government revenue is generated from indirect taxes, while environmental and property taxes are relatively low. However, there is significant tax evasion. Moreover, 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 thus recommended implementing policies improving tax compliance (particularly VAT compliance) and broadening the tax base.

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 new “social model,” if implemented in 2017, is expected to reduce social security contributions for employers by 1% from 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 recently proposed increasing 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. 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.

Citation:
COMMISSION STAFF WORKING DOCUMENT, country report Lithuania 2016: http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_lithuania_en.pdf
Tax Reforms in EU Member States 2015: Tax policy challenges
for economic growth and fiscal sustainability, September 2015, http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip008_en.pdf.

New Zealand

Score 8

Taxation policy has successfully continued to promote competitiveness and the generation of sufficient public revenues. Regarding equity, governments have followed a policy of equal treatment of tax types, including income earned outside New Zealand, but at relatively low rates. The National 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 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. The 2016 budget provided 857 million NZD for Inland Revenue's new tax administration system, which is supposed to meet public expectations, adapt to changing business models and reduce compliance costs for businesses.

Citation:
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Marriott, Lisa, 2016. Advancing Better Tax Policy. The role of wealth taxes in New Zealand. Institute for Governance and Policy Studies. University of Wellington. Policy Quarterly – Volume 12, Issue 3. August 2016 (http://igps.victoria.ac.nz/publications/files/4da6aee2dcb.pdf) (accessed 16 September, 2016).

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

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

Mehrtens, Philip (2014), Staatsschulden und Staatstätigkeit. Zur Transformation der politischen Ökonomie Schwedens (Frankfurt/New York: Campus).

Bulgaria

Score 7

Bulgaria's government revenues are a mix of direct taxes, indirect taxes and social security contributions. The direct taxes, both personal and corporate, are a relatively small component of the tax revenues, and are based on a strategy of having very low rates which are uniformly spread over a very broad tax base with very limited exemptions. The system of indirect taxes is centered on a VAT with a flat rate of 20% for all products except tourist packages. Excise taxes have to conform to European Union requirements, the strategy of Bulgaria being to set rates at the low end of what is set out in its membership obligations. Social security contributions are directed mostly toward pension and health insurance.

With its low rates and uniform and broad tax base, Bulgaria's tax system fully achieves the objective of horizontal equity and creates relatively good conditions for improving competitiveness, though this is limited to some extent by red tape and a highly bureaucratic tax administration. At the same time, the flat income tax and the low direct-tax burden limit the extent of vertical equity. As a result, the difference between income inequality before and after taxes and benefits is relatively small.

While the tax-to-GDP ration has remained among the lowest in the EU, revenues from direct and indirect taxes have substantially increased in 2015 and 2016. Part of the increase, which has helped the government to balance the budget in 2016, has been due to a number of government measures to improve tax collection launched in October 2015. However, the shadow economy and the VAT gap remain large.

Citation:
European Commission (2017): Country Report Bulgaria 2017 including an In-Depth Review on the prevention and correction of macroeconomic imbalances. SWD(2017) 68 final/3, Brussels (https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-bulgaria-en_3.pdf), 20-21.

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 have yet to be fully evident, as a portion of the reform package will not take effect until 2017 (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 yet been shown.

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 avoidance 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 reform within the education system. By and large, Chile has been successful in generating sufficient public revenue. There are flaws in the efficiency of tax spending, but in general the national budget corresponds to the claims of different sectoral ministries. However, most of the tax income generated by corporate and personal taxpayers is based on VAT, and therefore has a very regressive effect. 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 ask whether Chile's ratio of government expenditure to GDP – at its current level of per capita income – is within the empirical cross-country range suggested by Wagner's law, which predicts that the development of an industrial economy will be accompanied by an increased share of public expenditure in GDP. This is the case.

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

http://www.reformatributaria.gob.cl

http://www.sii.cl/portales/reforma_tributaria/index.html#&panel1-1

On VAT in Chile in comparison: http://www.emol.com/noticias/Economia/2015/07/28/740297/Chile-tiene-el-tercer-IVA-mas-alto-de-America-Latina-y-se-ubica-por-encima-del-promedio-mundial.html

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, it will be difficult to ensure sustained financial support for areas such as education, R&D, environmental protection after 2020, when EU structural funding will finish. 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 it 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. In 2016, changes in tax rates were confined to higher rates for lotteries and similar gambling activities as the first step towards a stronger regulation and taxation of gambling. Partly due to measures adopted in 2015 to fight VAT fraud, tax collection substantially increased in 2016.

Citation:
European Commission (2017): Country report Czech Republic 2017. SWD(2017) 69 final, Brussels, 14-15. (https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-czech-en_1.pdf)

Germany

Score 7

In recent years, German tax policy lost steam. This was caused by macroeconomic as well as political factors. On the one hand, sovereign debt crises in other European countries favored Germany as a business location, signaling that there was no need to overhaul the tax system for competitive reasons. Moreover, zero percent interest rates on new government bonds and buoyant tax revenues indicated that there was no need to raise tax revenues further. According to the Ministry of Finance, between 2010 and 2015, total tax revenues have risen by more than 25% from €531 billion to €673 billion (Bundesfinanzministerium 2016), which enabled the ministry to achieve its aim of balancing the budget in 2014 and 2015 despite considerable costs related to the refugee crisis. In addition, the soaring labor market created significant surpluses in the social security system. As a consequence, the reform vigor of the previous decade gave way to a complacent uncertainty regarding the future direction of tax policy. The guiding principle of today is “steady as you go.” 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 2016a).

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 2016: 35).

