Taxes Report

Tax Policy

Sustainable Governance Indicators 2019

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% and 31.25% (2018). Municipal taxes range from 17% to 22.5%, depending on the municipal authority. In 2018, the average overall personal income-tax rate was 51.6%. Generally speaking, demands for vertical equity are largely satisfied. However, this is less true for horizontal equity. The corporate income-tax rate was lowered in January 2014 from 24.5% to 20%, which is less, on average, than in other Nordic countries and EU member states. Adjustments in recent years have made Finland's taxation system less complex and more transparent. Finland performs well in regards to structural-balance, redistributional effects and overall taxation policies generate sufficient government revenue. There has thus far been no major shift away from the taxation of labor toward environmental taxation; the environmental taxes' share of tax revenues remains moderate. Taxes are generally high in Finland because the country has expensive health care and social-security systems, and also operates an efficient but costly education system. In Finland, the public in general has a favorable attitude toward high taxation. In polls in recent years, 96% of respondents agreed that taxation is an important means of maintaining the welfare state, and 75% agreed that they had received sufficient benefits from their tax payments.

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

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 ten percentage points higher if contributions to these two programs were included. This would bring Switzerland up to the OECD average in terms of public revenue.

Tax policy does not impede competitiveness. Switzerland ranks at the top of competitiveness indexes, and given its low level of taxation is highly attractive for corporate and personal taxpayers both domestically and internationally. Tax policy has contributed to an excellent balance between revenues and expenditures. Switzerland has very low public debt (29.5% of GDP in 2017) and a positive financial balance – that is, the government's revenues exceed spending.

The country's tax policy has come under scrutiny from the OECD and European Union for treating domestic and some international firms differently on the cantonal level. These international firms have their regional headquarters in Switzerland – employing more than 150,000 and contributing substantially to tax revenue – but do most of their business abroad. Examples includes Accor, Hewlett Packard, Philip Morris, C&A, Google and eBay. In response to the scrutiny, the federal government introduced a reform of corporate-taxation policy. This reform would have prohibited Swiss cantons from taxing the profits of domestic and international firms differently. In order to retain the international firms, the government's proposal aimed to lower taxes on all firms, irrespective of whether they are domestic or international. This first reform proposal failed in a popular vote in 2017. There were two major explanations for the no-vote. First, about a third of respondents said they felt insufficiently informed and were uncertain, and therefore opted against the reform. Second, another large share of respondents thought that the reform was too biased in favor of large enterprises and "the rich." In 2017, a quid pro quo was agreed to. The tax reductions of the original reform proposal have been largely retained. In order to win the support of politicians on the political left, contributions to the first pillar of the pension system (AHV) will be increased by the same amount as taxes are reduced for firms. These additional resources for the AHV will be generated through increased contributions from the federal state as well as from increased social security contributions from employers and workers. At the time of writing, it is unclear whether this compromise will be subjected to a popular vote.

Citation:
https://www.bfs.admin.ch/bfs/de/home/statistiken/oeffentliche-verwaltung-finanzen/ausgaben-schulden.html

Canada

Score 8

Like other Western economies, Canada has seen the share of total income going to the top 1% of earners increase dramatically since 1980. Moreover, the earnings of male workers have stagnated as labor demand has polarized due to changes in technology and trade.

The income-tax system is reasonably progressive and continues to be useful in equalizing after-tax incomes for lower income brackets. According to the Conference Board of Canada, there are now almost 200 tax breaks for federal income-taxpayers, resulting in an estimated CAD 100 billion of foregone tax revenue annually. Some experts have argued that the multitude of overlapping tax expenditures benefit high income individuals at the expense of low-income households. In 2016, the government 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 and the United States. The 2018 budget introduced the Canada Workers Benefit (CWB) as a refundable tax credit intended to supplement the earnings of low-income workers and improve work incentives for low-income Canadians. The move was welcomed by experts, as the CWB has higher benefits and is more easily accessible than its predecessor, the Working Income Tax Benefit, which was widely considered ineffective.

In terms of tax competitiveness, Canada fares well. There is no double taxation at the corporate or individual level. 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. Though some experts say that there is further room for improvement. Capital taxes have been largely eliminated. A 2018 U.S. tax cut, which implemented a series of corporate tax relief measures, is a concern, as it could trigger a loss of tax revenue and investment. The development has put some pressure on the government to respond, but the Trudeau administration has taken its time to respond and perhaps wisely so.

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

Department of Finance, Government of Canada, “Introducing the Canada Workers Benefit”. posted at https://www.fin.gc.ca/n18/docs/18-008_5-eng.pdf

Denmark

Score 8

The extensive welfare state is funded through a tax burden above 50% of GDP. This is among the highest within the OECD, although it should be kept in mind that unlike many other countries, all transfers in Denmark are considered taxable income. The tax structure differs from most countries in that direct income and indirect (VAT) taxation serve as the predominant taxes, while social security contributions play a modest role.

Large and small tax reforms have been implemented over the years following an international trend of broadening tax bases and reducing marginal tax rates (implying less progression). Decreasing income tax rates have, to a great extent, been financed by broadening the tax base, especially by reducing the taxable value of negative capital income (the majority of house owners have negative capital income because of mortgage interest payments). In 2004, an earned income tax was introduced to strengthen work incentives. Environmental taxes have also been increasingly used.

An important issue in policy design is tax competition. This has led to reduction of some excise taxes to reduce “border” trade. Corporate tax rates have also been reduced from 50% in 1986 to 22% at present, although the tax base has been broadened.

A recurrent issue in tax debates has been the role of the so-called tax freeze introduced by the previous government and, which, among other things, has implied a freeze of property taxes (the taxation of the user value of owner-occupied housing based on the current value of the house). This tax freeze was a contributing factor to the house price boom prior to the financial crisis. In 2017, a “house-tax” reform was approved, but its implementation has been postponed. The new tax system will be based on an assessment of property values and the statutory tax rate will be lowered. A number of transition rules are associated with the reform to ensure that no homeowner will experience an increase in tax on their property.

Further reductions in labor taxation were discussed, but political views differed regarding whether they should target low-income or high-income groups (lowering the top marginal tax rate). In the run-up to the upcoming parliamentary elections (which must take place before June 2019), it looks as if tax reductions have been put on the back burner to the chagrin of the Liberal Alliance party, which has been the leading advocate of tax reductions. The prime minister did not discuss taxes in his opening speech to the parliament on 2 October 2018.

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 2018.

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. Taxes on labor (personal income tax and social security contributions), which combined are above the average tax burden on labor in the EU, have become a barrier to the competitiveness of Lithuanian businesses. Furthermore, there is significant tax evasion. According to the European Commission, the VAT gap (as a percentage of theoretical VAT liability) is significantly higher than the EU average. In its 2018 report, the European Commission recommended improving tax compliance and broadening the tax base to sources less detrimental to growth.

In terms of horizontal equity, there are mismatches between various groups of economic actors with similar tax-paying abilities. Labor is taxed somewhat more heavily than capital, while specific groups such as farmers and lawyers benefit from tax exemptions. Previous governments have reduced the number of exemptions given to various professions and economic activities with regard to personal-income tax, social-security contributions and VAT. Social-security contributions are high, exceeding 30% of wages. While there are ceilings on payments from the social-security fund (pensions), there are no ceilings on contributions to it. The implementation of the new “social model” reduced social security contributions for employers by 0.5% from 1 July 2017 and will gradually introduce a progressive cap for employers’ contributions. Also, as of 1 January 2012, the tax base was broadened through a new tax on individuals owning residential real estate valued above €290,000, with a 1% rate on the value above this amount. In 2015, the value at which property tax must be paid was lowered to €220,000, while the rate was reduced to 0.5%.

