

TAXATION IN EUROPE

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What did 2007 bring in terms of fiscal reforms in Europe?

IREF, the Institute for Research on Economic and Fiscal Issues, asked eleven experts from the four corners of Europe to report on the main trends in their countries and neighboring countries. All the reports are available on IREF's website. Below you will find a report on **France** including the most recent changes in the fiscal policy presented by **Vesselina Spassova**.



Pierre Garelo

Director of Research, IREF
Aix-Marseille University

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In 2007 the level of public spending in France reached 54% of GDP, the second highest level of spending among OECD countries (Sweden is first with 56%, but following a downward trend). This record-high level of spending was made possible by heavy debt and heavy taxation. The first months of President Sarkozy's area do not lead us to expect that a substantial change will be taking place in 2008.

The 2007 presidential and legislative elections and the following constitution of a new government and parliament have brought some changes in tax policy. Some of the electoral promises have been concretized as early as August 21st, when was adopted the law on "work, employment and purchasing power" (loi en faveur du Travail de l'Emploi et du Pouvoir d'Achat or "TEPA"), some parts of which took effect October 1st 2007.¹

The general aim of that law is to give incentives for individuals to work more (one remembers the warnings sent by the Nobel Prize winner Ed. Prescott and others concerning working hours and marginal tax rates²) and for the wealthy ones to stay and invest in France. As often, the important question is: what remains from the, rather sound, initial intention once the law and its implementation decrees have been negotiated and lay down on paper.

- ✓ One of the key component of the law is that overtime work should become tax free: no income tax on the extra money earned and no social contribution either. As a consequence, the wage rate of overtime pay will be 25% higher than the usual wage rate. This was one of the main promises of Nicolas Sarkozy, whose leitmotiv in the campaign was "work more to earn more".
- ✓ Another fiscal incentive designed to boost the sluggish growth of households' purchasing power is the allowance of tax credit up to 20% of the interest paid on the loan contracted for the acquisition of their residency. The tax credit is granted to households for five years starting from the date of the purchase of the house with a cap at 3750 € for a single person and 7500 € for a married couple.
- ✓ The TEPA Law has also abolished the death tax when the heir is the spouse (husband) or, under some conditions, a sister or a brother. The expectation is that, thanks to the law, in 95% of the cases of straight succession there will be no tax on real estate transfer to be paid. Also, donations of non-estate wealth to direct heirs are exempted from taxes up to 30 000 €. Nevertheless,



Vesselina Spassova

**Aix-Marseille University
&
IREF**

The most important changes in 200è were brought by the new law on "Work, Employment and Purchasing Power" (TEPA law)

overtime work becomes free of taxes and of social contributions

a new tax credit for the purchase of the main residency

death tax has been reformed as well

¹ For more information on that law see <http://www.minefe.gouv.fr/tepa/index.htm>

² Edward C. Prescott, "Why do Americans work so much more than Europeans", Federal Reserve Bank of Minneapolis Quarterly Review, July 2004, pp. 2-13

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the inherited or donated capital gains from stock options are no longer exempted from taxes and the deduction of 50 000 € has been removed. In the case of the transmission of a company from parents to children, the marginal rate on the value of the assets is at 40% (with abatement of 150,000€). There is, however, the possibility to greatly reduce the amount of tax paid: if the owner of the company enter a “Pact Dutreil”, i.e., if the children agree to keep the assets for a while, then 75% of the value of those assets can be deducted from the tax base.

✓ The reduction of the wealth tax was very controversial. Some members of opposition and the press talked about “fiscal present to the richest”. As a matter of fact, the changes are much less radical than some had expected. The first measure concerns deduction from the fiscal value of your wealth of 30% (previously 20%) of the value of your main residency. The second (and last) one is the possibility to deduce from the fiscal value of your wealth up to 75% of your investments in small and medium enterprises or charitable institutions. This exemption is limited to 50 000 € per year.

✓ Another important change made by the new law is the reduction of the level of the “fiscal shield”. The “fiscal shield” has been adopted one year ago, and is in fact the maximum level of direct taxes (income tax, wealth tax, local taxes, CSG (contribution sociale généralisée) and CRDS (Contribution au remboursement de la dette sociale) that a taxpayer has to pay per year. Its initial level had been fixed at 60% of the revenues, and is now 50%. That means that if the amount of all the taxes paid exceeds 50% of the annual income, the taxpayer have the right to ask for reimbursement.

Surprisingly, only 2 800 taxpayers asked to benefit from the “fiscal shield” and asked for reimbursement of overpaid taxes in 2007 although, according to the estimations of the fiscal authorities, about 100 000 people could have benefit from it. One of the possible explanations for this paradox is the mistrust of French taxpayers *vis-à-vis* tax authorities. A demand for reimbursement could attract the attention of tax officials and lead to further controls, with all the inconveniences that this implies for the taxpayer.