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 relative competitiveness of Germany's tax system has continuously deteriorated since its last corporate tax reform in 2008 (Spengel and Bräutigam, 2015). The Global Competitiveness Report considers tax regulations and tax rates the two most problematic factors for doing business in Germany (Global Competitiveness Report 2016/2017). However, given to the overall positive economic environment these challenges have not as yet undermined Germany's relative attractiveness.

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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 the approaching 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 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 United Kingdom.

The indirect tax system is less progressive than the income tax and property-tax systems, and weigh 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. In October 2015, the European Commission delivered long-awaited judgments ruling that the tax deals between the Netherlands and Starbucks as well as Luxembourg and Fiat constituted illegal state aid.

Citation:
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 distrbited 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.

Since its first year in office, the Renzi government has introduced a number of new fiscal measures to reform the tax system. The government's fiscal policies have benefitted from a sharp decline in the interest rates paid on government debt. A tax credit for people in the lowest income brackets was introduced in 2014, and has been reaffirmed for 2015 and 2016. Meanwhile, the tax on financial assets was increased marginally, while income and corporation taxes were reduced. 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 Renzi government has introduced an on-line system for submitting income tax declarations, the 730 precompilato. The system replaces the old paper forms for the majority of income tax payers and has made it possible to double-check tax returns.

The shift to electronic invoices within public administration also increases the effectiveness of fiscal oversight.

New fiscal measures (accelerated write offs) to encourage investments in technological innovation introduced by the government will take effect from 2017. Major reductions in personal income tax, repeatedly announced, have been postponed for lack of resources. From 2016, taxpayers and land owners will benefit from the abolition of a public services tax on houses or flats used as a place of residence (Tributo per i servizi indivisibili, TARI).

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

Latvia

Score 7

Overall, Latvia has one of the lowest rates of tax in the European Union. However, more than in many other EU countries, the burden of tax falls disproportionately on wage earners, particularly low-income wage earners, as a result of its flat rate of tax.

With the aim of minimizing the tax burden for low-income groups, legislation was introduced during the economic and financial crises to reduce the tax rate for micro-enterprises. However, in November 2013, the parliament voted to gradually reverse this reduction, with rate of tax for micro-enterprises increasing from 9% to 15% by 2017. Significant changes are expected in 2017, which will mean that only micro-enterprises with a turnover under €7,000 will continue to be taxed at 5%. Enterprises with a turnover between €7,000 and €100,000 will be eligible for the 5% tax rate only during the first three years of operation. Additionally, micro-enterprises will be obliged to pay minimum mandatory social security contributions. In 2017, the payable minimum contribution will be €95.60 or 34.09% of three-quarters of the minimum wage. These changes to the tax system for micro-enterprises have been delayed during the final legislative phase, and are currently awaiting final changes and parliamentary approval.

Other tax policies have sought to increase the tax burden on the wealthy. Such policies have included the introduction of a tax on dividends and an increase in property tax. In 2016, a "solidarity tax" was introduced, which will be levied on any income exceeding the mandatory social security contributions ceiling. The rate of this tax has been set at 34.09%, of which 23.59% is to be paid by the employer and 10.5% by the employee. The constitutionality of this tax has been challenged in the Constitutional Court.

In 2012, the government reduced the rate of personal income tax for 2013 by one percentage point to 24%, followed by further reductions to 23% in 2015. The current rate of personal income tax remains 23%. Starting in 2017, the amount of applicable untaxable minimum is differentiated progressively (smaller income = larger untaxable minimum). In addition, tax allowances for dependents were increased in 2014, 2015 and 2016.

Latvia's corporate tax rate is 15%, one of the lowest in the European Union, which contributes to attractiveness for inward investment into the economy. The Foreign Investment Council's FICIL Sentiment Index 2015 notes, however, that while overall tax rates are attractive for investors, labor tax rates are excessive and do not compare favorably with other investment targets.

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%, but in 2015 at 1.3%.

Citation:
1. IMF (2015), Article IV Consultation, Available at: https://www.imf.org/external/pubs/ft/scr/2015/cr15110.pdf, Last Assessed: 20.05.2013

2. European Commission (2013), EU BOP Assistance to Latvia – Second Review Under Post - Programme Surveillance, Available at: http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/pdf/lv_efc_note_2nd_pps_mission_en.pdf, Last assessed: 21.05.2013.

3. Sauka, Arnis. The Investment Climate in Latvia: The Viewpoints of Foreign Investors. FICIL Sentiment Index 2015. FICIL, Stockholm School of Economics in Riga, 2015.

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, young first-time property buyers have been benefiting from a capped duty waiver since 2014. 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. In addition, there has been an annual increase in the income ceiling for those paying the 35% tax rate. A flat rate of 15% was introduced for income from all residential rentals.

However, the burden of taxation falls mainly on people in fixed and registered employment. Malta's informal economy is almost equivalent to 25% of GDP and its tax evasion controls are 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 and continued work to merge revenue departments into a single authority. The 2017 budget announced the setting up of a new unit to target tax evasion.

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. The EU's proposed Anti-Tax Avoidance Package, aiming to level the playing field in corporate taxation, has raised concerns that this might have implications for Malta's full imputation system. Nonetheless, the Ministry of Finance has confirmed that any potential negative effects on Malta's competitive tax regime have been averted. 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.

For the 2017 budget, the government announced several measures to promote competitiveness, including incentives for those investing in SMEs, start-ups launched by recent graduates, and income tax waivers on dividends paid to investors on the Malta Stock Exchange.