In terms of vertical equity, the Lithuanian tax system to a certain extent imposes a higher tax burden on those with a greater ability to pay taxes, insofar as large companies pay larger sums than do small companies, but there is a flat income-tax rate of 15%. However, an element of progressivity is introduced through the use of an untaxed income threshold currently fixed at around €1,633 per year, thus favoring those receiving lower wages. The government increased the income tax threshold from €200 per month to €310 per month in January 2017 and again to €380 per month in 2018 (with further variation depending on income level) to make the income tax system more progressive.

In terms of revenue sufficiency, despite the fact that a process of fiscal consolidation has occurred on the expenditure side, some gap between tax revenues and government expenditure remains. However, it is less an outcome of low taxation than a significant shadow economy, extensive tax avoidance, and insufficient structural reforms in education and health care (where budgetary resources are dispersed across many organizations, despite a declining population and low quality of service provision). Social-security contributions are a particular concern, as this gap has led to significant indebtedness within the State Social Security Fund. 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 in recent years; attributed partly to improvements in tax administration and partly to a reduction in fuel and tobacco-product smuggling from Russia's Kaliningrad region and Belarus (due to the general decline in trade with Russia).

In 2018, the Lithuanian parliament adopted changes to the individual income tax system that will take effect in 2019. The main goals of the reform are to ease the overall tax burden on labor, in particular for low and medium wage earners, and to make the social security contribution system clearer and more transparent (by assigning responsibility for paying social security contributions to employees rather than employers). To compensate employees for this shift in the tax burden, gross salaries will be recalculated by 28.9%. Furthermore, ceilings for social security contributions will be applied to incomes exceeding a threshold beginning in 2019. Also, a shift from a single rate of personal income tax (15%) to a progressive income tax system will be implemented. The standard rate of 20% will be applied for employment-related income up to the ceiling for social security contributions, while income exceeding that ceiling will be subject to a higher rate of personal income tax (27%). Despite these efforts, additional steps are necessary to extend the revenue base and develop a more efficient tax system.

Citation:
COMMISSION STAFF WORKING DOCUMENT, country report Lithuania 2018: https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-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.

Netherlands

Score 8

Taxation policy in the Netherlands addresses the trade-off between equity and competitiveness reasonably well. Looking at average income, pre-taxes in the Netherlands have a Gini coefficient of 0.563 (in 2015), after-taxes (and other redistributive measures) it is only 0.295 (in 2015). However, including wealth, the

Gini index jumps to 0.92. The Netherlands has a progressive system of income taxation which contributes to vertical equity. In general, income tax rates range between 30% for lower and 52% for higher income levels. There is a separate tax for wealth. Indirect taxes and local taxes hit lower income groups most. Yet, tax pressure for every income group, from low to high, allegedly is approximately 37%. Yet, partly as a result of ad hoc measures to alleviate crisis impacts, the tax system loses credibility because of its increasingly unequal treatment of different groups. For example, between self-employed and employed workers, between entrepreneurs operating as sole traders or private limited companies, between single-parent families and families where both parents earn a living, and between small savers and the very wealthy. There is more inequality than meets the eye. In particular, middle-income families only manage to make ends meet because women are working more; increasing the number of hours worked per household and the female labor participation rate.

Therefore, the Rutte III government has announced a general tax reform based on a “social flat tax” or a two-tier system of income taxation (a 37% lower and a 49.5% higher tax bracket). The government predicts that this would benefit over five million Dutch mid-income employees. Other measures envisage an increase (from 6% to 9%) of the lower VAT rate, and an accelerated decrease in mortgage subsidies. Corporate taxes will also be lowered to 15% for SMEs, and 21.5% for larger and multinational corporations. Tax policy debates in 2017/18 were dominated by a highly contested, presumably lobby-group induced, government proposal to completely abolish dividend taxation, generally viewed as a “present to big foreign companies.” When it became clear that this proposal was politically unacceptable, the debate refocused on whether the money involved (almost €2 billion) ought to be spent on wage increases and a reduction of labor shortages in the care, police and education sectors; a further reduction of state debt; or to private enterprise to improve the Dutch investment and location climate. This latter alternative proved to be the stronger one.

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.

Citation:
WRR, Economic inequality in the Netherlands in 8 figures, 2014 (Rijksoverheid, consulted 23 October 2018)

CBS, Parade van Pen: de vermogensverdeling in 2015, 8 July, 2017 (consulted 23 October 2018)

NRC-Handelsblad, Hoe lap je een regeerakkoord op, 17 October, 2018

Follow the Money, Afschaffen dividendbelasting is cadeautje voor de trust-sector, 12 May, 2018 (ftm.nl>artikelen, consulted 23 October 2018)

New Zealand

Score 8

Taxation policy in New Zealand has been relatively successful in promoting competitiveness and the efficient allocation of public revenues. Available studies suggest that compliance costs are fairly low and that key strengths of the tax system are its very lean business environment and relatively simple legislation. But the system exhibits weakness in achieving vertical equity and addressing inequality in society. The personal income tax system is less effective in reducing inequality compared to most other OECD countries. The same can be said for the inequality-reducing effects of the tax and transfer system, which are similar to those of Canada, but smaller than 26 other OECD countries.

For the 2015/16 year, central government taxes represented 30.5% of GDP and local government taxes represented 2.2% of GDP (combined OECD average was 34%). The largest share of revenue comes from personal income, together with company and goods & sales (GST) taxes. New Zealand does not have social security taxes and there is no tax on capital gains, although a “bright line” tax was introduced for property investors in 2015 (see below).

New Zealand collects the fifth highest amount of personal tax as a percentage of GDP among OECD countries. The personal income tax system is based on a broad-based, low-rate framework with a relatively flat tax scale (the top tax rate begins to apply at the relatively low level of 1.2 times the average wage). While the country has the sixth lowest rate of GST, collections amounted to 31% of total tax revenue in 2017 and about 10% of GDP, the highest proportion in the OECD. GST is regressive, with the lowest decile of households by income paying approximately twice the proportion of their income in GST than the highest income households Corporate taxes, which comprise 4.4% of GDP at a rate of 27% in 2017, are higher than the OECD and international average.

In 2010, the National government reduced personal income and company tax rates while at the same time increasing GST rates. As a response to rapidly increasing property and housing prices, in 2015 the government introduced a “bright line” tax on investors who sold their residential properties (other than the family home) within two years of purchase. In the lead-up to the 2017 general election, the National party announced a NZD 2 billion per year Family Incomes Package that would have raised the tax thresholds from April 2018 and made changes to the Working for Families and Accommodation Supplement policies. Immediately on coming into office, the new Labour-NZ First coalition government canceled these planned tax cuts, boosted family tax credits instead, and initiated a program of “free” tertiary education for new entrants. Moreover, the government reinstalled the Independent Earner Tax Credit, an entitlement for individuals who earn between NZD 24,000 and NZD 48,000 (after expenses and losses) a year, in July 2018.

In December 2017, the government established a Tax Working Group led by a former Finance Minister, Michael Cullen, with the stated goal of exploring “further improvements in the structure, fairness and balance of the tax system.” The Working Group will report to the New Zealand government on matters such as the fair operation of the tax system in relation to taxpayers, income, assets and wealth, whether the tax system promotes the right balance between supporting the productive economy and the speculative economy, and how the system could be made more fair, balanced and efficient. In September 2018, the group published its first interim report.

Citation:
Trevett, Claire, 2017. Election policies: Swords flash in tax battle. New Zealand Herald. 6 September 2017 (http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=11917669).
Inland Revenue 2017. The New Zealand tax system and how it compares internationally.
Evans, Chris/Tran-Nam Binh 2014. Tax Compliance Costs in New Zealand: An international comparative evaluation. WP 02/2014. Victoria University of Wellington. http://nzpublicfinance.com/wp-content/uploads/2014/08/20140611-Tax-Administration-WP02_-Evans_REVISED.pdf
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Tax Working Group. 2018. Future of Tax: Interim Report. https://taxworkinggroup.govt.nz/resources/future-tax-interim-report

Norway

Score 8

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.