✓ A last tier of the TEPA Law is to make sure that someone taking a first job or going back to work will not see his/her disposable income reduced. This so-called “revenu de solidarité active” (translate into “income reflecting active solidarity”) has not been implemented. As many of the novelties introduced by this law, its implementation (not yet lunched) is likely to give headaches to many.

minor changes in the wealth tax

the “fiscal shield” has been changed: the total tax contribution of a taxpayer is not allowed to account for more than 50% of annual income.

attempts to avoid the “poverty trap”: someone getting his first job or returning to work should see his disposable income at least stable

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Besides TEPA, The 2008 budget law (Loi des finances 2008) brings some marginal changes. The income tax is still devised in five brackets, which amounts have been slightly increased (by 1.3%), to take inflation into account. The first bracket – annual income below 5 687 €, remains exempted from income tax. Incomes between 5 687 € and 11 344 € are taxed at 5.5% rate, incomes between 11 344 € and 25 195 € are taxed at 14% rate, those between 25 195 € and 67 546 € - at 30%. The maximum rate is 40% and is applied on income above 67 546 €.

Following a widely publicized conference organized by the government on environment related issues (*Le Grenelle de l'environnement*), a new “ecological tax” was created, effective January 1st, 2008. It is applied on the purchasing of new cars with carbon emissions over 160 g. per kilometer and varies from 200 to 2600 €. To the contrary, a tax credit up to 3 000 € can be allowed to the purchase of a “clean” car, and bonus of 300 € is allowed when the buyer replaces a car older than 15 years. The first feedback on this mechanism is that it is likely to cost money to the State, cars with emissions below 160g having recently an enormous success!

The wealth tax is paid from taxpayers with capital over 770 000 € (760 000 in 2007). The tax scale is divided in 6 levels, with rates going from 0.55% to 1.8%.

Corporate income tax remains the same as previous years. The tax rate has been set at 33,33% since 1993. There is also a reduced rate of 15%, which is effective, under some conditions, for the small and medium enterprises. Large companies (turnover above 7 630 000 € and benefits above 2 289 000 €) are bound to pay a rate 2,5% above the normal rate.

More importantly, if one takes into account not only corporate income tax but also the other taxes (labour taxes, local taxes,...) and mandatory payments a company ought to make, the *total tax rate* hence obtained for France is extremely high reaching 66.3% of commercial profits (see “Paying Taxes 2008: The Global Picture”, *World Bank & PriceWaterhouseCooper*). In Europe, only Belgium and Italy have higher taxes on labour and more generally on corporate profits.

The Law on the financing of the social insurance 2008 (loi de financement de la sécurité sociale) introduces a new withholding tax effective October 15th 2007. This tax, at the rate of 2.5%, will be applied on the capital gains from stock option and will serve to refund the empty treasury of the social insurance (its deficit reached 8.7 billions € in 2006). In 2007, a similar tax has been introduced for some financial products (interest rate management and life insurance). The revenues collected by those taxes will probably be insufficient to bridge over the deficits of the social insurance system.

Other possible measures have been discussed by the government, including the proposition of a “social value added tax”. The idea behind the "Social VAT" is that, in order to finance the social security scheme, it is preferable (for exportation and employment) to raise the VAT rather than payroll taxes. A recent report from the sec-

Personal income tax: still five brackets and a top rate at 40%

A new “ecological tax-subsidy” scheme: €2,600 of tax if your car pollute and €3,000 of subsidy if your car is clean. The budget of this scheme is likely to be unbalanced.

Tax wealth is still here


Corporate income tax unchanged at 33.33% (or more if turnover and/or profits are high)

Total tax rate on labour is among highest in Europe at 66.3%

Attempts are made to cover the deficit of the social security (over 8 billions €) with new taxes on capital gains and some financial products

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retary of state for public policy, Eric Besson, praises the "social VAT" estimating that it could reduce labor costs and boost the country's international competitiveness. Mr. Besson said that the VAT may even be "rather favorable in the long term to gross domestic product (GDP) and to overall purchasing power." Nevertheless, no official decision has been made at that point.

In 2008, according to the 2008 budget law, the budget deficit is expected to be at 41.7 € billions (39 € billions for 2007). The public debt continues to grow, estimated this year to some 1,150 € billions. The situation is much worse if we take into account the so called "invisible debt" compounded by the fees for the retirement pensions of public officers, which amounts to another 790-1,000 € billions. This deterioration of the state of public finances is incomparable in size with the "fiscal presents" that Sarkozy is alleged to have made to the wealthiest. The deterioration has been around for long; the last time the budget was balanced was 33 years ago. It is time for much more radical reforms. Will they come in 2008? This is, unfortunately, unlikely. But let us wait for the March local elections to try to see clearer into France's future. 

Ongoing discussion on the "social VAT". The idea is to reduce labour cost and compensate with an increase of VAT.

The various reforms recently introduced, even if sometimes going in the right direction, do not match with the emergency of the situation.



contact@irefeurope.org