Citation:
https://ird.gov.mt/services/taxrates.aspx#2016
Budget Speech 2013 p. 14
Times of Malta 04/11/2013 Tax exemption for first-time property buyers announced
Times of Malta 13/10/2015 Changes in income tax
European Semester Thematic Fiche – Undeclared Work (Updated May 2016) p. 11
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
https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package_en
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
Budget 2017 Speech (Maltese) p. 98, p. 99, p. 106

Netherlands

Score 7

Taxation policy in the Netherlands addresses the trade-off between equity and competitiveness reasonably well. There is horizontal equity in that the taxes levied do not discriminate between different societal groups – especially men and women. The system is fully individualized. The Netherlands has a progressive system of income taxation which contributes to vertical equity. In general, income tax rates range between 30% and 52%. 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, 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.

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 next elections, after the political parties supporting the present tax system (which include both government and opposition parties) gained additional seats in elections for the upper legislative house. 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 Starbuck, 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

"Meer belasting gemeenten kan en helpt de democratie, in NRC-Handelsblad, 9 April 2015

NRC- Handelsblad, 'We hebben een geloofwaardig stelsel nodig'
Date: 17 September 2016

South Korea

Score 7

The South Korean tax system is fairly effective in generating sufficient public revenues without weakening the competitive position of the national economy. South Korea has one of the lowest tax rates in the OECD (as of 2014, tax revenues totaled about 25% of GDP). Taxes on businesses are relatively high compared to personal income taxes, and do reduce overall competitiveness. However, the corporate tax rate is relatively low compared to the OECD average. Tax instruments are used to nurture foreign direct investment, research and development, and human resource development. Equity is the system's primary weakness.

As of the time of writing, the government was preparing revisions of the tax law for 2017. However, debate regarding where taxes should be raised was intensifying.

Some opposition-party lawmakers submitted tax-code revision bills in 2016 aimed at raising the corporate-tax rate from 22% to 25%. The corporate-tax rate was cut from its previous level of 25% during President Lee Myung-bak's administration. Noting that the tax cut has not had the desired effect on the economy, opposition-party members said the hike would increase the government's tax income by around 3 trillion won, which would help defray snowballing welfare-system costs. However, the government and the ruling Saenuri Party, lobbied by the large conglomerates, elected not to include a corporate tax hike in the tax code revision that was announced in July 2016. The center of the current debate is the question of who should shoulder income-tax burdens, as too many workers are currently exempt from taxes. According to government statistics, 48% of workers pay no income taxes, up from 32% in 2012. This dramatic rise followed a tax revision aimed at lessening the burden on the working class, but could in turn shrink the middle class by increasing this latter group's tax burden. As contrast, just 15.8% of the working population in Japan and 19.8% in Germany are exempt from paying taxes.

Citation:
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"Korea to reduce consumption taxes to boost economy," Korea Herald, 2015-08-26
OECD (2016), Tax revenue (indicator). doi: 10.1787/d98b8cf5-en (Accessed on 30 October 2016)
"Government in dilemma over tax reform," The Korea Times, July 22, 2016. http://www.koreatimes.co.kr/www/news/biz/2016/07/488_210083.html
"Dozens of Korean names in leaked data on tax havens: ICIJ," The Korea Times, 24 April 2013

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.

Citation:
World Economic Forum 2015: The Global Competitiveness Report 2015-2016.

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. There was no change in income-tax rates over the review period, but the government has proposed a gradual increase in the taxation of superannuation for those on high incomes or high superannuation balances, and has also proposed reducing the company tax rate from 30% to 25%.

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

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

In 2008, the Labor government established a committee to review Australia's tax and transfer system, and make recommendations to improve its functioning. The committee identified several inefficient and inequitable aspects of the tax system, and recommended 138 changes. Few of the recommendations have been adopted. The coalition government subsequently released a discussion paper in 2015 outlining tax-reform issues for consideration and proposed a community consultation process. However, the only proposed reforms yet implemented involve changes to the taxation of superannuation, a slight reduction in income tax for individuals earning over 80,000 AUD and a reduction in the company tax rate.

With regard to sufficient inflow of tax revenue, as outlined in detail in "sustainable budgets," concerns have heightened in the review period that the federal government faces a structural deficit that will require difficult fiscal decisions in the near future, most likely involving a combination of reductions in spending and tax increases. Moreover, there is a long-standing concern about the fiscal sustainability of state and territory governments, which have very limited capacities for raising revenue. Growth in health and education expenditure demands on the states and territories 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.

Australian Government 'Re:think Tax Discussion Paper', March 2015: http://bettertax.gov.au/publications/discussion-paper/.

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

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 highest effective tax and social security wedge on labor in the OECD), which incentives tax avoidance and evasion. Conversely, many capital incomes (e.g., housing rents and capital gains) are either not taxed or inefficiently taxed.

Several factors have prevented the country from tackling these issues. There is a lack of political willingness to deeply reform the tax system and no common wealth registry to detect mismatches between declared income and spending. Also, the performance of the fiscal administration at the federal level is suboptimal.

As a result, within each income source (i.e., labor, capital and corporate), horizontal and vertical equity are guaranteed on paper, but differential treatment and lack of information undermine this principle. Nevertheless, low levels of inequality place Belgium among the most equitable countries (based on measured inequality; some sources of income are not declared, so it is hard to obtain accurate data).

The present government tasked itself with reducing the share of government spending in GDP. Its efforts have been, however, disproportionately focused on healthcare and social security spending, which may increase purchasing-power inequality in the medium term. Thus far it has not shown itself able to improve the performance of the federal fiscal administration.