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 so 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.

Taxes are obviously central to budget balance or surplus. The economic boom of the past few years have helped the government balance the budget and reduce the national debt. In 2017, the budget surplus was some SEK 61 billion, roughly equal to €10 billion.

Tax policy is less of a factor in national competitiveness today than it was 10 to 15 years ago when economists pointed to the high-income tax levels as a major impediment to the competitiveness of Swedish businesses. The first two budgets of the red-green government, however, signal a return – however modest – to a philosophy of higher levels of taxation and public spending, rather than incentives, as the engine of the domestic economy. Swedish tax levels are still largely on par with those of its main competitors – in fact, taxation of business is low from a comparative perspective.

Citation:
Finanspolitiska rådet (2018), Finanspolitiska rådets rapport 2018. http://www.finanspolitiskaradet.se/english/swedishfiscalpolicycouncil.4.6f04e222115f0dd09ea80001437.html

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

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

Bulgaria

Score 7

Government revenue in Bulgaria is dominated by indirect taxes centered on a flat-rate 20% VAT for all products except tourism packages and social security contributions (mostly pension and health care contributions). Meanwhile, direct taxes, based on a very broad base with low rates, only contribute about 20% of tax revenues. With its low rates, and uniform and broad tax base, Bulgaria’s tax system fully achieves the objective of horizontal equity. While the tax structure is simple, tax filing is extremely cumbersome for businesses due to extensive red tape and an unfriendly bureaucracy. This weighs on the competitiveness of the Bulgarian tax system.

The flat income tax rate and the low direct-tax burden limit the extent of vertical equity. As a result, the difference between income inequality before and after taxes and benefits is relatively small.

Tax revenues continued to increase significantly in 2018 with boosts from both direct and indirect taxes. This is especially valid for social security contributions, which have risen significantly due to a combination of rapidly increasing wages and a rising number of employed people contributing to the system. Since this portion of general government revenue is highly sensitive to the business cycle, it is unclear whether such a tempo can be sustained under less favorable circumstances. Recent revenues have been sufficient to allow the government to achieve a fiscal surplus for the third year in a row.

Chile

Score 7

Chile has a moderately complex tax system. The tax reforms passed in September 2014 and February 2016 raised the corporate-income tax rate from 20% to between 25% and 27% (since companies may choose between two tax regimes) and eliminated a tax credit (Fondo de Utilidades Tributarias, FUT). This latter measure expanded the base for taxes on capital income. Thus, companies now have to pay taxes not only on distributed profits, but also on profit retained for future investments. These changes are expected to increase overall equity within the system, according to a World Bank study commissioned by the Chilean Ministry of Finance. However, the short- and long-term effects are not fully evident as a portion of the reform package has not measurably taken effect yet (e.g., elimination of the FUT tax credit).

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

During the period under review, President Sebastián Piñera announced a further, smaller tax reform project in order to simplify the tax system and foster horizontal equity, especially for small- and medium-sized enterprises. These measures are planned to become effective from the beginning of next year’s tax declaration period.

The highest marginal rate for personal-income taxes is 40%. This implies that high-income wage earners have a high tax burden compared to low-income earners in general, and to high-income non-wage earners in particular. Few exemptions are applied to corporate and income taxes, reflecting a relatively high level of horizontal equity within each income-tax category. High-income non-wage earners can legally avoid high-income taxes through incorporation. The value-added tax (VAT) of 19% is the third highest in Latin America (after Uruguay and Argentina) and remains flat. It favors allocative efficiency but has a regressive impact. There is certainly tax evasion in Chile, probably at higher levels than the OECD average due to the prevalence of informality. Yet efforts to ensure tax compliance have generally been successful. Moreover, Chile probably has one of the most efficient computer-based tax-payment systems in the world.

The government's tax and non-tax revenue is sufficient to pay for government expenditure, at least at current spending levels. Additional revenue stemming from newly introduced fiscal changes is slated to finance reforms within the education and health systems. By and large, Chile has been successful in generating sufficient public revenue. There are flaws in the efficiency of tax spending, but in general the national budget corresponds to the claims of different sectoral ministries. However, most of the tax income generated by corporate and personal taxpayers is based on VAT, and therefore has a very regressive effect. The fiscal reform is expected to make improvements in this regard. Nevertheless, the tax system promotes vertical equity through redistribution at only a relatively low level in comparison to other OECD member states.

Expenditures for education and social security are far too low compared to other countries in the region and to the demands of the lower middle class and the poorer population. Tax policy fails to produce equity with regard to tax burden, as bigger companies and economic elites pay relatively low tax rates. This supports Chile's relatively strong international competitiveness, especially for services and products of comparatively low sophistication. Thus, in general terms, Chile's tax system contributes to the country's competitiveness with respect to world-trade and investment flows. On the other hand, taxation policy does not foster innovation or increase productivity, and thus endangers competitiveness in the long run.

The only reasonable way to assess Chile's tax system and the amount of revenue in order to finance a welfare state equivalent to 50% of GDP is to check whether Chile's ratio of government expenditure to GDP per capita 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: In Chile, this is the case.

Citation:
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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

Czechia

Score 7

Compared with other OECD countries, the Czech tax-to-GDP ratio is low. While revenues have been sufficient to generate a small fiscal surplus ever since 2016, it will be challenging to ensure sustained financial support for areas such as education, R&D, and environmental protection after 2020, when EU structural funding terminates. The Czech tax system broadly ensures horizontal equity. One exception is the blanket tax allowance given to the self-employed to cover operating expenditure with no checks on what is actually spent. This leads to a lower tax rate on the self-employed rather than employed and an incentive to convert employment contracts into contracts for individual services. While revenues from direct taxes are low and there is nominally 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. The Babiš government proposed a major reform of the income tax in 2018, but eventually postponed it until 2021 because of the resulting reduction in tax revenues.

Estonia

Score 7

Estonia is internationally recognized for its straightforward and transparent tax system. In 2018, the principle of perfect proportionality in personal income tax was dropped by making the personal tax-free allowance dependent on a tax-payer’s level of income. The allowance is more generous for low earners and is gradually removed for high earners. Neoliberal opponents have claimed that the reform constitutes a veiled move from a proportional to a progressive income tax.

The Estonian welfare system is financed almost entirely through social insurance contributions. This Bismarckian principle has both advantages and weaknesses. First, high labor costs may weaken the country’s economic position and can lead to labor relations abuses. Second, social insurance contributions alone cannot provide sufficient financing for social services given an aging population and changing work patterns, which destabilize social tax receipts. The public pension funds have persistently accumulated debt, and the health insurance fund is under long-term financial austerity. Major reforms of both health and old age financing are being discussed.

In contrast to stagnant social taxes, motor fuel and alcohol excises have increased rapidly to levels well above the EU average, raising concerns about the competitiveness of Estonian enterprises. According to some estimates, Estonia lost about €60 million in tax revenues in 2018 due to increased cross-border trade in alcohol and motor fuel. The government put further increases of excises on hold in response to these projections.

France

Score 7

Taxes and social contributions amount to 48% of GDP, one of the highest levels in the OECD. This is the consequence of extraordinarily generous political and budgetary commitments, which have led to continuously rising taxes. Nonetheless, tax revenues do not cover expenses, as public spending is exceptionally high by western standards (56.5% of GDP in 2017 and 55.9% in 2018, compared to the EU-28 average of 47.1% in 2017).

In spite of the lowering or deletion of many individual and company taxes, the tax ratio has remained at the same high level as in previous years. This is due to the increase in ecological taxes (e.g., on fossil fuel energy), and to the social contributions for the generous pension and health care systems. The effect on economic growth has been felt during the first semester of 2018, with a decline in consumption (a major factor affecting economic growth in France), prompting further financial incentives in the draft 2019 budget (e.g., the planned exemption of social contributions on additional hours worked beyond 35 hours per week) in order to boost consumption and company investment.