In its March 2016 recommendations, the Council of Europe writes 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 onwards have not been sufficiently specified." They also emphasize that "There 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://data.consilium.europa.eu/doc/document/ST-9190-2016-INIT/en/pdf

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' 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 rose to 19% in 2014. A special levy on salaries is expected to stop in 2017, while 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. In 2015, limited changes were made in areas including property-transfer fees and capital-gains taxation. The share of salaried government employees paying income tax appears proportionally higher than that paid by self-employed and liberal professionals. Principles of equity are negatively affected by continued tax evasion and avoidance, while uncollected taxes amounted to 2.5 billion euros 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 European Union. Bilateral treaties also 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.

Though the tax system appears successful in general terms, tackling tax evasion and avoidance, and increasing tax-collection efficiency are essential for achieving systemic fairness.

Citation:
1. IMF Eight Review on Cyprus, September 2015, https://www.imf.org/external/pubs/ft/scr/2015/cr15271.pdf
2. Global Forum, Cyprus Tax Transparency Review Report - Phase 2, 30 October 2015, http://www.oecd.org/tax/transparency/cyprus-supplementary.pdf
3. Tax Chief backtracks on 'coffee shop' comment, Cyprus Mail press report, 2016, http://cyprus-mail.com/2016/09/30/tax-chief-backtracks-bit-coffee-shop-comment

Estonia

Score 6

Estonia is internationally known for its simple and transparent tax system. The income tax for individual tax payers is proportional, and corporations only have to pay income tax if their profits are not reinvested. Dividends are not subject to social insurance, and many small enterprises therefore prefer to pay dividends instead of wages. This policy is quite controversial, and dividends are likely to be subject to taxes in the near future.

The Estonian welfare system is financed almost entirely through social-insurance contributions. Although this Bismarckian principle has some advantages, it also has some weaknesses. First, high labor costs may weaken the country's economic position and 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 functioning under a condition of long-term financial austerity.

Iceland

Score 6

As a consequence of the 2008 collapse, the Sigurðardóttir cabinet (2009-2013) introduced a new three-bracket tax system for individuals which came into effect in 2010. On average, income tax rates rose from 2008, despite reductions for the lowest income earners. Capital gains tax rates were also raised from 10% to 15% in 2009 and to 20% in 2011. In contrast, corporate tax rates still remain at their 2008 levels.

Under the IMF-supported rescue program launched in late 2008, total tax revenue was projected to increase from 38% of GDP in 2009 to 44% in 2014, while government expenditure was expected to be reduced from 53% of GDP to 41% over the same period. However, events turned out rather differently. In 2009, while the government budget deficit was expected to equal 14% of GDP, the actual deficit was just 9%. Faced with a less unfavorable fiscal situation than expected, the IMF-supported program aimed to cut government expenditure from 50% of GDP in 2009 to 40% in 2017, while keeping tax revenue at 41% of GDP from 2009 to 2017. This would amount to a fiscal adjustment equivalent to 10% of GDP over an eight year period. This was an ambitious goal given that the adjustment is limited to reducing expenditure and not to increasing tax revenues.

Four reservations are in order. First, Iceland's public debt burden is understated in official statistics because unfunded public pension obligations are not included, which is rare in OECD country data. Second, the ratio of gross public debt to GDP shot up from 29% in 2006 to 95% in 2011 and has since declined to 55% in 2016

according to IMF figures. Even so, in 2016 interest payments on public debt cost the equivalent 3.5% of GDP compared with social benefits that cost 7% of GDP (IMF, 2016). Third, while the left-wing government of 2009-2013 increased fishing fees significantly and budgeted further increases, the center-right government of 2013-2016 reversed course by reducing fishing fees against IMF protest. At last, many public institutions remain in a dire financial situation, including the State University Hospital, universities and schools at all levels, and the State Broadcasting Corporation (RÚV).

Under the center-right government of 2013-2016 public expenditure and tax policy was reversed once again from a progressive stance to a regressive one.

Citation:
Statistics Iceland, "Lágtekjumörk og tekjudreifing 2003-2006" (Risk of poverty and income distribution 2003-2006), April 2009.
International Monetary Fund, Iceland: Staff Report for the 2016 Article IV Cconsultation, June 2016, https://www.imf.org/external/pubs/ft/scr/2016/cr16179.pdf, accessed 12 January 2017.

Israel

Score 6

Until recently, Israel followed a consistent policy of low income tax and small government. Accordingly, it initiated cuts on direct taxes for individuals and companies and reduced public spending. According to a 2016 OECD report, Israel's budget depends heavily on taxes. In the last two years, Israel has collected more taxes than originally planned. This has created a gap between GDP growth – which increased 34% over the last decade – and income growth – which only increased 5% over the last decade.

Israeli taxation policy is somewhat regressive. It includes raising indirect taxes such as VAT, which is applied equally to all products. Furthermore, although the direct income tax is progressively structured and a large share of the population makes too little to pay any income tax at all, the system creates a curve so that middle-income individuals pay more taxes than their high-income counterparts. The VAT rate is 17%, reflecting a one percentage point decrease that took effect in 2015. This decrease, decided upon by the PM and finance minister, was possible because of extra tax collection and meant to encourage economic growth. Officials with the Bank of Israel worried, however, that this VAT decrease would increase the government's budget deficit. On the whole, the current tax system lacks vertical equality. The distortion is an intentional economic strategy meant to induce growth by reducing the tax burden associated with investments and running a business. While controversial, it is not necessarily unfair.