The tax policy initiated by Macron has been complemented by various measures that aim to better control the main factors of public spending, such as signing "contracts" with the main local government authorities in order to slow the expansion of local expenses, reduce fiscal niches (whose total cost is estimated by the Ministry of Finance at €100 billion per year), cut social expenses and streamline funding for social housing. This overall policy has attracted fierce criticism from opposition parties and the media, and Macron has been depicted as favoring the wealthy at the expense of the poor. The low flat rate for income on capital and particularly the partial abolition of the wealth tax (ISF) have been perceived as symbolic of Macron being a "president of the rich." The good news is that for the first time since 2006, the social security budget will be positive in 2019 due to the better management and control of social expenses. For instance, to the dismay of pensioners or beneficiaries of social allocations, state payments will be revalued less than the expected inflation in 2019 (0.3% increase only).

Some of the measures mentioned were altered or abolished (e.g., the rise in the fuel tax) in December 2018 in response to the riots.

Germany

Score 7

In recent years, German tax policy has lost steam due to various causes. 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, 0% 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 2017, total tax revenues rose by 38% from €531 billion to €734.5 billion. This has enabled the ministry to achieve its aim of balancing the budget since 2014, despite the considerable costs related to the refugee crisis. In addition, the soaring labor market created significant surpluses in the social security system.

With respect to some major indicators, Germany is performing reasonably 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 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. Due to the passivity of German tax policies, and corporate tax cuts in the United States and numerous other OECD countries, the country's effective tax burden on companies is now among the highest of any industrial country.

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. For companies, the German tax system has lost competitiveness over recent years. The Global Competitiveness Report ranks Germany the third most competitive economy in the world. Tax rates, tax regulations and labor market regulations are seen as the most problematic factors for doing businesses in Germany. However, given to the overall positive economic environment these challenges have not as yet undermined Germany's overall relative attractiveness.

Citation:
Bundesfinanzministerium (2018):

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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 with an eye on the 2016 general election, it was hardly surprising that the 2016 budget contained no tax increases (apart from a rise in the excise on tobacco products) as well as a significant reduction in the Universal Social Charge (USC), which is levied in addition to income tax. Incomes over €70,000 did not benefit from this change, which further increases the progressiveness of this levy. After the budget reforms are implemented, it is estimated that the top 1% of income earners will pay 21% of all income tax, while the bottom 76% of income earners will pay only 20% of the total. The new local property tax is steeply progressive with respect to property values.

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

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

Ireland has long relied on a low corporate tax rate as an instrument to attract foreign direct investment (FDI). This policy has been highly successful and is supported across the political spectrum. However, it has attracted an increasing volume of hostile comment from critics in foreign jurisdictions who assert that some features of the way Ireland taxes corporations constitute “unfair” competition and encourages profit shifting by multinational corporations. The OECD published a detailed report on this topic in October 2015. In an initial response to this report, Budget 2016 introduced a requirement that multinational corporations with Irish parent companies must file country-by-country reports on their income, activities and taxes beginning on 1 January 2016. This information may ultimately be confidentially shared with foreign tax authorities.

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

Citation:
Tim Callan, Maxime Bercholz, Karina Doorley, Claire Keane, Mark Regan, Michael Savage and John R. Walsh 'Distributional Impace of Tax and Welfare Policies: Budget 2018. ESRI Quarterly Commentary, Winter 2017.
Budget 2016 contains an annex that discusses the progressiveness of the Irish tax and welfare system in some detail:
http://www.budget.gov.ie/Budgets/2016/Documents/Budget%20Book%202016%20-%20full%20document.pdf
The conclusion is reached that "it is evident that, compared to other countries, the Irish tax and welfare system contributes substantially to the redistribution of income and a reduction in market income inequality. The income tax system is more progressive relative to comparator countries with the tax burden from income tax and USC falling in large part on households with the highest incomes."
See also Donal De Buitléir
http://www.publicpolicy.ie/wp-content/uploads/Budget-2013-Progressivity-of-Irish-Income-Tax-System1.pdf
and
Michael Collins
http://www.nerinstitute.net/research/total-tax-estimates-for-ireland/
For a review of how the burden of the adjustment during the period of 'austerity' was distributed by income class see John FitzGerald
https://www.esri.ie/UserFiles/publications/RN20140204.pdf
The OECD report on Base Erosion and Profit Shifting is available here
http://www.oecd.org/tax/beps-reports.htm

Latvia

Score 7

Overall, Latvia has one of the lowest rates of tax in the European Union. However, more than in many other EU member states, the tax burden falls disproportionately on wage earners, particularly low-income earners. To address this issue, tax reforms were undertaken in 2016 and 2017 to shift the tax burden away from low-income wage earners and increased the tax burden on the wealthy. Following this trajectory, a significant tax reform came into force in 2018.

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

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

In order to increase health care financing, social security contribution rates were increased from 34.09% to 35.09 % in 2018, of which 24.9 09% is paid by the employer and 11% by the employee. The solidarity tax, which will remain in effect until 2019, will be applied only to income that exceeds the cap for mandatory social insurance contributions: €55,000 in 2018.

In order to provide compensation for the loss in state and municipal budgets brought by the reform, the gambling tax and excise duties were increased in 2018 – a mechanism put in place to tackle the shadow economy and strengthen tax administration.

Economic recovery, structural reforms, improvements in tax collection and a reduction in the overall share of the informal economy have enabled the government to exceed its target for reducing the budget deficit. In 2013, the budget deficit was reduced to 1.0%, exceeding the target of 1.4%. In 2014, the deficit stood at 1.4%, declining to 1.3% in 2015. In 2016, the budget deficit was 0.0%. The general government deficit was 0.5% of GDP in 2017 and was forecasted to be 0.9% of GDP in the spring of 2018, but decreased to 0.8% in the autumn of 2018. Meanwhile, the general government gross debt is expected to increase to 1.0% of GDP in 2019, before declining again in 2020.

In the light of the extensive tax reforms, the short-term challenge for tax policy in Latvia will stem from the uncertainty around the cost and impact of the reforms. Therefore, prudent fiscal policies will be crucial for Latvia to preserve sound public finances.

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2. European Comission (2018), The Effect of Taxes & Benefits Reforms on Poverty and Inequality in Latvia, Available at: https://ec.europa.eu/info/sites/info/files/economy-finance/eb039_en_0.pdf, Last assessed: 28/12/2018.

3. European Commison (2018) Economic forecast for Latvia, Available at: https://ec.europa.eu/info/sites/info/files/economy-finance/ecfin_forecast_autumn_081018_lv_en.pdf, Last assessed: 28.12.2018.

4. IMF (2018), Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the

Republic of Latvia, Available at: https://www.imf.org/en/Publications/CR/Issues/2018/09/05/Republic-of-Latvia-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-46206 , Last assessed: 28.12.2018.

5. Constitutional Court (2017) Solidarity Tax Paragraph 6 does not conform to the Constitutional principle of equal treatment before the law (in Latvian). http://www.satv.tiesa.gov.lv/press-release/solidaritates-nodokla-likuma-6-panta- noteiktas-nodokla-likmes-neatbilst-satversme-nostiprinatajam-vienlidzibas-principam/. Last assessed 28.12.2018

Luxembourg

Score 7

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

On 20 March 2018, France and Luxembourg signed a new bilateral tax treaty to avoid double taxation and to prevent tax reductions in income taxes. The new Double Taxation Agreement (DTA) between Luxembourg and France, following the BEPS measures (OECD Action Plan on Profit Reduction and Profit Shifting – BEPS), includes the so-called Principal Purpose Test (PPT), which states that abusive structures are denied the benefits provided for in the agreement. The agreement applies to natural and legal persons resident and taxable in France or Luxembourg. Taxable French companies, such as SCI, may benefit from the agreement, which may result in reduced tax withholding rates. The new agreement is expected to enter into force in 2019, once it has finally been ratified by France and Luxembourg.