Israel's taxation system is also not characterized by horizontal equity. For example, unlike in other OECD countries, parental tax reductions are provided to mothers but not fathers. Like most other countries, Israel utilizes its tax system as a political

instrument. For instance, it offers tax reductions to army veterans. In 2014, the Knesset proposed a law that aimed to assist first time home buyers and young families by offering a VAT exemption on the purchase, with preference given to veterans. Since Israeli Arabs, ultra-Orthodox citizens, new immigrants and others do not serve in the military, this law could be construed as an unequal tax benefit. Supporters of this and similar legislation argue that soldiers lose income while serving and thus deserve special assistance. From this perspective, the tax reduction serves as a restorative tool. After the law was approved in the beginning of 2014, a stagnation developed in the housing market, mostly among first time buyers who were eligible for the exemption. As a result, the law was withdrawn at the end of that year.

As a part of a general review of the state budget for 2017 and 2018, the government advanced a proposal from the current finance minister, Mosha Kahlon, that would impose an additional tax on citizens who own more than three apartments. However, it is unclear whether the proposal will be eventually approved, since many coalition members remain critical of it.

In most instances, the Israeli tax system has a valid rationale for tax reductions that appear to violate the principles of horizontal and vertical equality. Due to Israel's commitment to OECD guidelines and the influence of its powerful central bank, it seems likely that the state will continue to manage tax policy responsibly.

Citation:
”Tax reduction guide and tax coordination,” Israel government portal:
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http://www.nrg.co.il/online/1/ART2/819/029.html
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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 been clearly too high in international comparison. According to the tax reform law of spring 2016, the combined national and local corporate effective income tax rate will decline from 32.11% to 29.97% in April 2016, with a further reduction to 29.74% in April 2018.

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% in April 2017 were shelved in spring 2016. The decision is thought to have played a considerable role in the election success of the ruling coalition in the July Upper House elections. While such political motives, along with concerns that a tax hike during weak economic conditions could undermine domestic demand further, are understandable, the decision undermines government reliability.

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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Luxembourg

Score 6

During the last years, Luxembourg has struggled with the new EU and OECD tax regulations that have made it difficult for Luxembourg 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, and to the state budget as a whole.

In 2016, most global players in the country had negotiated positions that exempted them from corporate income taxes (2016: 21%), municipal business taxes (6.75%), a special contribution (7%), and net wealth taxes (0.5%). More than 50,000 companies had negotiated tax deals with the government that allowed them to channel profits through Luxembourg and reduce their overall tax obligations, though only 340 were named in the leaked PwC "Luxleaks" documents. Oddly, Fiat Finance Europe's landmark conviction is in some degree beneficial to Luxembourg, as the penalty payment (between €20 million and €30 million) goes to the state treasury. 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 European Union 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 introduced new e-commerce rules for the European Union, which undermined Luxembourg's business-friendly e-commerce VAT regime. This led to a decline in VAT revenue of approximately €650 million in 2015. To improve public finances, Luxembourg has implemented new tax rates. Several tax rates were increased, including an increase in general VAT from 15% to 17%. Nevertheless, Luxembourg continues to have the lowest VAT rate in Europe. The impact of the higher VAT rate and low interest rates will lead to slight increase in the inflation rate.

Important milestones include a major tax reform, first announced in 2014 and passed in December 2016, which focused on harmonizing individual and corporate tax systems. The government has also implemented a restructuring program to attract more foreign investment. In 2015, the process of declaring VAT was simplified by the introduction of an electronic information system. In September 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 bitcoin exchange in Luxembourg and is planning to offer legal services in electronic payments.

Luxembourg's financial center has become 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 June 2016, the Luxembourg investment fund industry was home to €3,461 trillion in net assets, with 3,887 funds (and 14,208 fund units). Following a massive slump in the previous year, Luxembourg's investment funds deposits increased by 2.7% in the first semester of 2016. Furthermore, Luxembourg is a European leader for responsible investment fund management. Overall, the number of employees in the financial sector rose from 44,038 in 2014 to 45,097 in June 2016.

A PwC 2015 business report ranked Luxembourg favorably. The total tax rate, after deductions and exemptions, is currently 20.2% down from 20.7% in 2014. This is the second lowest total tax rate among European and European Free Trade Association countries, behind Croatia. 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 shows 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.

However, Luxembourg will implement an overall tax reform in 2017. Following international standards on tax competition, Luxembourg will reduce corporation tax

by 2% to 19% in 2017 with a further reduction to 18% planned for 2018. Meanwhile, higher personal tax allowances and income tax reductions will benefit middle class taxpayers.

Citation:
17th Update of the Stability and Growth Programme of the Grand Duchy of Luxembourg for the 2016 - 2020 Period. Le gouvernement du Grand-Duché de Luxembourg, 2016. www.mf.public.lu/publications/programme/17th_update_stability_growth_programme.pdf. Accessed 21 Feb. 2017.

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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. Tax reform had not featured very prominently on the agendas of the previous governments, except a new Tax Administration Act that was adopted in July 2015 and reduced the fragmentation of the tax administration, assigned more tax administration staff to inspection and enforcement, and reduced the number of documents required by tax payers.

For the PiS government, the problem has not been the lack of tax reform, but the frequent changes and the uncertainty over major reforms. In 2016, it adopted further measures to improve VAT collection and extended the application of the higher VAT rates for 2017-18 (previously set to expire at end of 2016). It 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. The introduction of two new taxes – a progressive retail tax on supermarkets and a tax on bank and financial institutions assets – stirred controversy with the European Commission, which has criticized both taxes for violating EU competition rules. In the case of the retail tax, the tax was suspended before it was actually levied when the European Commission opened an investigation of the policy. The PiS government has announced further measures to reduce the tax burden for people with low and medium incomes, but failed to specify them during the period under review.

Citation:
European Commission (2017): Country report Poland 2017. SWD(2017) 86 final, Brussels, 16-19 (https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-poland-en.pdf).

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. The third Fico government changed course by reducing the corporate-income tax rate from 22% to 21% for 2017. At the same time, it extended the levies on companies in regulated industries and on banks, which had been expected to expire in 2016, and re-increased lump-sum deductions for the self-employed, which were reduced in 2012 to ensure a more equal taxation of the self-employed and employees. Other measures have included a new 8% tax on non-life insurances and an increase in excise duties on tobacco and fees on gambling. The stop-and-go in taxation has been criticized for undermining certainty.

Citation:
European Commission (2017): Country Report Slovakia 2017. SWD(2017) 90 final/2, Brussels, 14-15 (https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-slovakia-en_0.pdf).

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Austria

Score 5

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

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

According to the most recent OECD data for the 2012-14 period, the tax burden for economically rather weak actors such as single parents with two children has continued to increase. Austria now has the second highest tax burden for single earners in the OECD.

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

Taxation has become a hot-button issue within the grand (Social Democratic Party of Austria, SPÖ - Austrian People's Party, ÖVP) coalition cabinet. The social democrats, in alliance with the unions, favor a significant shift away from the burden employees have to bear. The conservatives as the party of "fiscal discipline" are very skeptical of any changes as long as the budget cannot be balanced, and are generally against any form of property or inheritance taxes. In 2016, the social democratic chancellor proposed an increase of the tax burden of major properties but it seems unlikely that this proposal will find a majority in parliament.

Citation:
Tax burden 2015: http://www.oecd.org/ctp/tax-policy/taxing-wages-tax-burden-trends-latest-year.htm

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 fifty 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.

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 sufficient to prevent the emergence of high budget deficits. Tax revenues stem from a broad range of taxes, with a high percentage of about 40% of all tax revenues coming from social insurance contributions. A progressive income tax with rates of 16%, 27%, 41% 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 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 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. From 2017, the tax burden on personal income, including performance and Christmas bonuses, will be reduced, among other things by introducing a new tax bracket and by replacing the 41% tax rate with two rates of 34 and 39%. Contrary to the original plans of the Ministry of Finance, the top income tax rate of 50% will be kept. In order to compensate for the decline in personal income tax revenue, the corporate income tax rate will increase from 17 to 19% in 2017. Business organizations have complained that this rise 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.

Citation:
European Commission (2017): Country Report Slovenia 2017 Including an In-Depth Review on the prevention and correction of macroeconomic imbalances. SWD(2017) 89 final, Brussels, 25-27

(https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-repor t-slovenia-en.pdf).
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Slovenian Times (2016): Mini tax reform finalized, July 12, 2016 (http://www.sloveniatimes.com/mini-tax-reform-finalised).

Spain

Score 5

Spain collects less in taxes relative to wealth than do most other euro zone countries. Tax revenue totaled 37.3% of GDP in the period under review, as compared to an EU average around 45% (47.9% in France, 43.5% in Italy or 40.6% in Germany). At the end of 2015, the governing center-right Popular Party (PP) government 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 most of 2016, this change was compatible with the goal of reducing the public deficit, as it is assumed that the economic-stimulation effect may counterbalance reductions in some tax rates.

Tax policy only partially achieves the objectives of equity, competitiveness and sufficiency in Spain. The country's currently high levels of public deficit and debt (see "Budgets" section) highlight the deeply unbalanced relationship between public revenues and spending. Although this may be attributed to the crisis that shook the country from 2008 to 2013, previous budget surpluses (from 2005 to 2007) were largely derived from the real-estate boom, and vanished once the bubble burst. Nevertheless, expenditures continued to grow. 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 (which is much easier for companies and professionals to commit than for medium- and low-income taxpayers) and 3) the scope of the underground economy, from which the state does not collect taxes at all. Finally, recent increases in indirect taxation may have rendered the tax system less competitive.

Although the Spanish tax-collection agency (AEAT) is generally efficient, it has limited resources. A more radical reform of the taxation agency, which would expand its human, ICT and financial resources, is clearly needed.

Citation:
Heritage Foundation (2015). Index of Economic Freedom

Turkey

Score 5

General government revenue increased from 39.6% of GDP in 2014 to 40.7% in 2015. In 2014, taxes accounted for 52.4% in 2014 and 52.5% in 2015. As a result,

tax revenue totaled 21.4% of GDP in 2015.

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 2015, 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 2012, 66.6% of total tax revenues were derived from indirect taxes. This share amounted to 68.1% in 2015.

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.

In the 2012 year-end negotiations to prevent the so-called fiscal cliff, tax increases and spending cuts, Congress and the president agreed on limited increases in revenues. Increased revenues came mainly from raising the top income tax rate to 39.6%. With partisan gridlock preventing action, tax policy has seen little change since 2012. The 2016 tax policy discussion was dominated by opposing, often highly implausible, promises of the presidential candidates. President's Obama's budget FY 2017 would raise about $3.2 trillion in new tax revenue over the next ten years from a diverse set of sources, primarily wealthier taxpayers and large corporations.

Croatia

Score 4

In Croatia, the share of tax revenues in GDP is low compared to other EU countries. This is partly due to a high degree of tax evasion and an inefficient tax administration. While Croatia has a progressive personal-income tax, the

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

During its first years in office, the Milanović government tried to shift the tax burden from social-insurance contributions to consumption taxes. Later on, it focused on boosting the personal consumption of the middle class by reducing income tax. The Orešković government failed to implement any changes in taxation. By contrast, tax reform has been among the top priorities of the Plenković government. Immediately after coming to office, it presented a comprehensive package of 15 tax reforms. Beginning in 2017, these provide for a simplification and reduction in personal income tax, rationalization of corporate income tax, a one-off incentive for the writing-off of non-performing loans, and a shifting of VAT rates for goods and services. In 2018, a property tax will be introduced.