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

The effects of these proceedings and ongoing audits under the new rules will have a major impact on state revenues over the long term. The 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 implemented new e-commerce rules for the European Union, which state that value added tax is payable in the country in which the services are carried out or the product is sold, effectively undermining Luxembourg's business-friendly e-commerce VAT regime. To boost public finances, Luxembourg has implemented new tax rates. Several tax rates were increased, including the general VAT (from 15% to 17%). The higher VAT rate and low interest rates will lead to a slight increase in the inflation rate (about 1.7% in 2017). Nevertheless, Luxembourg continues to have the lowest VAT rate in Europe.

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

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

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

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

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

Citation:
18th Update of the Stability and Growth Programme of the Grand Duchy of Luxembourg for the 2017 – 2021 Period. Le gouvernement du Grand-Duché de Luxembourg, 2017. https://mfin.gouvernement.lu/fr/publications.html. Accessed 23 Oct. 2018.

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Malta

Score 7

Malta's income tax system ensures that a portion of income is non-taxable for all three tax categories (€9,100 for single individuals, €12,700 for married individuals and €10,500 for parents). Parents also receive a tax rebate on school fees, cultural activities, and creative education. No sales or inheritance tax is levied on a person's primary residence. Moreover, first-time property buyers have been benefiting from a capped duty waiver since 2014, while similar benefits were also extended to second-time buyers at the beginning of 2018. Other measures contributing to greater equity were introduced in the 2019 budget, including supplementary allowances for minimum-wage earners, unemployment benefits for self-employed individuals, income-tax refunds for all employees, higher tax-free pension ceilings and tax exemptions for those who invest in third-pillar pension plans. Significantly, the 2019 budget will not be introducing any new taxes, tariffs or duties.

However, the burden of taxation falls mainly on people in fixed and registered employment. Malta's shadow economy is officially equivalent to nearly 25% of GDP, though economists contend that the actual percentage is much higher. A 2017 ECB study shows that Malta is among the countries with the highest number of cash transactions in the EU, a fact that in all likelihood results from rampant tax evasion. Tax evasion controls remain ineffective. A number of mitigating measures have recently been introduced to consolidate previously introduced actions in this area. Among others, these include possible measures to reduce the use of cash. A joint task force that encompasses the Inland Revenue, VAT and Custom departments along with the Tax Compliance Unit has been established with the aim of facilitating the fight against tax evasion. A 2018 European Commission report stated that €200 million had been collected in previously lost taxes, and that Malta had made significant progress in the area of VAT revenue collection, reducing the gap by some 90%. Indeed, the report said, Malta had demonstrated the largest increase in VAT compliance rates in the European Union.

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. Special tax incentives are also available for industrial research and development projects, experimental development and the registration of intellectual property. Fiscal incentives enhance the competitiveness of various economic sectors and attract foreign direct investment. Indeed, corporate taxation is being regarded by the European Commission as an increasingly important source of revenue for the island. However, this is paired with concerns that Malta's corporate-tax rules are being exploited by companies conducting aggressive tax planning. The Maltese government is currently transposing the provisions of the EU's Anti-Tax Avoidance Directives, which aim to prevent companies from aggressively gaming differential tax rates across EU states.

Citation:
https://cfr.gov.mt/en/inlandrevenue/personaltax/Pages/Tax-Rates—2018.aspx
Budget Speech 2013 p. 14
Times of Malta 04/11/2013 Tax exemption for first-time property buyers announced
Times of Malta 03/02/2018 Second-time home-buyer scheme is rolled out
Times of Malta 22/10/2018 Budget 2019 at a glance
Times of Malta 13/10/2015 Changes in income tax
Budget Speech 2018 (English) p.17, 20, 61
https://ird.gov.mt/faq/rentalfaq.aspx
European Semester Thematic Factsheet – Undeclared Work (Updated 2017) p. 3

European Central Bank The use of cash by households in the euro area p.4
Tax Reforms in EU Member States 2012 Report p.75
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Study and Reports on the VAT Gap in the EU-28 Member States:
2018 Final Report TAXUD/2015/CC/131

South Korea

Score 7

The South Korean tax system is fairly effective in generating sufficient public revenues without weakening the national economy's competitive position. South Korea has one of the lowest tax rates in the OECD, with tax revenues totaling about 26.3% of GDP in 2016. In 2018, South Korea's tax income recorded an increase of 5.5% as compared to 2017, giving the government greater scope for public investment. The Moon administration also increased the tax rate on those with taxable income above KRW 500 million (5,700) from 40% to 42%. The government will additionally add a new 25% corporate-income tax bracket for companies with taxable income exceeding KRW 200 billion and above. One weakness of the Korean tax system is that the country's tax base is comparably narrow, with nearly half the population paying no income taxes due to the very high exemption rate.
In December 2017, the European Union added South Korea to its black list of "non-cooperative jurisdictions for tax purposes," mostly because of "harmful preferential tax regimes" within the country's special economic zones. After protest from the Korean government, the EU subsequently shifted Korea to its "grey list," which encompasses countries that have made promises to improve cooperation.

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OECD data, https://data.oecd.org/tax/tax-revenue.htm

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 member states. The financial crisis and the ensuing economic downturn sharply reduced tax revenue with the squeeze on wages contributing to a lower yield from income tax. However, overall tax revenue has risen in the past years and is projected to be sufficient to continue to narrow the public deficit over the course of the current parliament. A risk factor is, though, that the potential costs of leaving the European Union are still unclear and therefore not calculable yet.

The Autumn Budget 2018 included the introduction of a so-called digital tax, a form of taxation that has been discussed in many countries but has so far hardly been implemented. The United Kingdom will tax tech companies 2% of the revenue they make from UK users. The Treasury expects the tax to raise around £400 million per year. Further, the government will impose a new tax on the production and import of plastic packaging containing less than 30% recycled plastic to set an incentive for the reduction of plastic waste.

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

Australia

Score 6

The tax system achieves a reasonably high degree of horizontal equity, with income generally taxed at the same rate irrespective of its source. The main exception is 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 is retirement savings (known as superannuation), which are minimally taxed. These exceptions aside, the income-tax system is moderately progressive. Australia’s taxation system redistributes less than other OECD countries, and relatively high remuneration after taxes and social security is a major pull-factor in its migration policy.

The review period saw only minor changes to income tax. However, the federal government budget published in May 2018 laid out a seven-year plan for radical changes to the income tax schedule. Under the plan, from 2024 over 90% of taxpayers would face a top marginal income tax rate of 32.5%, which would apply on incomes up to AUD 200,000 per annum. The current 37% tax rate, applying to incomes AUD 40,000 - 180,000 would be eliminated, with the current maximum 45% rate retained for incomes over AUD 200,000. If implemented, this would represent a significant reduction in the progressivity of the income tax system. The Labor opposition has indicated that it does not support the plan.

The government has been frustrated by the Senate in its attempts to reduce the company tax rate from 30% to 25%, and has settled on a phased reduction for companies with annual turnover of less than AUD 50 million. The 25% tax rate will be fully implemented for companies with an annual turnover of less than AUD 50 million from 2021.

The tax-to-GDP ratio in Australia is among the lowest of any OECD economy. Arguably, this low level of taxation creates bottlenecks in infrastructure development, which have not been sufficiently addressed. Sydney and Melbourne are particularly exposed to infrastructure bottlenecks, although there has been a substantial surge in infrastructure investment in recent years (albeit, mostly funded by state governments).

With regard to sufficient inflow of tax revenue, as outlined in detail under the “budgets” indicator, despite some recovery of tax revenue in the review period, concerns persist 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 over the fiscal sustainability of state and territory governments, which have very limited capacities for raising revenue. The increasing need for health and education expenditure by the states and territories has outpaced revenue growth.

Citation:
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Belgium

Score 6

By OECD standards, Belgium's tax structure is inequitable. The tax base is too narrow, and puts excessive pressure on labor income (along with Italy, Belgium has the OECD's highest effective tax and social security wedge on labor), which in turn produces incentives for tax avoidance and evasion. Conversely, much capital income (e.g., housing rents, capital gains and some multinationals' profits – a significant sum given the presence of a large number of such firms in the country) is either inefficiently taxed or not taxed at all. Consequently, while horizontal and vertical equity within each income source (i.e., labor, capital and corporate income) are guaranteed in theory, differential treatment and a lack of information undermine this principle in practice.

The Council of Europe's July 2018 recommendations remain tough regarding Belgium's tax reforms, which are deemed insufficient and ineffective for stimulating economic growth. For example, Belgium maintains too many tax loopholes and exemptions to actually reduce distortionary incentives or to stimulate entrepreneurship. The council's recommendations also emphasize (paragraph 9) that "Based on the Commission 2018 spring forecast, there is a risk of a significant deviation from the recommended adjustment path toward the medium-term budgetary objective in 2018 and over 2017 and 2018 taken together."

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

Citation:
Council of Europe's recommendations: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018H0910(01)&from=EN

https://www.pwc.be/en/news-publications/news/tax-reform.html

http://www.doingbusiness.org/data/exploreeconomies/belgium

Cyprus

Score 6

The Inland Revenue Department and the Value-Added Tax (VAT) Service merged into one authority, the Tax Department, in 2016. This fusion was part of reforms aiming to strengthen tax collection and processing mechanisms (e.g., auditing) while countering tax evasion and tax avoidance.

Cyprus's tax system is comparatively uncomplicated, both with respect to individual provisions and structure. A high threshold for individual taxable income of €19,501 results in a low tax burden on labor. This is expected to increase given planned higher social insurance and medical insurance contribution rates. The VAT has been set to 19% since 2014. A special levy on salaries and a real-property tax imposed in 2013 were terminated in 2017. A levy on interest income for bank deposits set at 30% since April 2013 will be reduced to 17% in January 2019. Principles of equity are negatively affected by continued tax evasion and avoidance; a large share of the €2 billion overdue taxes may not be collectible.

Benefits provided to businesses have, over time, made Cyprus very attractive to international companies. The European Commission noted in 2018 that further regulation is necessary to address the phenomena of aggressive tax planning by companies. It also noted that the buoyant character of corporate tax revenues might induce risks if used for long-term expenditures.

Tax equity is to some extent achieved through the progressive increase in individual income-tax rates from 20% to 35%. However, the flat rate for companies leaves room for distortions: it may benefit some liberal professions and highly profitable companies that pay a lower tax share than the share paid by high income individuals.

The European Commission observed in 2017 that the tax-benefit system was the least effective in reducing inequalities; it noted some improvements in 2018.

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2. Almost €2 billion owed in overdue taxes, Cyprus Mail, 21 September 2018, https://cyprus-mail.com/2018/09/21/almost-e2-billion-euros-owed-in-overdue-taxes/

Iceland

Score 6

Frequent changes of government since 2013 have not resulted in significantly changes in tax policy. Tax revenue was stable at 42% of GDP during 2017 and 2018, and is projected to remain at this level, other things being equal. Though new labor market agreements in 2019 could change this if the government, as the single largest employer, uses tax policy as a bargaining chip or if large wage increases trigger a change in tax policy.

Fishing fees remain far below potential as only 10% of the common property resource rent of fisheries accrues to the taxpayer while 90% accrues to vessel owners. In late 2018, parliament decided to significantly lower fishing fees while disadvantaged social groups (e.g., disabled people and pensioners) complain bitterly about being left behind.

Citation:
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Israel

Score 6

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

Like most other countries, Israel utilizes its tax system as a political instrument. For example, it offers tax reductions to army veterans. However, in most instances the Israeli tax system has a valid rationale for tax reductions that appear to violate the principle of horizontal or vertical equality. The Encouragement of Capital Investments Law (ECIL) provides tax discounts for factories and businesses that invest in peripheral areas. This is done both to keep Israel's taxes competitive in the global market and to incentivize the creation of jobs in disenfranchised regions. The ECIL has been criticized in recent years, especially at the end of 2017 following the large layoff of Teva employees – an Israeli pharmaceutical company that received large tax benefits.

The current minister of finance, Moshe Kahlon, is opposed to rising taxes and has cut many taxes while simultaneously spending generously on plans to lower housing and living costs. Notably, his flagship program “Price for the House-Buyers” (initiated in 2013) has so far cost the government more than ILS 5 billion. This policy was criticized for being short-sighted by the former governor of the central bank of Israel, Karnit Flug.

Over the last five years, Israel has had annual tax surpluses, relative to forecasts. The surpluses stemmed largely from the sale of large companies – including the sale of the government’s controlling stake in Keter Plastic and the sale of Mobileye – in addition to increased Israel Tax Authority operations that yielded more tax revenue than forecast. Although a recent OECD report advised policymakers to devote tax revenues to improving social services, the current government has advocated tax cuts. In December 2017, Finance Minister Moshe Kahlon announced the abolishment of customs and purchase taxes totaling ILS 800 million per year.

In addition, in September 2018, Israel signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (“Multilateral Instrument,” MLI), a multilateral agreement that updates previous bilateral agreements between signatory countries in a way that will make tax evasion harder for global corporations. Time will tell if the agreement will have broader effects on Israel’s tax policy.

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Japan

Score 6

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

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

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

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

According to the OECD, energy-related taxes in the country should be increased, both for environmental and fiscal reasons.

The country's tax system achieves a reasonable amount of redistribution. However, salaried employees benefit from far fewer tax deductions than do self-employed professionals, farmers and small businessmen.

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OECD, Japan: Promoting Inclusive Growth for an Ageing Society, Better Policies Series, Paris, April 2018

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, the extent of red tape and the instability of tax provisions have been relatively high. In its first year in government, the PiS government reduced the corporate-income tax rate from 19% to 15% for small taxpayers and taxpayers in their first year of existence and increased the tax-free allowance for personal income tax, a measure that went into effect at the beginning of 2017. In its second year in office, the PiS government largely focused on fighting tax evasion and tax fraud, which have been comparatively high. In 2018, the government adopted a number of diverse tax changes that will take effect in 2019. To start with, it introduced three new taxes: a "solidarity tax" for high-income earners, an "exit tax" on companies and wealthy individuals, and a new fuel tax called an "emission fee." The revenues from the "solidarity tax" are earmarked for financing the Solidarity Fund for Support of Disabled Persons, which was created after protests by disabled people in May 2018 that drew considerable public attention. The revenues from the new fuel tax are targeted as well, and will be used for combating smog. At the same time, the government adopted some changes related to the withholding tax system and the taxation of profits derived from cryptocurrencies. It additionally lowered the corporate-income tax rate for small companies from 15% to 9%, simplified transfer pricing rules and created new tax incentives.

Citation:
European Commission (2019): Country Report Poland 2019. SWD (2019) 1020 final. Brussels, 20-22 (https://ec.europa.eu/info/sites/info/files/file_import/2019-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. Since 2016, tax policy has focused on the fight against tax evasion and improvements in tax collection. In addition, the government adopted a number of minor tax changes, including a lowering of the corporate-income tax rate from 22% to 21%, increases in the caps on social insurance contributions and a temporary doubling of the special levy on businesses in regulated industries (energy, telecoms, public health insurance, etc.). Both the Fico and the Pellegrini governments have thus largely ignored the long-standing calls by the European Commission, the OECD and the IMF to change the tax mix by financing a reduction of the relatively high tax burden on labor by increases in real estate tax, excises or environmental taxes. While tax revenues have soared on the back of a growing economy, they remain low in relation to GDP. Despite the improvements made in tax compliance, more could be done to reduce tax gaps.