Citation:
European Commission (2017): Country report Croatia 2017 Including an In-Depth Review of the prevention and correction of macroeconomic imbalances. SWD(2017) 76final, Brussels, 22-23 (https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-repor t-croatia-en.pdf).
Government of the Republic of Croatia (2016): Prime Minister Plenkovic: Tax reform aimed at boosting growth and employment, November 11 (https://vlada.gov.hr/news/prime-minister-plenkovic-tax-reform-aimed-at-boosting-growth-and-employment/19643).

France

Score 4

Taxes and social contributions amount to 48% of GDP, one of the highest levels in the OECD. This is the consequence of extraordinarily generous political and budgetary commitments, which have led to continuously rising taxes. Nonetheless, tax revenues do not cover costs, as public spending is exceptionally high by western standards (56.8% of GDP in 2015, compared to the EU-28 average of 47.4%).

A narrow income-tax base and a wide range of fiscal exemptions have resulted in an opaque, confusing and inequitable tax system. A small number of people (13 million) officially pay income tax and 90% of the total tax collected is paid by 10% of the taxpayers. To alleviate the burden on this taxpaying minority, many loopholes have been created with the additional purpose of directing exemptions toward targeted sectors (housing, small companies, overseas territories). Hollande, who at

the time of his election, committed to drastically reduce these "fiscal niches", has eliminated some but considerably increased others, such as one favoring the productive sector (the 2017 draft budget still foresees €87 billion in exemptions). The defects of the system have been further exacerbated by a reduction in the number of income-tax payers, shifting the burden partly onto very wealthy families and mainly onto the middle class.

Corporate tax and other levies are too high in international comparison, a clear handicap for the competitiveness of French companies, despite measures reducing corporate burdens by €30 billion.

The entire tax system requires an overhaul, but the political cost would be such that most governments have instead preferred a policy of constant and somewhat incoherent minor adjustments, rather than thoughtful, long-term reform. This has been true for the Sarkozy administration (2007–2012) as well as for the Hollande administration. The Socialist government increased value-added tax, eliminated loopholes, increased income taxes, introduced additional levies on companies' profits and adopted a "super tax" on the wealthiest individuals (75% marginal tax rate on incomes over €1 million), a highly ideological measure which soon had to be diluted, did not produce notable revenue and was subsequently cancelled in 2015. All this provoked tax revolts, tax evasion and, together with the lack of growth, reduced state revenue. Overall, since 2015, 35 billion additional euros have been raised mainly from the middle class. The government preference for tax increases rather than budgetary economies had lasting economic effects, such as on investment and consumption, as well as political effects. In spite of government efforts to alleviate the tax burden in 2015 and 2016, mainly for the poorest taxpayers, the Hollande era is perceived as a period of over-taxation and of mediocre results by a large majority of the public.

The rather dramatic situation faced by French companies forced the government to adopt a plan for rescuing them by lowering taxes and levies. The rather cumbersome and complex system initially put in place was simplified in 2014. According to an impact study, it will reduce the fiscal burden on companies by €32.5 billion for the period 2015-2017, which represents an increased profit rate of 2% of sales. This provides greater leeway for companies, but has not yet induced increases in investment, innovation or competitiveness.

After having added 1.3 million taxpayers to the tax roll in 2014, the 2015 budget exempted from income tax nearly 1.8 million taxpayers. In 2016 – the last year before the next presidential and parliamentary elections – it is expected that 3 million taxpayers will pay less taxes or be exempted.

In summary, the Socialist Party-led government's policies reflect the pursuit of short-term political, or clientelistic, aims with a preference for taxing rather than saving. A recent example of this policy inconsistency was the government's 8 October 2014 announcement that it would abandon plans to implement the so-called

ecotax when faced with protesting trucking companies. Hollande also announced that there would be no new taxes until 2017, but a number of technical tricks and adjustments have bypassed this commitment. Further pre-electoral commitments will make the search for a balanced budget even more problematic while the public debt slowly but steadily increases.

Citation:
Natixis Flash économie: France - Pacte de responsbilité et de responsabilité: les branches qui gagnent. Nr. 379, 18 May 2015.

Greece

Score 4

In 2015, Greece ranked 14th out of 35 OECD countries in terms of the tax-to-GDP ratio: Greece had a tax-to GDP ratio of 36.8% compared with the OECD average of 34.3%.

In 2015, political instability has hampered tax collection, as the Syriza-ANEL government twice reshuffled the cabinet, including ministers in charge of the state’s finances and tax collection. Even so, in contrast to its predecessors, the new government upgraded the fight against tax evasion by establishing a new anti-corruption minister post with a focus on tax evasion.

According to Greece’s third adjustment program, raising government revenue should have been effected through a combination of tax increases and privatization, but the Syriza-ANEL government has been, at least discursively, hostile to any privatization. It has thus preferred to increase taxes and broaden the tax base.

This is easier announced than implemented as during the tourist season, income raised in small and very small businesses remains undeclared, while throughout the year an unknown share of income raised in liberal professions also remains undeclared (e.g., engineers, lawyers, medical doctors and dentists as well as craftsmen, plumbers, electricians and computer technicians).