Austria

Score 5

Austrian tax policy is characterized by a significant bias, as the source of tax revenue is overwhelmingly skewed toward the personal income of the working population. As employees and self-employed individuals pay the maximum tax rate beginning at a level of income considered to be only middle class, and the country has virtually no property taxes and no inheritance taxes, the system of taxation as a whole is unbalanced. The new government has declared its will to lower the tax burden for labor. However, ÖVP and FPÖ (the new coalition alliance) have also declared they will aim to achieve a zero-budget deficit. In order to create incentives for business, the new government will also reduce the tax burden on businesses (e.g., for startups). As tax cuts and a balanced budget are difficult to reconcile even during an economic boom, these ambitious goals may be difficult to achieve simultaneously. So far, no significant innovation has been implemented.

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

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

Croatia

Score 5

Tax reform has been among the top priorities of the first Plenković government. Immediately after coming to office in November 2016, it presented a first comprehensive reform package. Drawn up by Minister of Finance Zdravko Marić already under the previous government, it aimed at amending a total of 15 tax acts. The measures adopted that became effective already in 2017, included cuts in the corporate income tax from 20% to 18% (and 12% for small and medium-sized enterprises), the adoption of two rates of personal income tax (36% and 24% instead of 12%, 25% and 40%) combined with an increase of non-taxable income from HRK 2,600 to HRK 3,800, as well as adjustments to VAT and excises. At the same time, the personal income tax has become less progressive. This has further limited the redistributive effects of the tax system, which relies strongly on VAT and social insurance contributions.

In 2018, the government adopted a second tax reform package that is scheduled to take into effect on 1 January 2019. The package is supposed to include additional HRK 1.4 billion of tax reliefs based on reducing the VAT on fresh meat, fish, eggs, fruit, vegetables and diapers from current 25% down to 13% and – as of 2020 – additional HRK 1.6 billion by reducing the general VAT rate down to 24%. In addition, the government is planning to raise the income threshold for applying the top income tax rate of 36% from current HRK 17,500 (€2,300) to HRK 30,000 and more (approx. €4,000). With this measure, the government wants to raise net salaries in the high-technology sector and in the professions like physicians, IT experts and pharmacists, in order to prevent the drain of these workers from the country. Once again, the government gave in to public pressure and has postponed the introduction of a real estate tax, although finance minister Marić's tax administration made all necessary preparations for it long ago.

Citation:
Blažić, H., Grdinić, M. (eds.) (2018): Tax Policy and Fiscal Consolidation in Croatia. Rijeka: Faculty of Economics and Business.

Italy

Score 5

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 remained very high over the years (42.5% in 2017) 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 very low for all those who can and do evade taxation (e.g., many businesses and large numbers of independent contractors and self-employed professionals). Families with children have very limited exemptions. Labor and business are also heavily taxed, which results in fewer new businesses and job opportunities. Italian tax policy provides limited incentives and no compelling reason to declare revenues. The monitoring of and fight against tax evasion within this system are insufficient and far from successful. One of the biggest problems is that the system results in significant competitive distortions that benefit non-compliant earners.

The Gentiloni government has not substantially changed this situation. The tax credit for people on low incomes which was introduced in 2014, has been maintained and has shown some redistribution effects, resulting in an improvement in Italy's Gini coefficient. The same applies to the marginal increase in tax on financial assets, and reductions to income and corporation taxes. The stabilization of these measures has had a modest beneficial effect on the fiscal system, but more needs to be done. The antiquated land register is yet to be reformed, despite repeated promises. As such, inequities in the property tax system continue to persist.

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

New fiscal measures (accelerated write offs) to encourage investments in technological innovation introduced by the government took effect in 2017.
The new government, which formed after the 2018 election, promised a revolutionary “flat tax” rate for everybody (in fact two rates of 15% and 20%), but faced with the budget difficulties and other priorities has reduced its promises for 2019 to a more limited tax reduction (15% rate) only for autonomous workers (“partite IVA”) with earnings below €65,000.

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.

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Mexico

Score 5

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

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

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

Over the last year, the Peña Nieto administration made several efforts to simplify the extremely complex tax regime, which the incoming president, López Obrador, has promised to continue. Obrador has announced that taxpayers would need to submit just one annual tax statement and that a lottery system would be used to determine who will be audited.

Citation:
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Portugal

Score 5

The very high levels of taxation on income and consumption noted in the previous SGI reports have remained in this period.

Overall, the tax burden increased to 34.7% of GDP in 2017, the highest level since the National Statistics Office (Instituto Nacional de Estatística) began compiling data in 1995.

This high level is a result of two factors.

First, while the Costa government has stated its intention to end austerity, it largely retains the income tax brackets approved in 2013, which generated a massive tax increase (and which boosted the tax burden from 31.8% of GDP in 2012, below the OECD average, to 34.1% of GDP in 2013, above the OECD average). Prior to this change in income tax, the tax burden had only once surpassed 32% (32.3% in 2011). Since 2013, it has never fallen below 34% of GDP.

Second, the Costa government has also sought to maintain budgetary consolidation despite increasing expenditure. To that end, it has resorted to indirect taxation, either maintaining existing high levels on some indirect taxes (e.g., VAT) or increasing the rate on other indirect taxes (e.g., on fuel and cars, particularly in 2016 but also in

2017 and 2018).

Overall, tax policy has failed to achieve horizontal and vertical equity during the period under review.

Fiscal receipts continue to rely excessively on more regressive indirect taxation. Thus, while the share of direct taxation on the overall tax burden in Portugal (29.6%) is below the EU-28 average (34.2%) in 2017, the share of indirect taxation in Portugal (43.5%) is well above the EU average (34%). Moreover, the overall balance is one where indirect taxation outweighs direct taxation, in contrast to the EU norm. The considerable dependence of public finances on indirect taxation measures (e.g., VAT) fails to satisfy the vertical-equity criterion.

The tax authority continued to implement measures to combat tax avoidance in 2017 and 2018, and approved a new strategic plan to combat fraud and tax evasion for the 2018 – 2020 period. However, as its own report noted, the tax authority was unable to implement all the proposed measures for the 2015 – 2017 period, with some 20% not implemented.

Existing data suggests historically high levels of tax evasion and fraud in Portugal. Thus, a paper by Annette Alstadsætera, Niels Johannesen and Gabriel Zucman, published in 2018, indicated that over 20% of Portugal’s GDP was held offshore in 2007 – more than twice the world average of 9.8%, and second only to Greece in the European Union. While its various measures are a step in the right direction, the tax authority appears unable to deal fully with the accumulation of offshored wealth or sophisticated modes of tax evasion.

At the corporate level, the effective tax rate is well below the nominal rate due to tax deductions, meaning that comparatively profitable companies often pay low effective rates.

Citation:
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Slovenia

Score 5

Slovenia's tax system was overhauled in the 2004 – 2008 term and has changed only gradually since then. Tax revenues have been relatively high in relation to GDP but have not been enough to prevent high budget deficits from emerging. Tax revenues stem from a broad range of taxes, with a high percentage of about 40% of all tax revenues stemming from social insurance contributions. A progressive income tax with rates of 16%, 27%, 34%, 39% and, since 2013, 50% provides for some vertical equity. As the thresholds are set rather low, however, the majority of middle class citizens fall into the second- or third-highest category. The tax burden for enterprises is below the EU average, but higher than in most other East-Central European countries. Moreover, tax procedures for both individuals and companies are complex.

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

One of the reform projects of the Šarec government's coalition agreement, which provoked substantial opposition from entrepreneurs and opposition parties, was tax reform. Based on a proposal by the Left, the coalition agreement calls for personal income from capital and rents to be subject to the personal income tax. In late October 2018, the National Assembly turned down a proposal from the opposition to lower VAT levels to its pre-crisis levels.

Spain

Score 5

Spain collects less in taxes relative to wealth than do most other European countries. The tax-to-GDP ratio in Spain increased from 33.2% in 2000 to 34% in 2018, but it is still low when compared with an EU average of 40%. Despite this, the 2018 budget prepared by the conservative Mariano Rajoy government included a tax cut for low-income earners. Notwithstanding this fact, Treasury revenues rose during

2018 thanks to economic growth, wealth creation and the modernization of revenue-collection mechanisms.

The new social-democratic prime minister who took office in June 2018, Pedro Sánchez, declared that his government would increase annual tax collections to 42% of GDP. The measures to be taken, but not yet implemented as of the end of the review period, were to include an increase in income-tax rates, changes in corporate-tax structures, a new tax on banking and financial transactions, a new tax on the sale of services by technology companies, an increase in tax surcharges on fuel, and an asset-tax increase.

Existing tax policy is difficult to assess with regard to equity and competitiveness. Vertical equity exists in principle, but horizontal equity suffers due to 1) corporate-tax engineering, 2) the prevalence of fraud and 3) the scope of the underground economy. However, one positive sign is that after years of reducing spending on public administration, resources provided to the taxation authorities have been (slightly) increased.

Turkey

Score 5

While taxes accounted for 52.6% of general government revenue in 2016, the share increased to 53.2% in 2017. The taxation system can be divided into three categories: direct taxes (e.g., the individual-income tax and corporate-income tax); indirect taxes (e.g., 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 2017, individual-income tax rates varied from 15% to 35%. The standard corporate tax rate was 20%, while capital gains were 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. While indirect taxes formed 67% of total tax revenue during 2016, the share declined to 66.4% in 2017.

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.

Congress enacted a sweeping “tax reform” measure in late 2017, which went into effect in January 2018. The Trump administration’s ostensible major objectives were to reduce corporate tax rates, reduce rates paid by high-income taxpayers, eliminate the inheritance tax, reduce taxes for middle income taxpayers, and make up for the losses of revenue by eliminating certain credits and deductions. Official estimates from the nonpartisan Congressional Budget Office and the Joint Economic Committee’s bipartisan staff indicate that the law will produce a $1.5 trillion increase in budget deficits over 10 years. The Republican Congress, with Trump’s support, made spending cuts in some social safety-net programs, such as food stamps, but has not touched the major middle-class social programs, Social Security and Medicare. Overall, the effect of the December 2017 tax reform will be a significant loss of long-term fiscal sustainability.

Greece

Score 4

In Greece, taxation policy only partially achieves its objectives, though there is some progress. Since January 2017, the Independent Public Revenue Authority has become organizationally and functionally independent vis-à-vis the Ministry of Finance. Also, Greek authorities have passed primary and secondary legislation to combat tax evasion. Total tax revenues slightly increased in 2017. Revenues from direct taxes decreased and those from indirect taxes, notably from value-added taxes, increased. Nevertheless, the level of outstanding debt has increased to €98 billion, though the rate of increase (which began in 2010) slowed down in 2017.

Measures to increase taxes are easier to announce than implement. During the tourist season, income raised by small and very small businesses remains undeclared, while throughout the year an unknown share of income for liberal professions likewise remains undeclared. Thus, engineers, lawyers, medical doctors, and dentists as well as craftsmen, plumbers, electricians, and computer technicians typically declare an amount of personal income below the threshold at which personal income tax would be imposed. For income earned in 2017 (and taxed in 2018) this threshold was €8,366 per year for a single taxpayer without dependents.

Furthermore, regulations on income and property taxes are altered almost every year. As long as tax regulations are constantly under revision, private investment will not be forthcoming and the business environment will remain unstable; nor will progress will be achieved in improving horizontal and vertical equity.

In contrast to other OECD countries, tax revenue still derives primarily from indirect taxes and VAT. The VAT rate for restaurant and catering businesses, which are very active in the tourism sector, remain at the prohibitively high level of 24%. Such taxation measures and arrears to suppliers of goods and services for the public sector (a practice pursued by various governments since at least the beginning of the economic crisis), have contributed to Greece achieving a primary budget surplus of 0.8% in 2017 (EU average: -1.0%).

The government is bound to maintain a budget surplus in order not to elevate an already very high public debt (180% of GDP in 2017). Given that in late 2018 or early 2019 parliamentary elections will be held, the government is also keeping taxes at relatively high levels so as to be able to distribute revenues to its electoral clientele. These ad hoc state transfers to selected groups have been common among successive governments. During the period under review, cases include recruiting governing coalition supporters to the public sector and the distribution of one-off allowances to select groups. For example, in December 2017, Prime Minister Tsipras distributed, as a one-off benefit, a total of €1.4 billion to households with an annual income up to €18,000 and to large categories of pensioners. However, compared to other OECD countries, the redistribution effect of the Greek taxation system is mediocre; in fact, the redistribution effect declined between 2010 and 2015. Thus, Greek taxation policy is subject to unpredictable shifts and contributes neither to redistribution nor to economic competitiveness.

Citation:
Comments on the redistribution effects of Greek taxes are based on the comparative data on OECD countries, available on this SGI platform. Data on the size of the state budget surplus is drawn on Eurostat, https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=teina200&plugin=1
European Parliament, Tax Collection in Greece, June 2018 http://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614518/IPOL_IDA(2018)614518_EN.pdf

Hungary

Score 4

Hungary's tax system has become less equitable under the Orbán governments, as the tax burden has shifted from direct to indirect taxes. While the government adopted substantial tax reductions in 2016 and 2017, the tax-to-GDP ratio is still above the level of regional peers, and the tax wedge remains one of the highest in the EU. With the introduction of the lowest corporate income tax rate in the EU (9%) in 2017, the tax burden especially on larger companies has substantially decreased. However, companies still struggle with frequent changes in taxation and a complex tax regime, including the high sectoral taxes. Moreover, tax policy and tax administration have been instrumentalized to favor oligarchs close to Fidesz and to punish outsiders. The classification of businesses as "reliable," "average" or "risky" by the National Tax and Customs Authority (NAV) combined with the promise of preferences for "reliable" taxpayers, has smacked of favoritism. So has the government's attempt to induce companies to contribute to sport organizations by granting them tax deductions (“tao”), but also secrecy and a special taxpayer status. The government has even used taxation as a political weapon in weakening civil society. As part of its 2018 measures to criminalize aid and support to migrants and asylum-seekers, it introduced a special 25% tax on organizations assisting refugees.

Citation:
European Commission (2019): Country Report Hungary 2019. SWD(2019) 1016 final. Brussels, 17-18 (https://ec.europa.eu/info/publications/2019-european-semester-country-report-hungary_en.pdf).

Romania

Score 4

Romania has the second lowest tax-to-GDP ratio in the EU. Tax compliance has been low, as exemplified by a high VAT gap. A high use of cash payments and a large shadow economy have gone hand-in-hand with massive tax evasion. As the tax system has strongly relied on indirect taxes, its redistributive effect has been limited. The substantial changes in the tax system that went into effect in January 2018 after a short preparation period – a decrease in the flat personal income tax rate from 16% to 10%, combined with an increase in the income tax allowance and a far-reaching shift in the distribution of social contributions from employers to employees – have further strengthened the reliance on indirect taxes. Their positive effects on the collection of social insurance contributions have been limited so far. During the period under review, the Dăncilă government has launched a number of additional changes to the tax system, most notably an extension of the application of the reduced VAT rate of 5% for sporting and recreational activities as well as to accommodations, restaurant and catering services and further changes to the taxation of micro-enterprises. However, the frequent amendments to the fiscal code, often adopted on short notice by government emergency ordinance, have undermined the credibility of the tax system. As part of the Revenue Administration Modernization Project, the National Tax Administration Agency (ANAF) has consolidated its tax forms. However, the effectiveness of the Romanian tax administration has improved only slowly.

Citation:
European Commission (2019): Country report Romania 2019. SWD(2019) 1022 final, Brussels, 22-24 (https://ec.europa.eu/info/sites/info/files/2019-european-semester-country-report-romania-en.pdf).

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