Frequent changes in tax legislation and government indecisiveness during 2015 and 2016 did not help either. Tax revenue still derives primarily from indirect taxes (at 57% is the highest percentage in Europe), such as taxes on the use of oil products (gasoline, heating oil) and VAT. In relation to other OECD countries, Greece receives lower tax revenues from personal income, profits and gains, corporate income and gains and property. In 2015, the VAT on restaurant and coffee shop consumption was raised to 23% (up from 13% in 2013-2014). In June 2016, the VAT was raised again, this time to 24%. In January 2016 the government increased corporate income tax rate to 29% from 26%. Also, Greek companies now have to pay 100% of their estimated annual taxes up front, versus 80% previously. A higher dividend tax follows in 2017.

The fiscal situation was not helped by promises from the Syriza party, winner of the 2015 parliamentary elections, that it would abolish the landed property tax (ENFIA). Neither this nor similar populist promises, such as increasing wages or salaries, were kept. ENFIA is important for the state budget since it brings revenues of €2.5-3.0 billion per year. It was reported this contributed to a fall in house prices and led to disinvestment in the housing industry, an important sector in the Greek economy.

In the meantime, 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 in 2015 and 2016.

As it had been the case before 2015, the government raised both direct and indirect taxes, while it proceeded with cuts in social spending, particularly in pensions. As long as such tax policy issues are constantly under revision, the business environment of Greece will not stabilize and progress will not be achieved in improving horizontal or vertical equity.

With the exception of indirect and real estate taxation, there are no signs of over-taxation in Greece when compared to other OECD countries. However, the personal income tax is unevenly distributed. The IMF has consistently argued that the Greek government should reduce the income tax threshold to 5,000 euros per year since half of the salaried workers in the country are exempt from paying income taxes, compared to the Eurozone average of only 8 percent.

Portugal

Score 4

The very high levels of taxation on income and consumption noted in the previous SGI report have remained in this period. The Costa government's 2016 budget partially alleviated the previous government's extraordinary income surtax, though without removing it. Moreover, it has not changed the high tax rates introduced in the 2013 budget. Moreover, the alleviation of some austerity measures was compensated through an increase in consumption taxes, notably on fuel, tobacco and cars.

Tax policy continues to fall well short of horizontal and vertical equity. 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 lower for comparatively profitable companies. Furthermore, the considerable dependence of public finances on indirect taxation, such as value-added tax, fails to satisfy the vertical-equity criterion.

While the Costa government's program indicates a commitment to combating tax evasion and making income tax more progressive, little change has changed during the period under review.

Romania

Score 4

Romania's tax system has generated relatively little revenue. Despite a cut in the standard VAT rate from 24 to 20% in January 2016 and down to 19% in January 2017, as adopted under the Ponta government in 2015, the system still strongly relies on indirect taxes. This may favor economic growth, but it clearly infringes upon vertical equity, as does the 16% flat income tax rate in place since 2005. Despite the adoption of various anti-fraud measures, tax compliance has been low, partly because of the low efficacy of the National Tax Administration Agency (ANAF). The high VAT gap, the largest in the EU, has led the Ministry of Finance to explore the implementation of reverse taxation. Under the Ciolos government, tax policy suffered from a lack of certainty. Several times, the PSD-majority parliament passed tax measures that were subsequently blocked by the government. In September 2016, the Ciolos government seriously considered overhauling the Fiscal Code via an emergency government ordinance, i.e., by circumventing the normal legislative process.

Citation:
European Commission (2017): Country report Romania 2017. SWD(2017) 88 final, Brussels, 14-15 (https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-romania-en.pdf).

Hungary

Score 3

Hungary's tax system has become less equitable under the Orbán governments, as the tax burden has shifted from direct to indirect taxes. Moreover, social insurance contributions and the tax wedge have remained high. The taxation of corporate income has been characterized by a high degree of differentiation and frequent changes. In the second half of November 2016, the government adopted a new reform package that included the introduction of a uniform corporate income tax of 9% (replacing a two-tier system with rates of 10 and 19%) as of January 2017 and a cut in employers' social security contributions by seven percentage points in 2017 and 2018. With the introduction of the lowest corporate income tax rate in the EU, the tax burden especially on larger companies will substantially decrease. However, companies will still struggle with a complex tax regime, include the high sectoral taxes which remained largely unchanged in 2016. The cut in employers' social security contribution, though partly compensated for by cuts in allowances and the increase in the minimum wage, will reduce the tax wedge and non-wage labor costs.

As of January 2016, the National Tax Authority (NAV) was reformed under its new president András Tállai. The fact that Tállai has kept his position as state secretary in the Ministry of National Economy has raised fears about a politicization of the agency. 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 towards favoritism. So has the government's recent attempt to induce companies to contribute to sport organizations by granting them tax deductions, but also secrecy and a special taxpayer status.

Citation:
European Commission (2017): Country Report Hungary 2017. SWD(2017) 82 final/2, Brussels, 14-16 (http://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report -hungary-en_1.pdf).

Address | Contact

Bertelsmann Stiftung
Carl-Bertelsmann-Straße 256
33311 Gütersloh
Germany
Phone +49 5241 81-0

Dr. Daniel Schraad-Tischler
Phone +49 5241 81-81240
daniel.schraad-tischler@bertelsmann-stiftung.de

Dr. Christian Kroll
Phone +49 5241 81-81471
christian.kroll@bertelsmann-stiftung.de

Dr. Christof Schiller
Phone +49 5241 81-81470
christof.schiller@bertelsmann-stiftung.de

Pia Paulini
Phone +49 5241 81-81468
pia.paulini@bertelsmann-stiftung.de

www.bertelsmann-stiftung.de
www.sgi-network.org

BertelsmannStiftung